



# Platform Briefing on EC targeted consultation regarding SFDR Implementation

December 2023

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EU Platform on Sustainable Finance

December 2023

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## Background

On 14 September 2023, the European Commission published two consultation papers on the Sustainable Finance Disclosure Regulation (SFDR) Delegated Regulation (EU) 2088/2019, a public and a targeted consultation. While the public consultation is shorter and is aimed at the general public, the targeted consultation is longer and is aimed at experts such as financial market participants, investors, NGOs, relevant public authorities, NCAs etc. It includes the questions of the public consultation, and then goes further to explore potential changes to disclosures and the possible creation of a product categorisation system.

The Platform has prepared this brief to address the main questions raised by the European Commission in the targeted consultation, in particular questions around:

1. Current requirements of the SFDR
2. Interaction with other sustainable finance legislation
3. Potential changes to the disclosure requirements for financial market participants
4. Potential establishment of a categorisation system for financial products

This brief includes the Platform's vision of the SFDR.

**IMPORTANT NOTICE:** This brief does not incorporate the final Joint ESAs SFDR RTS. As of the completion of this report, the SFDR RTS had not been published. The Platform commits to analysing the regulatory standards and will provide updates to this document or its perspectives in a new publication in 2024.

## Key recommendations

The platform believes that the following 3 measures will help improve the effectiveness and the understanding of ESG and sustainable investment products:

1. It is essential to establish a precise alignment between the product's name, its sustainability marketing claims, declared sustainability contributions, and the actual investment strategy, particularly when it comes to the stock selection process and defining the investment universe. This alignment should encompass the substantial majority of the product and account for any negative or offsetting impact from the non-binding share of the product.
2. Reporting on sustainability performance should cover the entire product, rather than just a portion of it. Providing information on only a segment of the fund is insufficient. There are instances where the negative or adverse impact of a single stock can be more substantial than the sustainability efforts of the entire fund, potentially compromising its overall sustainability credibility.
3. When referencing sustainable economic activities, the definitions of environmentally sustainable investments should be exclusively derived from the Taxonomy, as outlined in Article 9 of the Taxonomy Regulation. Until the Taxonomy is finished, those economic activities that have not yet been analysed, could be considered SI using Taxonomy objectives, when substantiated but not Taxonomy-aligned. In any case, the term Taxonomy-alignment should not be used.

The Platform reiterates the importance of PAI disclosure on product level, in particular for products that consider PAIs under Article 7 of the SFDR. Such consideration should apply to the whole product and not only to part of the product.

The Platform notes that consideration of PAI is operationalised differently by data vendors and further clarification of the meaning of process descriptions (e.g. biodiversity, pollution PAI) and required updated cycles would be welcome.

The Platform recommends assessing to what extent the disclosure of Principal Adverse Impacts (PAIs), at an entity level, could be integrated into CSRD/ESRS disclosures for Financial Market Participants (FMPs) that adhere to both regulations. The Platform believes that conducting a review of the effectiveness of various requirements, simplifying them and prioritising GHG emission reduction targets, progress reporting, taxonomy and transition plans would be beneficial.

The Platform proposes a streamlined approach to disclosures, recommending a set of pre-contractual disclosures and a single set of periodic reporting disclosures as follows:

- For products classified under Article 8, the Platform underscores the importance of a thorough PAI disclosure that encompasses the entire product, including all consistent investments. The Platform asserts that reporting on PAI indicators relevant for the product's characteristics should be mandatory for all investments of an Article 8 Product, eliminating the option to report on PAI indicators under Article 7 of the SFDR for only a portion of the product.
- In contrast to Article 9 products, Article 8 products should have the flexibility to concentrate their PAI reporting on the family of characteristics—be it environmental, social, or governance—they promote, provided they limit the promotion to one set of characteristics. This focus should always include disclosure on Taxonomy and GHG emissions, with an understanding that the reporting should cover the entire product, which encompasses all consistent investments.

Disclosures should focus on key information, accommodating multi-option products by utilising website disclosure for additional details, such as individual PAI indicators.

The Platform envisions the integration of the Taxonomy into the periodic reporting of any financial product in the future. This would demonstrate the alignment of existing (turnover) or future (Capex) investments. To implement this, a revised SFDR could gradually introduce it, aligning with improvements in corporate reporting practices.

Over the long term, the Platform advocates mandatory minimum ESG reporting requirements, including GHG emissions and the Taxonomy, across all financial products. This extends to products not classified as Article 8 or 9, often referred to as Article 6 under the SFDR.

Lastly, the Platform underscores the importance of distinguishing between pre-contractual commitments and periodic reporting. The former entails product restrictions, while the latter provides information on the current investments of the product.

The Platform advocates for the introduction of a common categorisation scheme to address the existing fragmentation and confusion in the European market. The Platform suggests that such categorisation:

- should be structured in such a way to be easily understood by retail investors and used to address sustainability preferences.

- should avoid the impression that one product's processes are ranked better than another's (e.g. 'best in class' better than 'engagement' or vice versa), whereas a ranking according to the extent of transparency (e.g. Article 9 or 8) appears suitable from a precautionary principle perspective
- should only be based on a thorough analysis of the intended use, how to ensure clarity of categorisation, proper evaluation of the impact of such categorisation as well as an analysis whether it should be mandatory or optional. In addition, it should be analysed whether the categorisation should be based on committed elements or actual elements of a product.

## Platform's proposal on further work

The Platform stresses the need for conducting thorough analysis and further work with respect to SMEs, investments in developing countries as well as derivatives for the broader requirements of the SFDR and the Taxonomy.

1. **SMEs:** FMPs should be able to use the indicators included in the Voluntary simplified ESRS for SMEs that EFRAG is developing as PAIs indicators for investments in SMEs. The evolution of a positive contribution through taxonomy and efforts to bridge gaps with sustainable investments should consider the specifics of SMEs.
2. **Investments in developing countries (other than in large multinational companies) and the need to give special treatment to development finance.** The Platform is continuing the work started by its predecessor on how to apply the Taxonomy to development finance and investments in developing countries other than in large corporates. The EC established a high-level expert group (HLEG) on scaling up sustainable finance in low-and middle-income countries to identify the challenges and opportunities that sustainable finance presents in low-and middle-income countries. The outcomes of the work from both groups needs to be considered in the application and a future revision of the SFDR.
3. **Derivatives.** Discussions regarding the treatment of derivatives in PAI indicators, Taxonomy and Sustainable Investment share calculation reveal the complexity of this issue. This is inter alia based on the fact that derivatives can be used for different purposes (e.g. hedging, increase of leverage, speculation) and that their potential impact on sustainability indicators is not identical with the financial impact, i.e. existing methods there cannot necessarily be used. The Platform emphasises that conducting further analysis built on the ESAs' considerations in their consultation paper should aim at developing a consistent framework for the treatment of derivatives throughout the sustainable finance package, i.e. for all sustainability KPIs (i.e. taxonomy-alignment, sustainable investments and PAIs).

The Platform would also like to stress the importance of minimum safeguards and the social indicators as part of the PAI indicators; and recall that the minimum safeguards of the Taxonomy Regulation should be considered on a company level despite DNSH of Taxonomy Regulation being applied at activity-level. This calls for full alignment between the social and governance indicators within the

SFDR Regulatory Technical Standards (RTS) and the issues covered by minimum safeguards outlined in the Taxonomy Regulation, essentially creating a unified set of safeguards.<sup>1</sup>

## The Platform's principles for disclosure requirements

The Platform has established five principles to govern and frame its thinking on disclosure requirements in its briefing on SFDR and responses to the ESAs consultation of the review of the RTS<sup>2</sup>. The Platform believes that the principles should apply for all disclosure requirements including when considering an indicator such as a potential Principal Adverse Impact (PAI). The Platform has consequently analysed the questions in this consultation through the lenses of these five principles that can be found in Annex 5.

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<sup>1</sup> This is a call that the previous Platform has made previously (please refer to the Platform's Data and Usability report (October 2022) and the EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS (europa.eu). In that regard, the Platform welcomes the Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation, C/2023/3719 (OJ C 211, 16.6.2023).

<sup>2</sup> EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS, available at: [https://finance.ec.europa.eu/system/files/2023-07/230704-sustainable-finance-platform-briefing-esas-consultation-sfdr\\_en.pdf](https://finance.ec.europa.eu/system/files/2023-07/230704-sustainable-finance-platform-briefing-esas-consultation-sfdr_en.pdf)



# 1. Current requirements of the SFDR

The SFDR has been an important step to evolve maturity of the markets for sustainable products and the general understanding around sustainability. FMPs have moved their understanding from a more qualitative to a more quantitative, data-driven approach through the need to define and assess indicators and ensure that they measure any commitments or legislative requirements against such indicators.

The SFDR has successfully implemented a unified disclosure framework across the single market. Given the Platform's strong endorsement of a sustainable finance framework at the EU level, in contrast to individual national measures, particularly concerning transparency and labelling, any potential revision of the SFDR should consider the possibility of replacing or incorporating national approaches into the EU regulatory framework.

The Platform fully supports a thorough evaluation of the SFDR's efficacy and the broader Sustainable Finance Framework. The result of this assessment should enhance its efficiency, address existing gaps, and make it easier for Financial Market Participants (FMPs) to integrate sustainability into their financial products as well as at entity-level.

## 1.1. Effectiveness of SFDR

### 1.1.1. Transparency

The quantity and quality of information available to investors regarding the sustainability of their financial products and their providers have indeed improved, although it is still too early to make a comprehensive assessment. In the EU, the majority of assets under management (AUM), in Europe, approximately EUR 7 trillion out of a total of EUR 12 trillion, are invested in ESG funds or strategies with some focus on sustainability.<sup>3</sup>

Following the implementation of the SFDR in March 2021, there has been a significant increase in the offering of financial products that have either a sustainable investment objective or promote environmental or social characteristics (products disclosing under Article 9 and Article 8 SFDR – “**Article 9 Products**” and “**Article 8 Products**”) in Europe. In the fourth quarter of 2022, 38% of UCITS funds were disclosing under Article 8, indicating their focus on promoting sustainability characteristics. Additionally, 4% of UCITS funds were disclosing under Article 9, signifying their specific objective of sustainable investment. Combined, these funds disclosing under Article 8 and Article 9 managed 55% of UCITS fund assets,<sup>4</sup> which shows that funds disclosing only Article 6 information are considerably smaller in size than Article 8 and 9 funds.

However, the provided information is not easily comprehensible and demands a high level of familiarity with environmental metrics, performance data, and the regulatory framework. Many retail

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<sup>3</sup> MSCI July 2023, Funds and the State of European Sustainable Finance Report. ESG funds are defined as funds that employ any ESG or sustainability-related considerations in its security-selection process. All fund characterizations based on data from Broadridge and MSCI ESG Research, as of March 20, 2023. Available at: <https://www.msci.com/documents/10199/f89743d6-037f-bb73-1750-d606482224b0#:~:text=We%20estimated%20that%20the%20majority,Taxonomy%2C%20SFDR%20and%20MiFID%20II>

<sup>4</sup> ESMA (2023)

investors, both now and in the future, may not possess the necessary understanding to interpret such information, which, in turn, affects their ability to assess the sustainability performance of financial products. That being said, retail investors are also known to struggle with financial information.<sup>5</sup>

The Platform recognises several factors undermining comparability that should be considered to enhance effective disclosures:

- **Transparency is not consistently comprehensive:** The SFDR permits the disclosure of Principal Adverse Impact (PAI) indicators and other information for only a segment of the financial product. The lack of knowledge about the tolerance levels set by FMPs hampers comparability and complicates investment decisions for investors.
- **Differing interpretations of key concepts:** The concept of 'consideration of PAIs' for the DNSH test of sustainable investments (see Article 2a SFDR<sup>6</sup>) as well as the understanding within IDD/MiFID and 'taking PAI indicators into account in Article 4(1) and 7(1) SFDR, lacks a clear definition. As clarified by the EU Commission, there is no uniform methodology to date for identifying Sustainable Investments (SI) as defined in Article 2 (17) SFDR. In both cases, this allows for a variety of methodologies, hindering comparability between financial products and FMPs.
- **Limitations regarding Article 8's approach to sustainability:** Products disclosing under Article 8 SFDR provide for a very diverse range of strategies and degrees of sustainability. Such products range from those that (i) only apply one exclusion criterion to those that (ii) are nearly exclusively invested in SI but have one investment that is neither SI nor for hedging and liquidity purpose and can therefore not disclose under Article 9 of the SFDR.

### 1.1.2. Risk assessment and channelling capital towards investments considered sustainable.

Financial products currently disclosing under Article 8 or 9 of the SFDR do not necessarily make a substantial contribution to one or more of the EU's environmental objectives as defined by the Taxonomy Regulation, unless they commit to a certain level of alignment with the EU Taxonomy either based on turnover or CapEx<sup>7</sup>. Some financial products might make a substantial contribution to such objectives through activities not yet covered by the Taxonomy. Clarity though is only provided where FMPs report on the actual share of Taxonomy-alignment.

Research has for instance been undertaken with respect to funds disclosing under the SFDR. Specifically, 88% of funds invested in listed assets disclosing under Article 8 and 63% of funds disclosing under Article 9 did not report any investments in revenues aligned with the Taxonomy. Of the 13,419 European funds analysed by MSCI in April 2023, of which 6,603 were funds disclosing under Article 8 or 9, only 126 reported a figure for EU Taxonomy-aligned revenue. Of these, the majority (114 funds)

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<sup>5</sup> <https://www.sciencedirect.com/science/article/pii/S0304405X18303076>

<sup>6</sup> Article 2a SFDR has been added through Article 25 of the Taxonomy Regulation.

<sup>7</sup> Alignment must also be gauged through an operational expenditure (OpEx) perspective. The Platform has advocated for the removal of this requirement, asserting that financial institutions do disclose their GIR/GAR in terms of OpEx. Moreover, it introduces unnecessary complexity to the disclosures without commensurate benefits.

reported zero aligned revenue.<sup>8</sup> This lack of alignment or reporting of alignment is primarily due to a deficiency, for the time being, in disclosures by the underlying companies, which has improved since April 2023. It is equally worth highlighting that the figures are all based on revenue and not on CapEx. The first year of corporate reporting has proven that Taxonomy-alignment ratios are significantly higher when it comes to CapEx than turnover or revenues which is consistent with the purpose and design of the Taxonomy.<sup>9</sup> The Taxonomy has been designed to incentivise companies from a forward-looking paradigm<sup>10</sup> to invest in greening their activities and transition to Net Zero and facilitate such investments. European and the global economy are far from being close to a net zero stage, therefore the share of the economy that meets the criteria is by definition very low.

The extent of alignment is therefore still uncertain as FMPs need the information from the companies in order to calculate the alignment of their portfolios. Furthermore, it was not until April 2023 that the European Commission clarified that the use of estimates regarding the Taxonomy-related disclosures on financial products under the SFDR were allowed for companies outside of the scope or not yet reporting under the Taxonomy Regulation. The PSF is working on a proposal to the European Commission on how estimations could be conducted and a set of principles to guide FMPs when doing so.

Finally, it is acknowledged that Article 2(17) encompasses investments in social and environmental objectives beyond the Taxonomy. However, the provision in Article 2(17), allowing the use of a different sustainability definition concerning the taxonomy objectives by FMPs, creates a regulatory loophole. These de facto fragments the market, preventing a unified language to define sustainable economic activities which is the core of the sustainable finance regulatory package. This regulatory discrepancy could potentially circumvent substantial contribution thresholds, such as 100g of CO<sub>2</sub>e/kWh, leading to activities that fall short of this threshold being labelled as sustainable. This undermines the ultimate objective of mobilising capital flows toward genuinely sustainable investments. *Principio del formulario*

Financial products that use the revenue and/or CapEx alignment figures to construct their portfolios especially as part of a wider analysis based on reliable company's transition plan; or based on GHG emission real reductions against reduction targets and/or decarbonise their emissions following EU Paris-Aligned Benchmarks (PABs) or EU Climate Transition Benchmarks are those that are contributing significantly to tackling climate change.

In terms of financial relevance, however, in particular funds disclosing under Article 8 have become very widely used and represent the most prominent product type as of Q3 2023 at 53%, whereby products disclosing under Article 9 add 3.4% to a total of 56.6% of assets invested with a minimum consideration of good governance in the EU.<sup>11</sup>

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<sup>8</sup> MSCI July 2023, Funds and the State of European Sustainable Finance Report.

<sup>9</sup> [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_23\\_3194](https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3194)

<sup>10</sup> Please note that CapEx is usually forward looking for several years while annual revenue and OpEx metrics are inevitably backwards looking at the last reported fiscal year, which is 3-15 months outdated just after annual report publication and 14-26 months outdated just prior to the next annual report publication.

<sup>11</sup> Morningstar (Q3 2023) SFDR Article 8 and Article 9 Funds: Q3 2023 in Review

Exhibit 6a SFDR Fund Type Breakdown (by Assets)

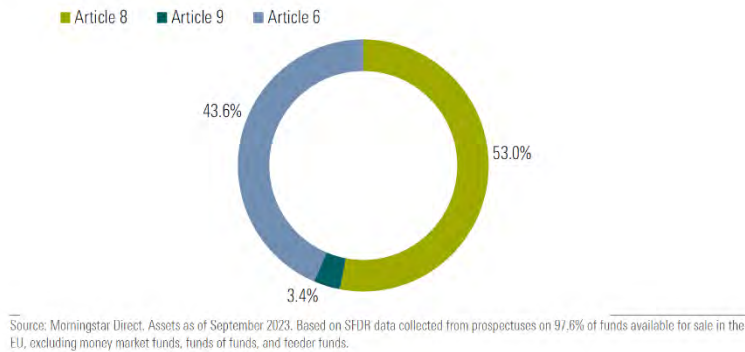


Figure 1: SFDR Fund Type Breakdown by Assets (Morningstar)

Generally, products disclosing under Article 8, can report a 0% commitment to Sustainable Investment (SIO), which means that they do not invest in sustainable activities classified by the Taxonomy or in line with the product providers` approach to SI and neither apply DNSH tests. They are surprisingly common, possibly indicating that some asset managers disregard the SIO percentage. This group appears quite heterogeneous, suggesting that several of these managers could report higher percentages if they chose to do so.

Funds disclosing under Article 8 themselves are a very heterogeneous category and with only a few funds committing to SIO percentages above 50% as visible from Figure 2. For these >50% SI funds, improvements in impact characteristics can be observed, which may well result from reclassified funds formerly disclosing under Article 9. <sup>12</sup>

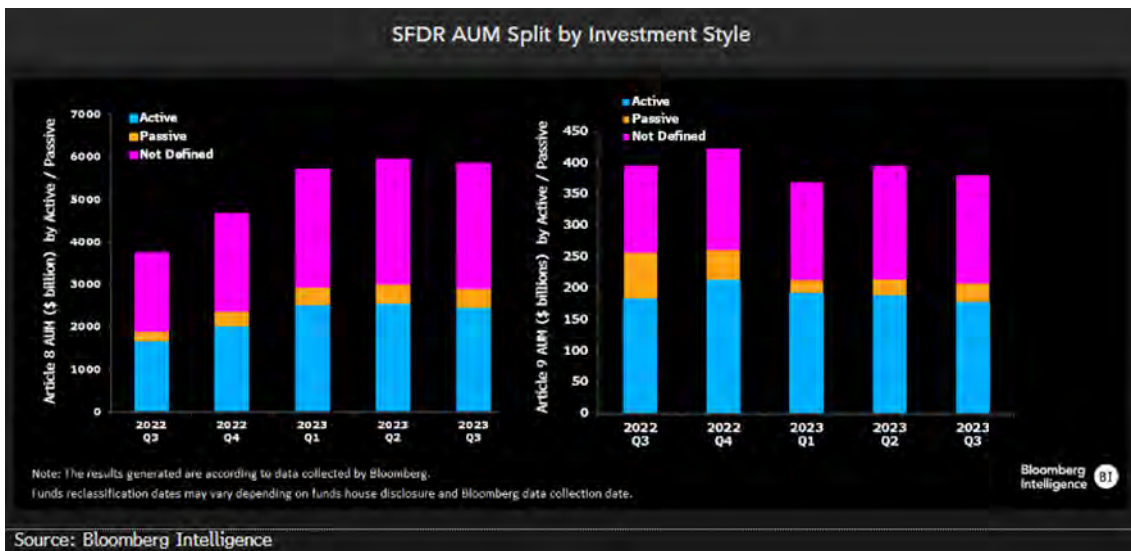


Figure 2: SFDR Barometer on 26,000 SFDR Classified Funds (Bloomberg Intelligence)

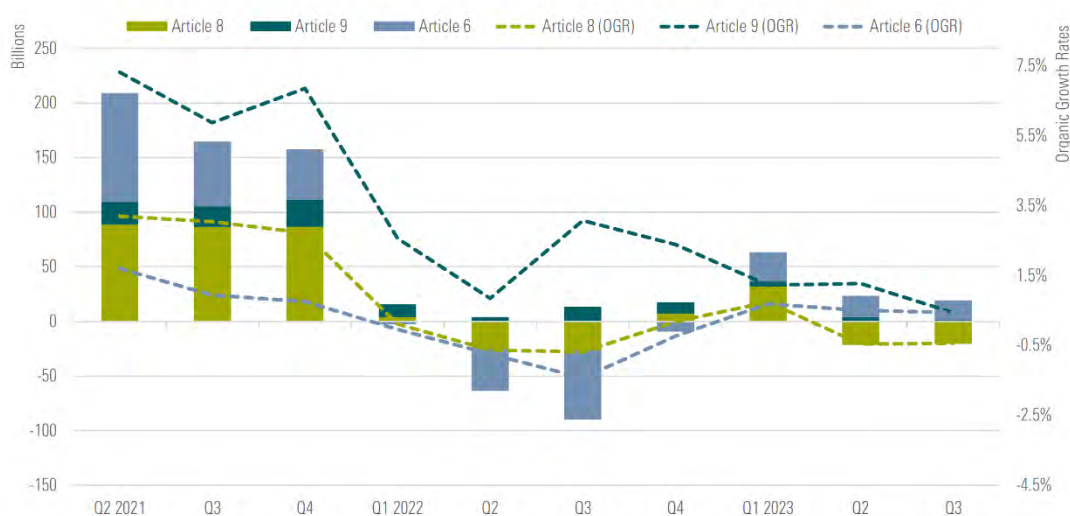
Active funds account for more than 60% of funds disclosing under Article 8 and 9, totalling \$2.7 trillion in assets (passive accounts for \$456 billion and not-defined \$3 trillion). Article 8 passive strategies are growing at double the rate of active strategies.

<sup>12</sup> MSCI (Q3 2023) report forthcoming.

Since funds disclosing under Article 9 must make only sustainable investments, and products disclosing under Article 8 have no minimum requirements on sustainable investments, Article 9 Products would typically show how PAI indicators are taken into account for DNSH purposes for a higher share of their investments than products disclosing under Article 8. Though disclosure requirements contain a section to explain the purpose of the remaining proportion of investments, including a description of any minimum environmental and social safeguards this does not comprise a full picture of any principal adverse impacts. Consequently, even high SIO percentages can potentially be misleading due to a lack of transparency on the non-SIO proportion of the product. Also, generally, some products might be invested with a bias towards low-emission sectors.

In terms of overall size, as of the end of February 2023, EUR 5.9 trillion was invested in funds disclosing under Article 8, and EUR 323 billion was invested funds disclosing under Article 9, of which roughly one third respond to ETFs based on PABs. Remarkably, funds disclosing under Article 9 had positive organic inflows in 10 out of 10 quarter since their inception. This was even during phases where all other funds had outflows – which could also have been based on general market developments. This suggested that while a lot of work is still needed to ensure funds disclosing under Article 8 channel capital to sustainability objectives, those funds that are willing to be a hundred percent transparent on adverse impacts (and in many cases decarbonise like a PAB) are being successful in attracting capital (i.e. had positive organic inflows in each quarter).

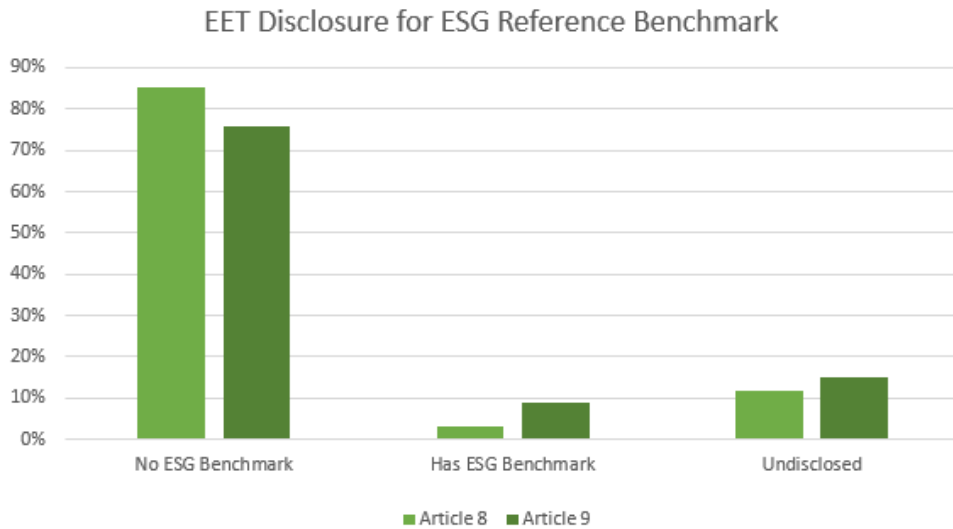
**Exhibit 1** Quarterly Flows Into Article 8 and Article 9 Funds Versus Article 6 Funds (EUR Billion) and Organic Growth Rates (%)



Source: Morningstar Direct. Data as of September 2023. Based on SFDR data collected from prospectuses on 97.6% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

*Figure 3: Flows into Article 6,7,8 Funds (Morningstar)*

Besides their fundraising success, funds disclosing under Article 9 display considerably less adverse impact than others. While some products disclosing under Article 9(3) of the SFDR designate PABs as their reference benchmark, which exclude fossil fuels, it is expected that these funds have substantially lower exposure to fossil fuels, it is very welcome to observe that funds disclosing under Article 9 have much less problematic biodiversity impacts and somewhat higher gender board diversity. Intuitively, funds disclosing under Article 9 are also more likely to have an ESG benchmark than funds disclosing under Article 8 are seen from Figure 4.



Source: Bloomberg, based on Fund EET Disclosures

Figure 4: Fund EET Disclosures for ESG Reference Benchmark (Bloomberg)

While funds promoting environmental and/or social characteristics disclosing under Article 8 are clearly ahead of funds only complying with disclosure on sustainability risks according to Article 6 of the SFDR on board diversity and somewhat ahead of them on mitigating biodiversity impacts, funds disclosing under Article 8 considerably trail so-called funds only disclosing according to Article 6 in terms of fossil fuel exposure. This bears the risk of a mismatch between market perception of Article 8 Products as having sufficient sustainability safeguards and reality where such products still can be significantly invested in fossil fuel. It is worth noting that fossil fuel exposure is captured through revenues generated from such fuels and not in terms of CapEx.

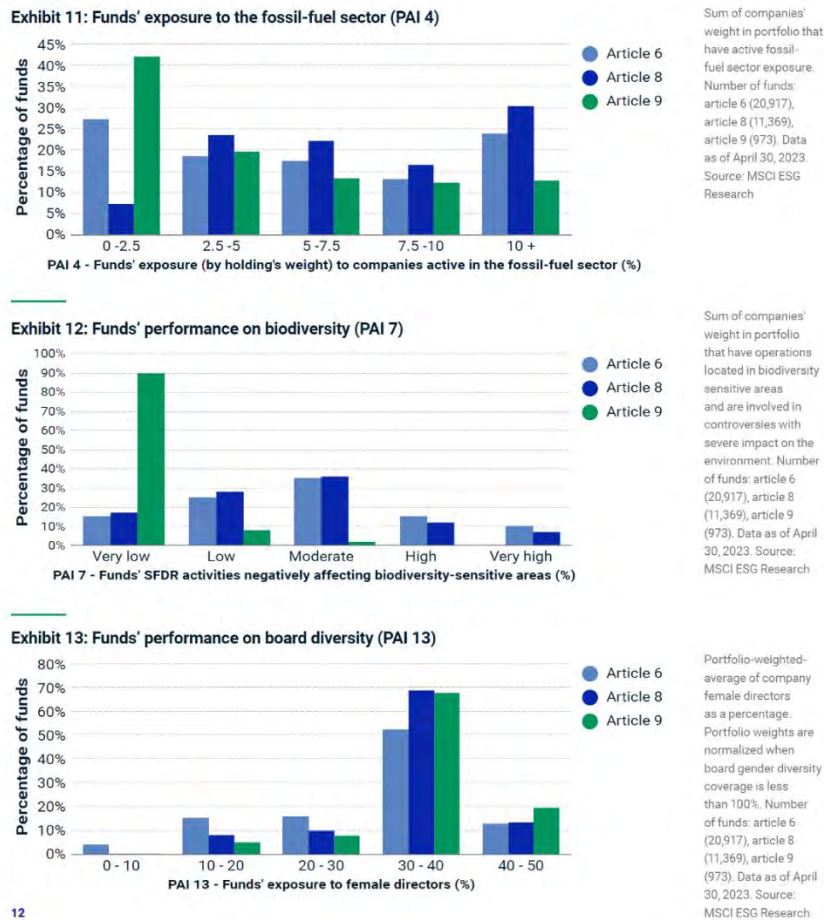


Figure 5: PAIs 4,7,13 across Article 6,8,9 Funds (MSCI ESG Research)

Few financial products are in alignment with a decarbonisation pathway consistent with the 1.5°C goal of the Paris Agreement.<sup>13</sup> While ESG or sustainable commercialised funds appear to be more effective in managing climate risks, although not uniformly and on a significant scale,<sup>14</sup> only a small number are actively pursuing decarbonisation in line with the Paris Agreement goal. Notable exceptions include those that replicate a CTB or PAB benchmark, collectively representing nearly EUR 120 billion in assets under management.<sup>15</sup>

<sup>13</sup> “Mind the ESG capital allocation gap”, by economists Jan Fichtner, Robin Jasper, Johannes Petry (May 2023) using Bloomberg data. Universe of 250 largest funds marked “social responsible” or “environmentally friendly”

<sup>14</sup> Ref. various studies

<sup>15</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ganda\\_23\\_3194](https://ec.europa.eu/commission/presscorner/detail/en/ganda_23_3194)

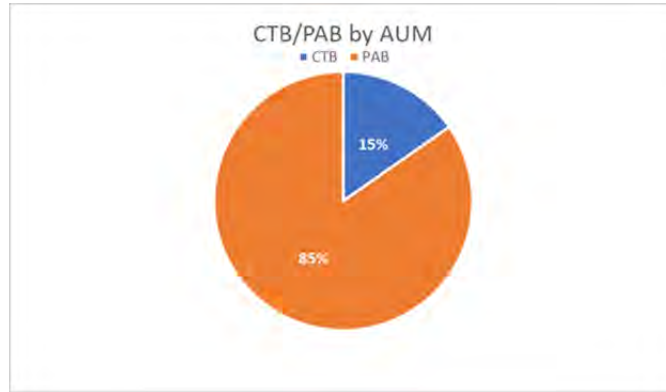


Figure 6: CTB/PAB by AUM

The availability and quality of disclosures concerning the extent of alignment with the 1.5°C objective of the Paris Agreement at the financial product level remain inadequate.

However, FMPs are increasingly keen to add carbon emission reduction objectives to their strategies. Close to 600 funds disclosing under Article 8 and Article 9 now report tackling carbon reduction. The Platform acknowledges the efforts made by FMPs to include GHG emission reduction targets and particularly welcomes the ESAs proposal on carbon emission targets following the EC mandate in this more encouraging environment.

Exhibit 31 Number of Article 8 and Article 9 Funds With Carbon Emission Reduction Objectives



Source: Morningstar Direct. Data as of September 2023, based on a total of 3,775 funds that populated the field, including 3,104 Article 8 funds and 671 Article 9 funds. The increase in the number of funds with carbon reduction objectives also partly reflects the increase in EET coverage.

Figure 7: Number for Article 8 and 9 Funds with Emission Reduction Objectives



**Exhibit 32** Proportion of Article 8 and Article 9 Funds With Carbon Emissions Reduction Objectives



Source: Morningstar Direct. Data as of Oct. 18, 2023, based on a total of 3,775 funds that populated the field, including 3,104 Article 8 funds and 671 Article 9 funds

Figure 8: Proportion of Article 8 and 9 funds with Carbon Emissions Reductions Objectives

At the entity level, disclosures regarding the degree of alignment with the 1.5°C trajectory remain an area for improvement. Currently, these disclosures often appear vague, with FMPs stating their alignment with the Paris Agreement without specifying the indicators used to measure the decarbonisation progress of their investments. It's important to note that these disclosures are not mandatory, as the degree of alignment with the Paris Agreement's objectives should be disclosed "where relevant"<sup>16</sup>.

The Platform in response to the European Commission's request, aims to offer greater clarity on the redirection of capital flows toward sustainable activities by the end of its mandate.

### 1.1.3. Integration of ESG consideration in investment and advisory process

SFDR is indeed a disclosure regulation, and it mandates that FMPs are transparent about how they incorporate sustainability risks into their investment processes, as is the case for Principal Adverse Impact (PAIs). However, the disclosure requirement does not automatically mean that FMPs are obligated to assess sustainability risks and PAIs in their investment processes.

Supplementary legislation, such as changes in the Alternative Investment Fund Managers (AIFM) and UCITS and solvency II frameworks are imposing though the underlying material duty of taking sustainability risks into account in the investment process. The same principle applies to PAIs, provided the FMP is classified as a large entity.

<sup>16</sup> See also JC 2023 09 Joint Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures, available at: [https://www.esma.europa.eu/sites/default/files/2023-04/JC\\_2023\\_09\\_Joint\\_consultation\\_paper\\_on\\_review\\_of\\_SFDR\\_Delegated\\_Regulation.pdf](https://www.esma.europa.eu/sites/default/files/2023-04/JC_2023_09_Joint_consultation_paper_on_review_of_SFDR_Delegated_Regulation.pdf)

The SFDR requires, however, FMPs to disclose how the remuneration policies are consistent with the integration of sustainability risks into the investment-decision making process.

#### 1.1.4. Use of the SFDR as labelling and unclear concepts of SI and consideration of PAI

The Platform shares the EU Commission's view that the classification of products under the SFDR is frequently misunderstood or misapplied, often being treated as a form of categorisation or labelling. While Article 9 Products require SI to encompass the entire fund with the exceptions provided, Article 8 Products can comprise a very diverse degree of ambition.

Furthermore, the existence of diverse underlying definitions of Sustainable Investment (SI), compounded by differing interpretations of the SI concept and the handling of PAIs, has resulted in a range of divergent market practices.

##### **Sustainable Investments (SI)**

According to Article 2 (17) of the SFDR: '*sustainable investment*' means ***an investment in an economic activity that contributes to an environmental objective***, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or ***an investment in an economic activity that contributes to a social objective***, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, ***provided that such investments do not significantly harm*** any of those objectives and that the ***investee companies follow good governance practices***, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance. [...]

The predominant implementation of Sustainable Investment (SI) is currently rooted in the definition outlined in Article 2(17) of the SFDR. This focus is logical, particularly because this year marks the initial period in which companies, albeit limited to large publicly traded ones, are reporting in accordance with the Taxonomy framework.

In its Q&A, the European Commission provided clarification that the Sustainable Finance Disclosure Regulation (SFDR) does not establish minimum requirements for defining the key parameters of a 'sustainable investment.' Instead, FMPs are responsible for conducting their individual assessments for each investment and disclosing the underlying assumptions they rely on.

The definition of SI in Article 2(17) of the SFDR led to diverging approaches within the market. A way to regard them in a highly simplified manner to help structure the discussion would be to differentiate between those based on:<sup>17</sup>

- **Activity-level:** This involves identifying activities that make a positive contribution to environmental or social objectives, considering factors such as revenues, capital expenditures (CapEx), and operational expenditures (OpEx).
- **Company Practices:**

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<sup>17</sup> The Platform acknowledges that the upcoming Level 2 RTS are likely to clarify if all of these four market practices are actually valid.

- Companies that outperform their peers in terms of environmental and social factors.
- Companies that commit to reducing their negative impact over time.
- Calculation of Sustainable Investment Quota at the Portfolio Level:
- **Using a Pass/Fail Approach:** The whole investment in a company is considered sustainable if the proportion of revenue generated from sustainable economic activities surpasses a certain threshold.
- **Employing a Revenue-Weighted Approach:** The revenue share from sustainable economic activities for each company is considered, and the results are aggregated in an asset-weighted manner.

The application of these approaches can yield significantly different outcomes. For example, product providers using a pass/fail approach may often report a higher sustainable investment share compared to those using the revenue-weighted approach. This discrepancy poses a risk of misinterpretation, both for end investors and investment advisors who might focus solely on the percentage without fully comprehending the underlying methodology. In addition, SI is offered as one of the three options for applying sustainability preferences which is separate to the Taxonomy-based option. Given that SI shares, when left at the discretion of each FMP to define the criteria, are usually significantly higher than Taxonomy shares, there is the additional risk that retail investors might choose products with a higher SI share under the impression that these products have stronger sustainability features. Therefore, the Platform fully supports a review of this concept and offers some considerations in the following section (Section 4.1). Please note that article 2 (17) defines sustainable investment as an *investment in an economic activity*. A valid interpretation is that sustainable investments are inherently based at the activity level by definition, with the exception of passive funds tracking an EU Climate Benchmark as provided a safe harbour to automatically be considered as making sustainable investments under the SFDR.<sup>18</sup>

### **Take into account PAIs**

The lack of a clear definition for the term 'take PAI indicators<sup>19</sup> into account' for the DNSH assessment<sup>19</sup> has resulted in varying DNSH methodologies, leading to a lack of comparability between financial products.

Article 2a of the SFDR<sup>20</sup> requires the DNSH assessment to be consistent with the PAI indicators which means considering the indicators of adverse impact only for the sustainable investments made, ensuring that these investments do not cause significant harm to the environment or society. However, there is still no consensus on how this should be practically implemented with the SFDR Level 2 review pending.

An obvious practical issue with PAIs is furthermore that data vendors' measures of these PAIs differ due to interpretation issues or update delays. This difference is larger for more complex PAIs such as

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<sup>18</sup> Commission Staff Working Document on *Enhancing the usability of the EU Taxonomy and the overall EU sustainable finance framework* (SWD/2023/209 final, 13.6.2023) and SFDR Q&A published in April 2023 (Commission's answers to questions on the interpretation of Regulation (EU) 2019/2088, submitted by the European Supervisory Authorities on 9 September 2022 and available at: [https://www.esma.europa.eu/sites/default/files/2023-04/Answers\\_to\\_questions\\_on\\_the\\_interpretation\\_of\\_Regulation\\_%28EU%29\\_20192088.PDF](https://www.esma.europa.eu/sites/default/files/2023-04/Answers_to_questions_on_the_interpretation_of_Regulation_%28EU%29_20192088.PDF) ).

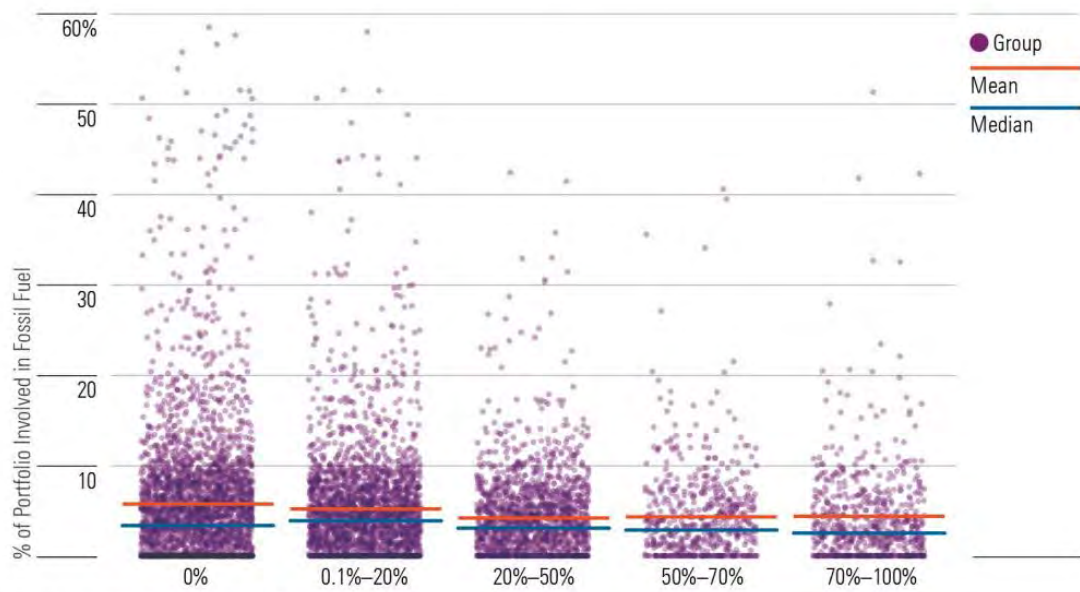
<sup>19</sup> See Annex II and Annex III of Regulation 2022/1288 which include under the description of how Sustainable investments do not cause significant harm the question "How have the indicators for adverse impacts on sustainability factors been taken into account".

<sup>20</sup> Article 2a SFDR has been added through Article 25 of the Taxonomy Regulation.

biodiversity and smaller for less complex PAIs such as percentage of fossil fuels or UNGP principles / OECD Guidelines for Multinational Enterprises. When looking at all funds disclosing under Article 8, Morningstar sees significant reductions in adverse impacts on these PAIs the larger the SI % as seen in Figure 9. For a medium, complex PAI – Scope 1 & 2 GHG emissions – Bloomberg on a smaller sample of funds disclosing under Article 8 cannot find a distinct difference.<sup>21</sup>

The Platform would welcome guiding principles to foster alignment, as it would enhance the comparability of products in the market.

**Exhibit 27d** Fossil Fuel Percentage of Covered Portfolio Involved<sup>16</sup> as Calculated by Sustainalytics (Y-Axis) and Ranges of Minimum Sustainable Investments (X-Axis) For Article 8 Funds

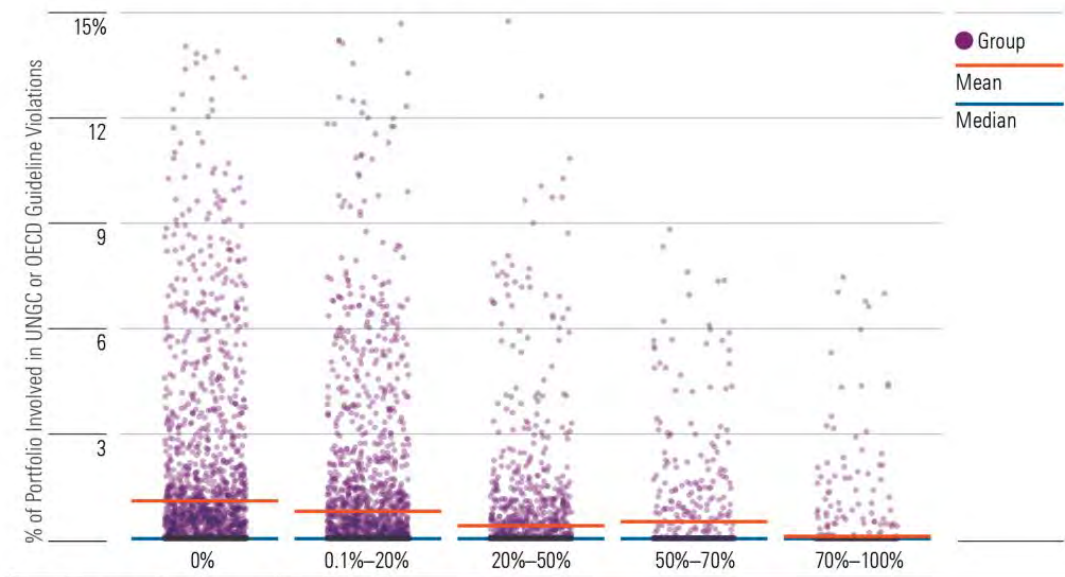


Source: Morningstar Direct. Data as of September 2023.

Figure 9: Fossil Fuel Percentage of Covered Portfolio Involved and Ranges of Minimum Sustainable Investments for Article 8 Funds (Morningstar)

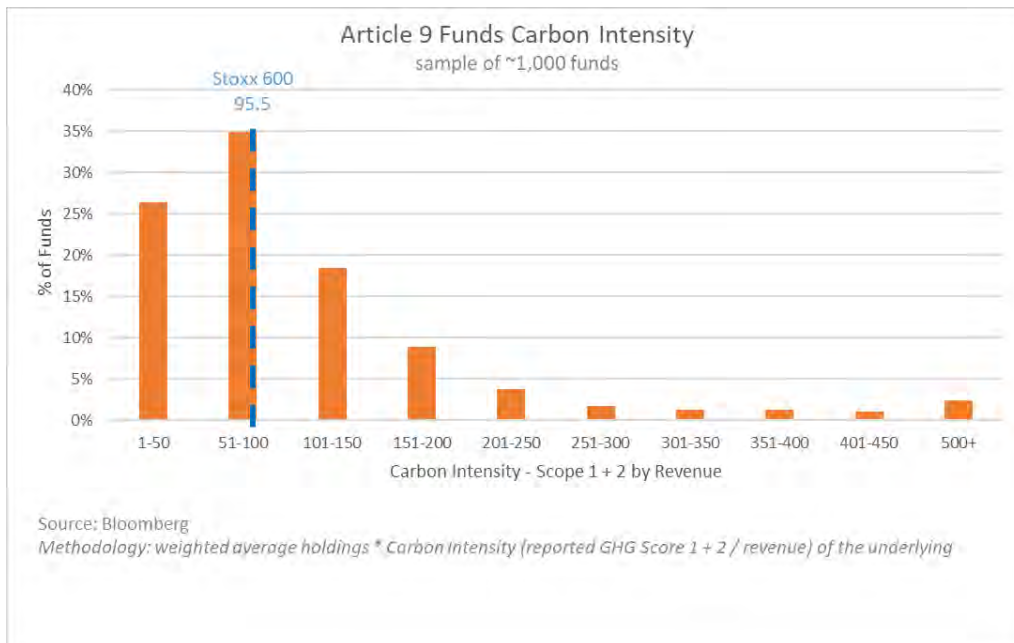
<sup>21</sup> Please note that MSCI does find a difference for the entirety of funds as stated above.

**Exhibit 30** UNGC or OCDE Guideline Violations Percentage of Covered Portfolio Involved<sup>19</sup> as Calculated by Sustainalytics (Y-Axis) and Ranges of Minimum Sustainable Investments (X-Axis) For Article 8 Funds



Source: Morningstar Direct. Data as of September 2023.

Figure 10: UNGC or OCDE Guideline Violations Percentage of Covered Portfolio Involved and Ranges of Minimum Sustainable Investments for Article 8 Funds (Morningstar)<sup>22</sup>



Source: Bloomberg

Methodology: weighted average holdings \* Carbon Intensity (reported GHG Score 1 + 2 / revenue) of the underlying

Figure 11: Article 9 Funds Carbon Intensity (Bloomberg)

<sup>22</sup> SFDR Article 8 and Article 9 Funds: Q3 2023 in Review. Available at: <https://www.morningstar.com/en-uk/lp/sfdr-article8-article9>

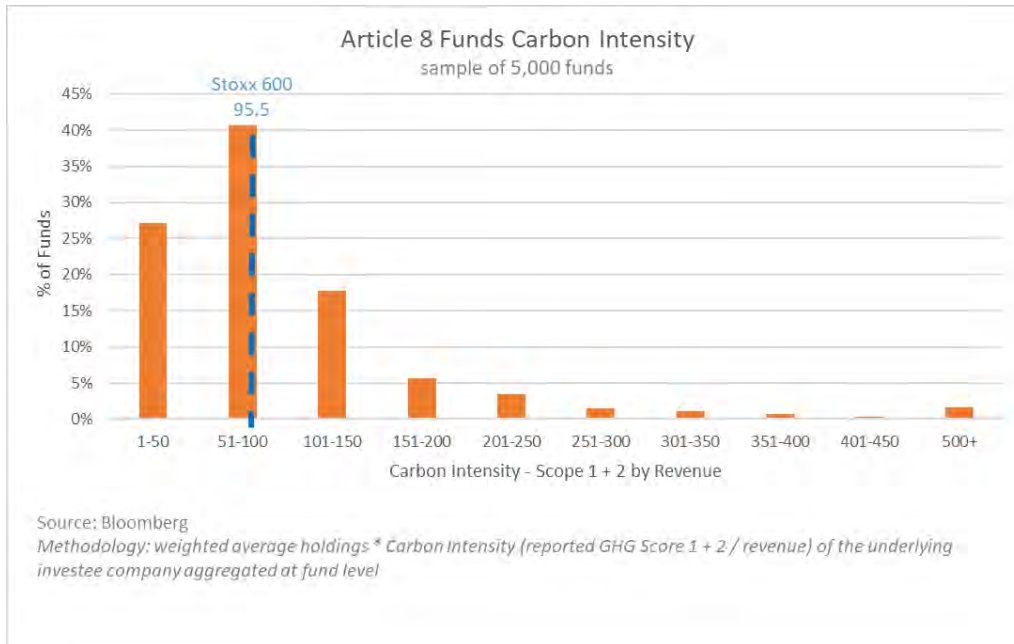


Figure 12: Article 8 Funds Carbon Intensity (Bloomberg)

### 1.1.5. Legal uncertainty, reputational risks and greenwashing

Legal uncertainty is a term used *inter alia* to describe situations in which the application of the law is unclear. When applying legal requirements, some level of interpretation is typically required. However, legal uncertainty is specifically used when the range and potential outcomes of different interpretations vary significantly. Additionally, legal uncertainty can also arise from inconsistencies within the law. While some degree of interpretation is generally needed to account for practical variations, legal uncertainty always carries risks for individuals or entities subject to legal obligations. If applied incorrectly, individuals or entities could be held liable.

In the context of sustainability, legal uncertainty introduces an additional reputational risk, commonly referred to as "greenwashing". This risk arises from the fact that the term "greenwashing" is open to different interpretations. The Platform acknowledges that the ESAs have provided a comprehensive interpretation of greenwashing, which encompasses any form of communication related to the sustainability of a product that does not accurately and transparently reflect the product's underlying sustainability characteristics. Essentially, maintaining truth in labelling, ensuring that the product aligns with all the elements described in its communication, is the minimum requirement to avoid greenwashing. Beyond this baseline, the term and its understanding can be subject to interpretation, especially given the market's varying standards based on industry, jurisdiction, or the type of market participant.

Both regulators and Financial Market Participants (FMPs) have a strong interest in avoiding greenwashing and related allegations. An objective assessment of the validity of greenwashing allegations is crucial. Therefore, any progress in objectifying the understanding of sustainability, such as the use of indicators, can significantly contribute to addressing greenwashing and the associated

risks of allegations. This approach would enable regulators, FMPs, and auditors to conduct a thorough analysis of how a product is presented to the public.

The Platform believes that the following 3 measures will help not only help tackle concerns around greenwashing but improve the effectiveness and the understanding of ESG and sustainable investment products:

1. It is essential to establish a precise alignment between the product's name, its sustainability marketing claims, declared sustainability contributions, and the actual investment strategy, particularly when it comes to the stock selection process and defining the investment universe. This alignment should encompass the substantial majority of the product and account for any negative or offsetting impact from the non-binding share of the product.
2. Reporting on sustainability performance should cover the entire fund, rather than just a portion of it. Providing information on only a segment of the fund is insufficient. There are instances where the negative or adverse impact of a single stock can be more substantial than the sustainability efforts of the entire fund, potentially compromising its overall sustainability credibility.
3. When referencing sustainable economic activities, the definitions of environmentally sustainable investments should be exclusively derived from the Taxonomy, as outlined in Article 9 Taxonomy Regulation. Until the Taxonomy is finished, those economic activities that have not yet been analysed, could be considered SI using Taxonomy objectives, when substantiated but not Taxonomy-aligned. In any case, the term Taxonomy-alignment should not be used.

Indirect investments through SFDR products such as multi-option products or fund of funds have encountered substantial challenges in complying with SFDR, primarily due to varying interpretations of concepts and a lack of available data. For a such investments the commitment to specific binding elements is influenced by the following:

- **Uniform Interpretation:** The same interpretation of these elements should be shared among different indirect investments (e.g. target funds).
- **Continuous Monitoring:** Continuous monitoring is necessary to ensure that the commitments made at the indirect investment (e.g. target fund) level remain consistent.
- **Data Requirements:** Access to data is essential for this monitoring process.

Setting specific, quantitative, *ex-ante* Key Performance Indicators (KPIs) is exceptionally challenging for a in indirect investment, especially when it has limited control over the composition of its portfolio and determination of data used like in an external target fund. Also, indirect investments usually increase the time lag and the timing inconsistencies: Investee companies already have different reporting cycles than the SFDR product. An additional layer such as a target fund increases such time lag with an additional reporting cycle being added.

For example, if a fund of funds aims to disclose as a product with environmental or social characteristics under Article 8 of the SFDR, it could consider a wide range of approaches at the target fund level from external asset managers to get full access to a broad range of investment styles, with the following consequences:

- Such target investments could include diverging sustainability strategies such as exclusion strategies, best-in-class approaches, or alignment with Sustainable Development Goals (SDGs).
- Even within a similar strategy, the approaches will be different, such as different exclusion criteria thresholds or measurement which makes it impossible to have one set threshold on the fund of fund level or different ratings for a best-in-class approach.
- Data from different data providers used can lead to diverging results which increases the volatility of the measurement of indicators.

SFDR does not specifically address the challenge of such indirect investments. This divergence poses challenges for indirect investments when considering Principal Adverse Impact (PAI) but also for setting binding elements including commitments to Taxonomy-alignment or SI.

The Commission has clarified<sup>23</sup> that the disclosure obligation regarding the consideration of PAI under Article 7 of the SFDR comprises, in addition to the disclosure of the principal adverse impacts themselves, also the procedures to put in place to mitigate such impacts. Common understanding in the market regarding this as well as consideration of PAI under MiFID is that exclusions are one of the methods to mitigate PAIs. For a manager of a portfolio including indirect investments, establishing a uniform threshold at the portfolio level is an extremely complex task. Structuring such product in line with Article 9 requirements is even more challenging, given the limited control over indirect investments and the reliance on interpretations by e.g. managers of the indirect investment.

Furthermore, in the case of closed-ended target funds that cannot be redeemed in the event of a breach, classifying the product investing in such target fund as an article 9 product, even when the investments would technically allow it, exposes the manager to a significant risk.

Similar challenges are present when dealing with commitments related to the Taxonomy, SI commitments, or duties that are not exclusive to Article 8 and 9 products. These encompass the obligation to consider sustainability risks and Principal Adverse Impacts (PAIs) in the investment decision-making process and reporting on PAIs. One notable challenge is that Fund of funds managers may not use the same data providers as the target fund managers, and even the target fund managers themselves may rely on different data providers with potentially divergent results.

To address these issues, two market practices have emerged:

- **Independent Assessment by Fund of funds Managers:** In this approach, fund of funds' managers independently evaluate the holdings within their funds against their own data and criteria. As a result, the fund of funds manager may arrive at a different assessment of Taxonomy alignment or other sustainability criteria compared to the target fund manager. This method is advantageous in that it ensures consistent assessment by the Fund of funds manager. However, it can lead to discrepancies, especially if the Fund of funds manager's assessment differs from the target fund manager's assessment. This approach allows the Fund of funds manager to maintain control over the assessment process.
- **Data Provided by Target Fund Managers:** In this approach, fund of funds' managers rely on the data and assessments delivered by the target fund managers. The European ESG Template (EET) has been a useful tool in this context. However, this approach may result in an aggregated Taxonomy share at the Fund of funds level that has different underlying

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<sup>23</sup> JC 2023 18 Consolidated Q&A on the SFDR and the SFDR Delegated Regulation, available at [https://www.esma.europa.eu/sites/default/files/2023-05/JC\\_2023\\_18\\_-\\_Consolidated\\_JC\\_SFDR\\_QAs.pdf](https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf), Q. IV 3.



methodologies or criteria. This difference in assessment methodologies may also apply to the calculation of SI shares. While this approach simplifies data collection, it may introduce variability into the overall assessment process due to differing practices among target fund managers.

### 1.1.6. Transition assets

The Climate Mitigation Taxonomy includes transitional activities as described in Article 10 (2) of the Taxonomy Regulation. Taxonomy CapEx-alignment includes those investments made to become Taxonomy-aligned, thus capturing the financing of transitioning to near net zero or best performance in the case of transitional, but also investments made in individual measures.<sup>24</sup> The Platform argues that the former investments as well as those made in transitional activities respond to transition purposes.

However, as pointed out in the European Commission's Recommendation on facilitating finance for the transition to a sustainable economy, achieving a stage where the activity or asset meets technical criteria may require more than one capital expenditure (CapEx) plan or take longer than the 5-year timeframe. In such cases, the recommendation suggests that issuers communicate their intentions to align, preferably by setting Taxonomy-based targets as part of their transition plans. Financial planning, particularly CapEx plans, is a crucial component of transition plans.

Notably, the EU Green Bond Standard mandates issuers to disclose the use of bond proceeds, commit to a green transition plan, and report on how investments contribute to those plans. While transition bonds and sustainability-linked bonds are innovative financial instruments for funding the transition, the absence of a standardised framework has led to certain scepticism. The EuGB Regulation includes rules on optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds.

There are no uniform disclosure requirements for securities claiming sustainability, excluding them from the Sustainable Finance Disclosure Regulation (SFDR), which encompasses green, transition, and sustainability-linked bonds. This shortcoming poses challenges for product manufacturers and financial advisers, impacting the assessment of investment choices against clients' sustainability preferences. To address this, the Commission proposed targeted additional information for non-equity nor general purpose bonds ESG securities under the Listing Act, leveraging existing disclosures like those in the Corporate Sustainability Reporting Directive (CSRD).

In a previous report, the Platform recommended that issuers of green bonds and similar use-of-proceeds financial instruments reporting against the Taxonomy, have their allocation and impact reports verified by a third-party verifier registered and supervised by ESMA or an official authority for non-EU issuances. With the publication of the ESRS, which includes tangible disclosure requirements on transition plans, the Platform emphasises linking those securities and investments to the credibility of transition plans and key disclosures, such as taxonomy-aligned CapEx and transition plans or GHG emissions reduction targets and progress.

The Platform is committed to build on the EU Commission's recommendation on transition finance and to develop further guidance on the interplay between transition plans, GHG emissions reductions, and CapEx alignment with the Taxonomy including Minimum Safeguards.

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<sup>24</sup> Ref. capex b and c descriptions.

### 1.1.7. Machine-readable format

ESG data is often only reported in human readable reports, with few companies reporting in a machine-readable format with the proper tags.

Companies can disclose quantitative and narrative disclosure in different sections and formats, with quantitative data being reported in different unit of measures. With a lack of these digitalised reporting tags, concepts need to be manually reviewed to ensure consistency between years and comparability across companies. Without these tags, data may need to be manually acquired rather than collected in seconds by a machine, leading to delays in analysing a company's ESG performance.

In order for machine readable tags to ensure comparability, there needs to be a restriction of company specific extensions used which can allow for concepts to be altered or scope to be different across companies.

If companies only report in machine readable format, without the human readable display, readers of these reports may not be able to easily see concepts and values.

## 1.2. Disclosure of PAIs

The Platform reiterates the importance of PAI disclosure on product level, in particular for products that consider PAIs under Article 7 of the SFDR. Such consideration should apply to the whole product and not only for part of the product.

The Platform notes that consideration of PAI is operationalised differently by data vendors and further clarification of the meaning of process descriptions (e.g. biodiversity, pollution PAI) and required updated cycles would be welcome.

Disclosure Level	EET Field
88%	Has A Reference ESG Benchmark
84%	SFDR Minimum Or Planned Investments With Environmental Or Social Characteristics
80%	SFDR Minimum Or Planned Investments Sustainable Investments
66%	SFDR Minimum Or Planned Investments Sustainable Investments Taxonomy Aligned
66%	SFDR Minimum Or Planned Investments Sustainable Investments Social
64%	SFDR Minimum Or Planned Other Investments With Environmental Or Social Characteristics
64%	SFDR Minimum Or Planned Investments Sustainable Investments Other Environmental
55%	SFDR Minimum Or Planned Investments Sustainable Investments Environmental
37%	Exposure To Companies Active In The Fossil Fuel Sector Value
36%	Percentage Taxonomy Aligned Excl Sovereign Revenue
35%	Carbon Footprint Scope 1 & 2 Value
33%	Percentage Taxonomy Aligned Excl Sovereign Capex
33%	Board Gender Diversity Value
32%	GHG Emissions Total Scope 1 & 2 Value

Source: Bloomberg - Based on a sample of 36,000 EET Fund Disclosures (Incl. Share Classes)

Note: This includes a disclosure of a “0” or “N” value

The SFDR currently does not mandate that Article 8 and 9 Products report on PAI indicators in their product reporting. However, some product providers have voluntarily started providing such information, or they have announced their intention to do so, particularly if they have considered PAIs.

The Platform emphasises the need to incorporate the performance of PAI indicators in the periodic reporting for Article 8 and 9 Products, where data is available. There are two main reasons for this:

- **Complete Information for Investors:** Reporting on only a percentage of the product does not offer investors the necessary data to assess the potential adverse impact of a product on social, environmental, or governance aspects. This lack of information hinders investors from making informed decisions.
- **Full Picture of Impact:** Only in the case of financial products for which Financial Market Participants (FMPs) have quantitatively considered all PAIs can investors obtain a comprehensive understanding of the product's impact. Otherwise, the remainder of the product may contain investments that significantly deviate from PAIs and could practically offset any potential benefits.

Additionally, the Platform highlights that PAI data is not universally available, as demonstrated by the data analysis conducted in February 2023.<sup>25</sup> This analysis did not identify any single issuer with available data across all mandatory PAIs, indicating the need for further data collection and disclosure in this area.<sup>26</sup>

<sup>25</sup> Sustainalytics, May 2023, Filling in the Data Gaps: The Current State of Reporting on Principal Adverse Impacts Disclosures for the SFDR, available at: <https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/filling-in-the-data-gaps-the-current-state-of-reporting-on-principal-adverse-impacts-disclosures-for-the-sfdr>.

<sup>26</sup> Idem

**Exhibit 28a** Number of Companies Covering the Mandatory PAIs

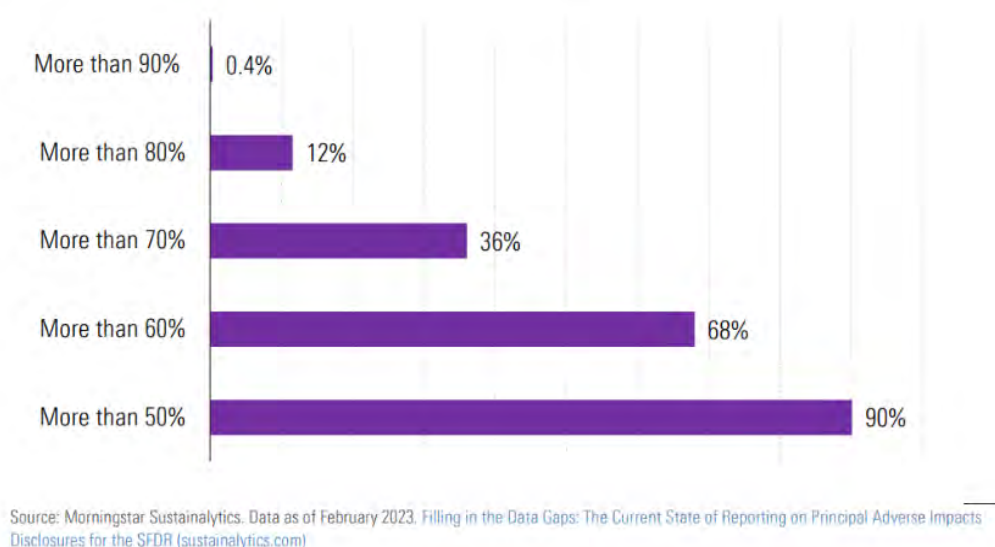


Figure 13: Number of Companies Covering the Mandatory PAIs (Morningstar Sustainalytics)

Reporting under the European Sustainability Reporting Standard (ESRS) will notably enhance data availability and quality for over 49,000 companies throughout Europe. Beyond the EU, sustainability reporting is also seeing significant improvements and will continue to do so, especially as various jurisdictions implement climate and sustainability reporting requirements or endorse the standards set by the International Sustainability Standards Board (ISSB). Despite improvements, in particular for investments outside the EU, data may still be unavailable for one or more required Principal Adverse Impact (PAI) indicators. In addition, for PAIs that are centred around violations of international norms and standards (e.g. PAI 10), or around controversies, relevant data is unlikely to be reported voluntarily directly by investee companies in a reliable and useful manner. If such reporting were to be triggered by court rulings, related reporting would occur years after the violations happened. The Platform notes that research by data providers and NGOs can reveal such violations.

The Platform appreciates the European Commission's clarification that FMPs may assume that any indicator reported as non-material by an investee company does not contribute to the corresponding PAI indicator in the context of SFDR disclosures. This clarification will reduce or even eliminate the need for data assessed as non-material by the investee company. Nevertheless, the Platform notes that need for investee company's materiality assessment of Scope 1, 2, and 3 GHG emissions should be reviewed (see section 2.2).

It is important to recognise that FMPs may not always have the resources or capacity to demand such data from companies. For example, a European FMP might face challenges when trying to engage with large U.S.-listed companies to obtain information on PAI indicators or to engage with every holding in their portfolio. Acknowledging the necessity of relying on estimates for a portion of their holdings, the Platform has initiated efforts to assist Financial Market Participants (FMPs) in understanding the nature of each PAI and in using estimates (see Annex 1). The Platform intends to continue this work and welcomes further developments in the area of estimates. Additionally, the Platform supports the use of a coverage ratio for data that cannot be reasonably estimated.

Voluntary disclosure of due diligence policies by Financial Market Participants (FMPs) who are not obligated to disclose such information remains notably limited.<sup>27</sup> For the period prior to the detailed Level 2 regime being applicable as of 1 January 2023, some National Competent Authorities (NCAs) have pointed out that FMPs not under a legal obligation to disclose their due diligence practices face difficulties in systematically conducting due diligence.<sup>28</sup> These FMPs may not make specific reference to Principal Adverse Impact (PAI) indicators and often fail to provide a clear explanation of how they take these indicators into account. This lack of voluntary disclosure can hinder transparency and comprehensive reporting on sustainability practices within the financial industry.

When applying the concept of consideration of PAIs or taking into account of PAIs the following market practices have emerged:

Aspect	Process	Reporting
<b>Consideration of PAIs on entity level</b> (Art. 4 SFDR and UCITS, AIFMD, Solvency II)	Screening investments <ul style="list-style-type: none"> <li>- using ratings or scorings</li> <li>- pre-trade or post-trade</li> <li>- on holding or portfolio level</li> </ul> Using PAI indicators for engagement with investee companies.	Reporting of PAI aggregated on entity level: <ul style="list-style-type: none"> <li>- Understanding of AuMs to be included is very diverse.<sup>29</sup></li> <li>- Coverage ratio disclosed for data which is not or cannot be estimated</li> <li>- Some provide reporting in different languages.</li> </ul>
<b>Consideration of PAIs on product level</b> (Art. 7 SFDR and IDD/MiFID)	<ul style="list-style-type: none"> <li>- Reporting on PAI indicators on product level</li> <li>- Taking actions such as applying a ‘best in class’ approach or exclusions matching specific PAI indicators</li> <li>- Engaging with investee companies to improve PAI indicators</li> <li>- Mixing aforementioned elements</li> </ul> Aforementioned actions might be limited or comprehensive both with respect to the actions taken (one or more) or also the PAIs used (one or more).	Reporting on single PAI indicators on product level quite common Reporting shows that consideration of involvement indicators such as PAI 4 and 14 are more likely to be considered than quantitative indicators such as PAI 7 and PAI 8. <sup>30</sup>
<b>Taking into account PAI for DNSH test of SI</b>	- Setting specific thresholds for PAIs	Reporting is usually not provided for each indicator but only overall

<sup>27</sup> Joint ESAs’ Report on the extent of voluntary disclosure of principal adverse impact under the SFDR.pdf (europa.eu), available at: [https://www.eba.europa.eu/sites/default/documents/files/document\\_library/Publications/Reports/2023/106\\_2224/Joint ESAs%20%99 Report on the extent of voluntary disclosure of principal adverse impact under the SFDR.pdf](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2023/106_2224/Joint%20ESAs%20%99%20Report%20on%20the%20extent%20of%20voluntary%20disclosure%20of%20principal%20adverse%20impact%20under%20the%20SFDR.pdf)

<sup>28</sup> Idem.

<sup>29</sup> The Platform notes that the ESAs have published several Q&As in November 2022 clarifying the scope: Q&As III.2, IV.23,24 and 25, JC 2023 18 Consolidated JC SFDR QAs.

<sup>30</sup> MSCI July 2023, Funds and the State of European Sustainable Finance Report , p. 17.

Aspect	Process	Reporting
	<ul style="list-style-type: none"> <li>- Performing DNSH test will all or only some PAIs</li> <li>- Engaging with investee companies to reduce PAIs</li> <li>- Engaging with investee companies and data providers to improve data coverage</li> <li>- Mixing aforementioned elements</li> </ul>	reporting on the SI share (which includes only those investments passing the DNSH test).

Larger Financial Market Participants (FMPs) <sup>31</sup> have been mandated to publish information about their due diligence related to Principal Adverse Impact (PAI) since 2021. Smaller FMPs must disclose on a comply or explain basis whether they consider PAI and, if they do not, they must provide clear reasons for not doing so. As of the end of June this year, the PAI statements are required to include quantitative reporting on PAI indicators aggregated at the company level. While the preparation of these statements has been a substantial undertaking for FMPs subject to this obligation, several challenges and low comparability of such statements persist.

The identified reasons for these challenges include<sup>32</sup>:

- **Different Data Sources, Methodologies and Update cycles:** FMPs utilise a range of data sources, including reported data, estimates, data based on internal research, or data provided by third-party providers. Additionally, some of the data may be updated in fewer sequences than others or require interpretation, leading to variations in PAI statement values.
- **Varying Size, Geographic, and Asset Exposure:** The composition of aggregated information is significantly influenced by the types of investments held by the FMP. For instance, the disclosure of an FMP that primarily invests in fixed income in Asia will not be directly comparable to an FMP that invests in both equity and fixed income globally, or one that includes illiquid assets.
- **Differing Understandings of Including AuMs:** There is inconsistency in how FMPs include assets under management (AuMs) in their PAI statements. Some include only funds, while others may include segregated accounts or even cases where they have delegated portfolio management from another FMP, which may include investment managers. This could result in the same adverse impact being reported multiple times in PAI statements, as in the scenario where an insurer employs an investment manager who, in turn, delegates part of the portfolio management to an asset manager. This is occurring despite clarifications already provided by the ESAs<sup>33</sup>.
- **Limited Usage of PAI Statements:** Intention of the PAI statement on entity level was to mobilise capital towards sustainable investments (see e.g. Recital 8 SFDR). Feedback from stakeholders regarding quantitative PAI statements has been low which could indicate limited use by the market. The Platform would also see merit in clarifying whether an entity level

<sup>31</sup> Defined in Art. 4 (3) SFDR as FMPs exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year.

<sup>32</sup> See e.g. Morningstar (September 2023), SFDR Article 8 and Article 9 Funds: Q2 2023 in Review, available at: <https://www.morningstar.com/en-uk/lp/sfdr-article8-article9>, p. 32.

<sup>33</sup> [JC 2023 18 Consolidated JC SFDR QAs \(europa.eu\)](#), Q&As III.2, IV.23, 24 and 25.

statement has a relevant impact in mitigation of PAIs and whether such mitigation is more significant than it would be with a product level disclosure of PAIs. The Platform therefore recommends analysing the use and usefulness of PAI statements on entity level by the different stakeholder groups including which information is relevant for investors as information for a general corporate profile or by asset owners as part when selecting asset managers.

The Platform's recommendations with respect to PAI disclosure on product level are outlined in section 3.2.1 Content of product disclosure.

### 1.3. Data and estimates

The Platform suggested in its Data and Usability Report (October 2022) and in its brief on SFDR (July 2023) that guidance on estimates should encompass specific recommendations for each PAI indicator, which should include guidance on how to estimate these indicators or suggest potential proxies for non-CSR Directive (CSRD) undertakings. Furthermore, the Platform recommended the provision of guidance on establishing tolerance levels for these estimates where the PAI indicators are used for the DNSH test. Annex 1 is the first Platform attempt to respond to our own suggestions.

The file offers a comprehensive examination and recommendations for all compulsory PAI indicators. It includes information on the scope of PAI, some context on the relevance of PAI, an overview of data availability, suggestions for using estimates, and broad guidance on setting thresholds for these indicators.

Additionally, the Platform recommends that more work on estimates and broader guidance on how to apply not only the indicators, but the overarching requirements of the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy should be conducted in the following cases to further enhance the implementation of the EU sustainable finance package:

**Small and Medium-sized Enterprises (SMEs):** FMPs should have the capacity to use PAIs for investments in SMEs, with the basis for such indicators relying on the future simplified voluntary reporting requirements that the European Financial Reporting Advisory Group (EFRAG) is developing specifically for SMEs.

**Investments in Developing Countries (excluding large multinational companies) and Special Treatment for Development Finance:** The Platform continues the work initiated by its predecessor concerning the application of the Taxonomy to development finance and investments in developing countries, especially those not involving large corporations. Additionally, the European Commission (EC) has established a high-level expert group (HLEG) on scaling up sustainable finance in low-and middle-income countries to identify the challenges and opportunities in this context. The results of the work carried out by both groups should be taken into consideration in any future revision of the SFDR. The Platform intends to contribute to this ongoing work.

## 2. Interaction with other Sustainable Finance Legislation

The Platform expresses its approval of the European Commission's recent guidance, which stipulates that investments in Taxonomy-aligned 'environmentally sustainable' economic activities can automatically qualify as 'sustainable investments' under the Sustainable Finance Disclosure Regulation (SFDR). Additionally, the clarification that the SFDR regards products passively tracking Climate Transition Benchmark (CTB) and Paris-Aligned Benchmark (PAB) to be making 'sustainable investments,' as defined in the SFDR, is welcomed. This guidance provides important clarity and aligns with the goal of promoting sustainable investments and transparency in the financial industry.

**IMPORTANT NOTICE:** This brief does not incorporate the Final Report of the ESAs regarding the joint consultation on the review of SFDR Delegated Regulation.<sup>34</sup> As of the completion of this report, the SFDR RTS had not been published. The Platform commits to analysing the regulatory standards and will provide updates to this document or its perspectives in a new publication in 2024.

In the meantime, please refer to the Platform's response<sup>35</sup> to the Joint ESAs Consultation on SFDR RTS and latest briefing on SFDR where the Platform makes concrete proposals to enhance consistency between SFDR and the other Sustainable Finance Legislation, including CSRD/ESRS, Benchmarks Regulation.<sup>36</sup>

### 2.1. Consistency with Taxonomy and Benchmarks Regulation as well as CSRD/ESRS

The Platform acknowledges that there are disparities in the interpretation of DNSH, Minimum Safeguards, and Good Governance among the various regulatory frameworks. The Platform firmly believes that efforts should be made to minimise these inconsistencies to simplify the regulatory landscape and promote a shared understanding. Further information on how these objectives could be realised is outlined in section 4.

### 2.2. Further consistency with CSRD

The Platform recommends that the European Commission ensures that all other non-sectoral indicators relevant to investor and financial sector sustainability reporting regulations, particularly the Sustainable Finance Disclosure Regulation's (SFDR) mandatory Principal Adverse Impact (PAI) indicators, are disclosed by in-scope companies on a mandatory basis. The Platform recognises that certain indicators are only material for companies involved in specific economic activities. Therefore,

<sup>34</sup> <https://www.esma.europa.eu/document/joint-consultation-paper-review-sfdr-delegated-regulation-regarding-pai-and-financial>

<sup>35</sup>

[https://www.esma.europa.eu/system/files/webform/200622/94818/Platform\\_Response\\_to\\_the\\_ESAs\\_Consultation\\_on\\_SFDR\\_RTS\\_03072023\\_vf.docx](https://www.esma.europa.eu/system/files/webform/200622/94818/Platform_Response_to_the_ESAs_Consultation_on_SFDR_RTS_03072023_vf.docx)

<sup>36</sup> EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS (July 2023), available at: [https://finance.ec.europa.eu/system/files/2023-07/230704-sustainable-finance-platform-briefing-esas-consultation-sfdr\\_en.pdf](https://finance.ec.europa.eu/system/files/2023-07/230704-sustainable-finance-platform-briefing-esas-consultation-sfdr_en.pdf)



it suggests formally acknowledging their sectoral nature in the respective regulations when requested by Financial Market Participants (FMPs) as PAI indicators or by credit institutions as Investment-Related Sustainability indicators (ITS).

For instance, this is applicable to PAI 9 (hazardous and radioactive waste ratio), PAI 5 (non-renewable energy consumption and production, specifically for energy production), and PAI 8 (emissions to water). The rest of the PAIs should be considered material by definition, given their significance for company performance and their potential impact on shareholders and investors.

The Platform wishes to express its specific concern regarding the determination that corporate disclosures on Scope 1, 2, and 3 greenhouse gas (GHG) emissions are subject to a materiality assessment. There is a potential risk that these critical indicators could be overlooked by companies opting for immateriality assessments. The urgent need for robust corporate emission data across all scopes is widely acknowledged, particularly recognising its relevance to various stakeholders, including the financial sector.

The Platform recommends that the European Commission advance the ESRS in a manner that incorporates Scope 1, 2, and 3 GHG emissions reporting as part of the remaining list of mandatory disclosures without the need to be subject to materiality assessment. This step is crucial for ensuring a robust framework that ensures Europe's transition to Net Zero.

The Platform appreciates the European Commission's clarification that FMPs may assume that any indicator reported as non-material by an investee company does not contribute to the corresponding PAI indicator in the context of SFDR disclosures. To enhance legal certainty, it suggests aligning this with SFDR level 2, where it should be clarified that, where these cases indeed constitute a reasonable assumption,<sup>37</sup> no further assessment or estimation is required. In addition, SFDR should clarify how to approach materiality for out of CSRD-scope investments.<sup>38</sup> Such approach should consider a reasonable best effort by the FMP to obtain data for out of CSRD-scope investments.

## 2.3. Consistency with IDD / MiFID

The Platform acknowledges that sustainability preferences have been established based on the indicators available in the Sustainable Finance Disclosure Regulation (SFDR) regime, including Taxonomy-alignment, Sustainability Investment (SI), and Principal Adverse Impact (PAIs). The Platform fully supports the use of Taxonomy together with PAI indicators as an objective tool for assessing the degree of sustainability in a product. With respect to SI, more guidance is needed to establish a stringent comparable understanding. A couple of documents to support the implementation of IDD / MiFID have been developed by different organisations. For instance, the Financial Data Exchange (FinDatEx) created the European ESG Template (EET) to support exchange of ESG information between

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<sup>37</sup> The Platform acknowledges that assuming, for example, the biodiversity KPI non-material in both categories for a consulting firm may be reasonable. However, the Platform advises against automatic acceptance of certain assumptions. For instance, assuming that Scope 1 CO<sub>2</sub>e emissions (i.e., PAI1) would be non-material for a utility provider, or that PAI6 – the Energy consumption intensity per high-impact climate sector - would not be material for a company clearly involved in a high climate impact sector. Annex 1 provides detailed insights into the nuances of all mandatory PAIs.

<sup>38</sup> Similar to the footnote above, the Platform recommends the Commission to consider the nuances of different PAIs when providing guidance as to which assumptions maybe reasonable. Annex 1 provides considerable detail as to the nuances of all mandatory PAIs.

manufacturer and distributor of financial products, containing a high number of data fields focusing on the implementation of SFDR, as well as MiFID II and IDD.<sup>39</sup> Others provided guidance on questionnaires for investors.<sup>40</sup> However, the Platform believes that using these indicators as the foundation for questioning sustainability preferences may not be the most ideal approach.

It is important to note that while the scope of SFDR and the Insurance Distribution Directive (IDD) / Markets in Financial Instruments Directive (MiFID) is not identical, many SFDR products, including insurance-based investment products, funds, and mandates, fall under the IDD / MiFID framework. Therefore, the Platform considers it crucial that both regulatory regimes share the same understanding of products with sustainable features / environmental social characteristics. In a future framework, products recognised as having sustainable features / environmental social characteristics under SFDR should also be recognised as such for sustainability preferences. Moreover, the disclosure under SFDR should facilitate the process of identifying clients' sustainability preferences. In this regard, the Platform reiterates its support for an adjusted dashboard to facilitate consistency with the current regulatory framework.

The Platform emphasises the necessity of aligning product categorisation with sustainability preferences. As detailed in section "4.1 Options with respect to categorization," the primary purpose of product categorisation is to simplify decision-making for retail investors.<sup>41</sup>

## 2.4. Consistency with PRIIPs

The Platform observes that the European Commission's proposal to amend the Packaged Retail and Insurance-based Investment Products Key Information Document (PRIIPs KID) is not fully consistent with the Sustainable Finance Disclosure Regulation (SFDR) disclosure and sustainability preferences. The proposal introduces the expected Greenhouse Gas emissions as a new prominent disclosure element in addition to the taxonomy commitment. The Platform agrees and welcomes the prominence given to GHG emissions and taxonomy disclosures.

However, while the Platform understands the constraints of limited space in the PRIIPs KID, it believes that such disclosures should be consistent to avoid confusing investors. One approach to achieving consistency is to use the same elements from the SFDR templates or to not include any disclosure in the PRIIPs KID but simply a link to the PCD under SFDR.

Any classification regime for end investors should also be evaluated for its integration into the PRIIPs KID. The Platform encourages consumer testing to ensure that consumers do not confuse sustainability information with other features of the financial product. An alternative solution is to include a sentence in the PRIIPs KID that directs investors to the Product Disclosure Channel (PCD) for

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<sup>39</sup> See <https://findatex.eu/>

<sup>40</sup> See e.g. The 2° Investing Initiative (March 2022), Draft questionnaire & guidance for client sustainability preferences, available at: <https://2degrees-investing.org/resource/draft-questionnaire-guidance-for-client-sustainability-preferences/>

<sup>41</sup> Emerging mystery shopping analysis appears to unveil a variety of challenges with MiFID, originating from financial advisor behaviour and incentives. These challenges may not necessarily be directly linked to SFDR itself. <https://2degrees-investing.org/mystery-shopping/>

more information on sustainability. This approach can help maintain clarity and consistency in disclosure.

### 3. Potential Changes to Disclosure Requirements for Financial Market Participants

The Platform appreciates the assessment of the effectiveness of existing disclosure and the exploration of ways to enhance this effectiveness.

#### 3.1. Entity Level Disclosures

The Platform recommends assessing to what extent the disclosure of Principal Adverse Impacts (PAIs) on an entity level could be integrated into CSRD/ESRS disclosures for Financial Market Participants (FMPs) that adhere to both regulations. The Platform believes that conducting a review of the effectiveness of various requirements, simplifying them, and prioritising GHG emission reduction targets, progress reporting, taxonomy and transition plans would be beneficial.

The Platform welcomes the fact that the three disclosure requirements at the company level are addressed by the Corporate Sustainability Reporting Directive (CSRD) as follows:

Type of disclosure	SFDR	Corresponding norm in CSRD
Management of sustainability risks	Art. 3	IRO-1 in ESRS 2
Consideration of PAI	Art. 4	Appendix B to ESRS 2
Information in remuneration policy how policies are consistent with the integration of sustainability risks	Art. 5	GOV 3 in ESRS 2

The Platform acknowledges that comparing Principal Adverse Impact (PAI) statements might induce FMPs to mitigate their impact which is one benefit the PAI statement might be able to achieve. Such comparison, at present, is challenging, as outlined in Section 1.2. Initial feedback suggests diverging views on the utilisation of PAI statements.<sup>42</sup> PAI indicators offer valuable insights into negative impacts. Aggregation of such impacts on entity level might facilitate an encouragement of FMPs to reduce their negative impacts at the company level. Various factors, such as asset classes and investment strategies, significantly influence the PAI numbers and therefore have an impact on the year-on-year comparison for FMPs. Understanding trigger of such changes likely requires deep analysis. Further, the significant effort and complex questions for compiling such statements including aggregation of numbers and decision on how to deal with coverage would need to provide substantial benefits to the planet and to stakeholders. The multi-dimensional impact on PAI indicators could potentially limit the facilitation of intended results. In addition, comparability of PAI statements is limited due to variety of factors influencing the aggregated numbers. Though some of these limitations could be mitigated through use of dynamic PAI measures such as weighted averages and ratios consisting only of non-zero values to remove the effects from data coverage and allocation between asset classes. While comparability might not have been a goal from the outset, it would still be an important feature if investors would use PAI statements as a sensible basis to choose product

<sup>42</sup> The Platform is currently preparing a deeper analysis into the extent (e.g. number of pages and languages), utilisation, and comparability of entity level PAI statements.

providers. Furthermore, the entity level disclosure does not allow Investors to relate such disclosures to their specific investments.

As a result, the Platform recommends that a proper assessment on the extent to which asset owners use the information and which information they value the most could help a review of the requirements which should aim at:

- Enhancing consistency and avoiding duplications between SFDR and CSRD/ESRS, and eventually CSDDD, requirements at entity-level.
- Simplification while focusing on those data points and qualitative information most valued by asset owners when selecting asset managers and most urgent to decarbonise portfolios and enhance financial resilience to the physical and transition risks of climate change.

Disclosures of Principal Adverse Impacts (PAIs) on an entity level could be integrated into CSRD/ESRS disclosures or CSRD/ESRS refer to the disclosures under SFDR entity-level. The CSRD/ESRS disclosure should provide corresponding disclosures regarding company-level information. By utilising the Principal Adverse Impact (PAI) disclosure for products and integrating it with disclosures on sustainability risk management and remuneration through the CSRD/ESRS, it can help streamline entity-level disclosures.

The ESRS for the financial sector, anticipated in 2026, could provide guidance on net-zero targets for investors at the entity level. This may encompass a disclosure framework and guidance on due diligence and stewardship practices.

The Platform believes that FMPs that fall outside of the scope of CSRD should also develop their own transition plans to Net Zero and report on those even if in a simplified manner. The Platform believes that GHG emission reduction targets and progress reporting, taxonomy, and transition plans should be gradually made mandatory at entity-level.

The Platform recommends using the entire PAI regime and efforts aimed at providing PAI disclosure at the product level, as outlined in Section 3.2. and ensure one set of disclosures at entity-level (through Article 4 or CSRD/ESRS) which prioritise mandatory GHG emissions and emission reduction targets for the bulk of their overall investments, taxonomy and transition plans.

This approach may offer a more practical and effective way to address sustainability concerns and impacts related to specific financial products and the overall undertaking strategy to decarbonise its portfolios as a whole.

Currently, information provided under SFDR Entity Level Reporting (Articles 3/4/5) duplicates content found in the company's or group's Report (see table above). Streamlining the process and avoiding redundancy could enhance efficiency and clarity in reporting.

Finally, the Platform supports the European Supervisory Authorities (ESAs) in their caveated call to reduce the frequency of the Article 18 SFDR reporting in alignment with the proportionality principle. This would involve reporting every two or three years, as recommended in the ESAs report. Such an adjustment would enable more meaningful analysis of longer-term trends.<sup>43</sup>

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<sup>43</sup> The ESAs note that the recommendations are formulated with the caveat that the ESAs do not have complete information yet on the number of FMPs below the 500 employee's threshold complying with Article 4(1)(a) SFDR. As noted above, the Platform is preparing an in-depth analysis of Article 4 reporting.

## 3.2. Product Level Disclosures

The Platform proposes a streamlined approach to disclosures, recommending a set of pre-contractual disclosures and a single set of periodic reporting disclosures as follows:

- For products disclosing under Article 8, the Platform underscores the importance of a thorough PAI disclosure that encompasses the entire product, including all consistent investments. The Platform asserts that reporting on PAI indicators relevant for the product's characteristics should be mandatory for all investments of a product disclosing under Article 8, eliminating the option to report on PAI indicators under Article 7 of the SFDR for only a portion of the product.
- In contrast to products disclosing under Article 7, those disclosing under Article 8 should have the flexibility to concentrate their PAI reporting on the family of characteristics—be it environmental, social, or governance—they promote, provided they limit the promotion to one set of characteristics. This focus should always include disclosure on Taxonomy and GHG emissions, with the understanding that the reporting should cover the entire product, which encompasses all consistent investments.

Disclosures should focus on key information, accommodating multi-option products by utilising website disclosure for additional details, such as individual PAI indicators.

The Platform envisions the integration of the Taxonomy into the periodic reporting of any financial product in the future. This would demonstrate the alignment of existing (turnover) or future (Capex) investments. To implement this, a revised SFDR could gradually introduce it, aligning with improvements in corporate reporting practices.

In the long term, the Platform advocates for mandatory minimum ESG reporting requirements, including GHG emissions and the Taxonomy, across all financial products. This extends to products not disclosing under Article 8 or 9, often referred to as Article 6 under SFDR.

Lastly, the Platform underscores the importance of distinguishing between pre-contractual commitments and periodic reporting. The former entails product restrictions, while the latter provides information on the current investments of the product.

The Platform fully supports the EU Commission's aim at collecting feedback on what transparency requirements stakeholders consider useful and necessary on a product level.

### 3.2.1. Content of product disclosure

#### Pre-contractual Disclosures

In the context of pre-contractual mandatory disclosure, FMPs are required to provide information on the framework within which the product can be established, such as investment thresholds or eligible assets. The Platform recognises that the requirement to disclose binding elements and related indicators to measure these aspects has been a significant step in enhancing the maturity of sustainability-related product markets. Therefore, the Platform strongly recommends retaining binding elements and indicators in these disclosures.

In addition to pre-contractual disclosure, FMPs often provide marketing materials in which they present the current state of the products, such as the actual shares of SI. Detailed disclosure on the actual state of the product is captured in periodic reporting, where FMPs report on the assets in the portfolio. The Platform suggests that there should be a clearer distinction between commitments and reporting within the Sustainable Finance Disclosure Regulation (SFDR) framework. The Platform supports a less detailed pre-contractual disclosure in this regard, focussing on the contractually binding commitments. For instance, it is highly unlikely that a Financial Market Participant (FMP) would commit from the outset to a specific percentage of investments in taxonomy-aligned investments (as opposed to specifying a minimum per company or a description of the selection factor(s)) in transitional or enabling activities. Providing information on the actual investments in such activities in the periodic reporting is feasible and allows investors to identify these investments effectively.

While the Platform believes that pre-determining a specific percentage of investments in taxonomy-aligned nuclear and gas activities is unrealistic, it does, however, believe that FMPs should disclose if they have the intention, the potential or exclude to invest in any activity related to the Complementary Delegated Act on climate, given that those activities are subject to specific disclosure requirements.

#### Periodic Disclosures

The Platform strongly advocates for the incorporation of Principal Adverse Impact (PAI) indicators' disclosure at the product level for all financial products falling under Article 8 and 9 (or their corresponding future equivalents), **encompassing the entire product.**

There are two primary reasons for this recommendation:

- Providing performance data for only a percentage of the product does not furnish investors with the necessary information to evaluate the extent to which a product might have adverse social, environmental, or governance impacts. This hinders investors from making well-informed decisions.
- Only for those financial products for which FMPs have quantitatively considered all PAIs, do investors have a comprehensive understanding of the product's impact. The market tends to disclose PAI indicators when they have assessed PAIs. Without such disclosure, the remaining portion of the product may contain investments that significantly disregard PAIs, which could offset any potential benefits. Furthermore, it limits investor choices and impedes the establishment of a level playing field.

Unlike Article 9 products though, **Article 8 products could focus their PAI reporting on the PAIs of the family of the characteristics – environmental, social, or governance – they promote if they restrict**

**the promotion to one set of characteristics** in addition to the Taxonomy and GHG emissions. Disclosures in all cases should span the entire product.

PAI reporting regarding controversies or violations could be confined to proven adverse impacts, excluding reports on unfounded allegations of impact. Investor disclosures of PAIs should then specify whether the company is active/expected to solve the controversy.

The Platform also suggests considering the possibility of **comparing Principal Adverse Impact (PAI) performance to a market index**. Such a comparison could illustrate the sustainability performance of a product relative to the broader market, for instance, in terms of absolute emissions or carbon intensity. This comparison data, such as benchmarking against their reference index, could provide valuable insights, acknowledging that this might create bias for investments in less emitting sectors such as Information and Communications Technology. Such comparison could also comprise other KPIs like Taxonomy-alignment.

The Platform reiterates its previous recommendation for increased disclosures, including **the disclosure of tolerance levels set**, as outlined in its report on data and usability.

Additionally, the Platform believes that the European Supervisory Authorities (ESAs) should mandate FMPs to disclose **absolute thresholds in real units rather than percentages for the following mandatory PAI indicators: 1, 2, 3, 6, 8, 9, 14, 19, and 20**. In cases where FMPs set thresholds in percentage terms (e.g., excluding the worst X%), they could convert these thresholds into real units as of the reporting date while also including the percentages. Until such disclosure is included in the framework, the Platform encourages FMPs to disclose such thresholds on a voluntary basis.

In this context, the Platform reaffirms its previous recommendation from the data and usability report, which is to **consider applying Environmental, Social, and Governance (ESG) periodic reporting requirements for non-environmentally or socially sustainable financial products**. The minimum requirements for such reporting **should include disclosing Taxonomy alignment and Greenhouse Gas (GHG) emissions**.

The Platform welcomes that periodic reporting on Taxonomy encompasses both alignment on existing (turnover) and future (Capital Expenditure or Capex) investments for Article 8 and 9 Products. Implementing this reporting requirement across all financial products would help highlight any 8 or 9 Product out-performance on Taxonomy metrics in comparison to products often referred to as Article 6 SFDR. It would also aid FMPs in the gradual decarbonisation of their portfolios and mobilise capital towards financing sustainable projects and transition, which broadly is the ultimate purposes of the sustainable finance regulatory package.

The Platform reiterates its suggestions for GHG emission disclosure, as previously provided in its briefing paper on the review of SFDR Regulatory Technical Standards (RTS).

### **Stewardship-related Disclosures**

Engagement with investee companies is a vital tool for driving the transition of the real economy toward sustainability, particularly for companies outside the EU that may prioritize sustainability differently or use alternative indicators. The Platform therefore suggests exploring of how, as of today, engagement activities are disclosed. SRD II requires live insurers, pension fund providers as well as fund and asset managers, on a comply or explain basis, to disclose an engagement policy that describes how the integrate shareholder engagement in their investment strategy including how they



monitor investee companies and how they conduct dialogues and exercise voting rights.<sup>44</sup> Such engagement policies shall also include matters of social and environmental impact and corporate governance. Further, those investors are obliged to publicly disclose how their engagement policy has been implemented.

The Platform suggests issuing guidance how PAI could be used for investors' engagement activities, considering them as dynamic, actionable data within the engagement process rather than static information for exclusion. The focus should be on tangible improvements and impact in the real economy.

The Platform suggests exploring whether such guidance could include outlining of standardised disclosure of engagement activities. Any standardised disclosure must carefully consider its impact on engagement activities. Mandating FMPs to disclose engagement details may influence investee companies' willingness to engage in discussions.

To enhance the quality and consistency of disclosures, the Platform suggests learning from the UK and other national Stewardship Codes, which have improved clarity by emphasising case studies, outcomes, and engagement processes rather than sheer quantity.<sup>45</sup>

Considering the continued significance of shareholder engagement, disclosures could provide a precise and standardised account of these activities, especially for strategies focused on transition or positive contributions. These disclosures could be included in the minimum requirements for such strategies. However, the Platform sees the following preconditions for this:

1. A thorough assessment of the effect to the SRD II should be undertaken in order to identify whether existing disclosure should be enhanced or standardised.
2. If there is a need for standardised disclosure, it should be assessed whether guidance or Q&A could be sufficient in order to address the need.
3. Whether build into the law or provided by guidance or Q&A, any disclosure requirement should not overlap with SRD II disclosures. Any standardised disclosure should be built on existing rules and if the rules are to be included in the law, it should be assessed whether the requirements on engagement policies should be moved from SRD to SFDR.

Most engagement activities are based on entity-level stewardship policies, and any additional disclosure at the product level should align with entity-level disclosures.

### 3.2.2. Format of product disclosure

#### **A unified format**

The Platform fully supports a unified pre-contractual disclosure for all products falling under Article 8 and 9 (or their future equivalents). Similarly, it endorses a single set of periodic reports for all products,

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<sup>44</sup> See Article 3g (1) Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (SRD II)

<sup>45</sup> For instance, the UK Asset Owners recently published their own Stewardship Review and found significant misalignment between them and their asset managers. <https://www.brunelpensionpartnership.org/2023/11/21/uk-asset-owner-roundtable-publishes-uk-ao-stewardship-review-2023/>

with a focus on sustainability-related products, while also mandating that all other products include reporting on Taxonomy-alignment and GHG emissions. This simplifies the implementation process and enhances the comparability of products.

To prevent investor confusion regarding the commitments of specific products, it is recommended to limit pre-contractual disclosure regarding sustainability commitments to sustainability-related products. However, periodic reporting can be extended to all products as described in the previous section.

### **Website Disclosures**

The Platform recommends a re-evaluation of website disclosure concerning pre-contractual disclosure, periodic reporting, and any additional information that might be useful to investors and appropriate. The following factors should be considered when streamlining disclosures:

- Pre-contractual disclosure should focus on conveying crucial information about mandatory product features.
- Periodic reporting should include reporting on the performance of indicators to measure the binding elements provided in the pre-contractual disclosure, as well as those that are mandatory (for Article 8 or 9 products).
- Specificities of some financial products. For example, Multi-Option Products often necessitate 60 to 100 pages of pre-contractual disclosure.
- Regulatory requirements, such as the Insurance Distribution Directive (IDD), still require periodic reports to be sent to customers.

In any case, website disclosure should align fully with pre-contractual disclosure and reporting. Additionally, it can include further information such as on individual PAI indicators.

The Platform maintains its support for proposals to electronically display pre-contractual and periodic reporting disclosures in an expandable manner, utilising templates and a dashboard.

### **Tailored products to institutional investors**

The Platform acknowledges that certain products are customised for institutional clients only and not made for the eventual use by retail investors.

Disclosures for products individually designed upon request and instruction of or negotiated with institutional investors (tailored products) are typically not publicly available on websites due to distribution rules that restrict public disclosure.<sup>46</sup> In addition to the information requested by the client, such disclosures could be confined to key sustainability as potential negative impacts, or to taxonomy-alignment and GHG emissions and emission targets.

### **Machine and human readable**

It is crucial that disclosures are presented in a format that is both machine-readable and human-readable format. For instance, the inline eXtensible Business Reporting Language (iXBRL) format allows reporting entities to incorporate machine-readable tags (XBRL) into an electronic file, which remains readable by humans (HTML). This format preserves the content of the report while altering

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<sup>46</sup> For instance, AIFMD, Annex III requires information on the arrangements established to prevent units or shares of the AIF from being marketed to retail investors. Such arrangement, for instance, comprises that documents on respective products are not published. Please also note the ESAs Q&A V.3 JC 2023 18 Consolidated JC SFDR QAs.

how it is reported. Machine-readable XBRL tags facilitate the automation of data collection, improving the quality and consistency of reports.

EFRAG's ESRS DRCF advises the EFRAG Sustainability Reporting Board (EFRAG SRB) and the EFRAG Sustainability Reporting Technical Expert Group (EFRAG SR TEG) in their digital reporting activities and maintains an XBRL classification<sup>47</sup>. On the other hand, the IFRS's ISSB ITCG is responsible for providing guidance to both the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB) concerning their digital classifications<sup>48</sup>, specifically in XBRL and iXBRL formats. The development of digital concordances will enable better comparability across different classifications<sup>49</sup>.

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<sup>47</sup> Please note that it is formally called XBRL taxonomy, but in order not to confuse it with the EU Taxonomy on sustainable activities, it has been changed to classification.

<sup>48</sup> Idem. Taxonomies in the original text

<sup>49</sup> Idem.

## 4. Potential Establishment of a Categorisation System for Financial Products

The Platform welcomes the European Commission's evaluation of whether product categorisation could be a valuable means to enhance the SFDR regime.

The Platform advocates for the introduction of a common categorisation scheme to address the existing fragmentation and confusion in the European market. The Platform suggests that such categorisation:

- should be structured to be easily understood by retail investors and be used to address sustainability preferences.
- should avoid the impression that one product's processes are ranked better than another's (e.g. 'best in class' better than 'engagement' or vice versa), whereas a ranking according to the extent of transparency (e.g. Article 9 or 8) appears suitable from a precautionary principle perspective
- should only be based on a thorough analysis of the intended use, how to ensure clarity of categorisation, proper evaluation of the impact of such categorisation as well as an analysis whether it should be mandatory or optional. In addition, it should be analysed whether the categorisation should be based on committed elements or actual elements of a product.

### 4.1. Options with respect to categorisation

To evaluate the components of a categorisation, it is essential to identify clear objectives and potential consequences. The Platform believes that the development of a categorisation should be purpose driven. Moreover, to ensure widespread acceptance, it should incorporate as many relevant elements that have been developed in recent years as is appropriate and feasible.

#### 4.1.1. The need and objective for categorisation

The Platform advocates for the introduction of a common categorisation scheme to address the existing fragmentation and confusion in the European market. This proposal is motivated by challenges related to inappropriate utilisation of SFDR disclosure requirements, varying national labelling regimes, and the persistent fragmentation in the European market. A categorisation scheme would aim at enhancing clarity, comparability, and consistency, fostering a unified understanding of different sustainable financial products across the European Union.

The Platform argues for the introduction of a categorisation scheme due to the existing fragmentation and confusion in the European market:

1. The **inappropriate utilisation of the SFDR disclosure requirements** under Articles 8 and 9 as a labelling regime indicates a need for a unified understanding of a wider array of sustainable products within the European Financial Markets. While Article 9 provides clear rules, products disclosing under article 8 are hard to categorise as they encompass a wide range of strategies and approaches to sustainable investing.
2. **National Regimes:** National approaches including labels have been established in certain jurisdictions by public authorities or stakeholder groups or the industry, evolving over decades. While some aim to operate across EU borders, challenges arise for product providers operating across borders due to varying views of National Competent Authorities (NCAs) or the labelling schemes setters on criteria, notably on exclusion. This can create frictions in cross-border product offerings and investments, potentially undermining the capital markets union. In addition, some national authorities have introduced their own approaches regarding sustainable products beyond labelling (see e.g. the French NCA's AMF [doctrine](#) or German NCA's BaFin [practice](#)). Annex 2 provides examples of labelling regimes and categorisation approaches by NCAs or national label providers.
3. **EU Taxonomy:** The EU Taxonomy is designed to establish uniform criteria for national labelling regimes, aiming to enhance comparability among various green or environmental labels by providing a common framework. However, despite the existence of various labels, there hasn't been a widely accepted labelling regime spanning the European Union or the global stage.
4. **An expansion of the Ecolabel Regulation** was envisioned to create a foundation for promoting the adoption of the most environmentally friendly financial products, incorporating elements from the EU Taxonomy.<sup>50</sup>
5. **Fragmentation in Market:** The market remains fragmented, with the classification under the SFDR as Article 8 or 9 being the only shared EU terminology. The Platform notes variations in the interpretations of Article 8 Products by FMPs and the market in general, which cover diverse degrees of contribution to sustainable objectives.

To address the challenges and variations in existing labelling schemes, as outlined above, the Platform recommends the introduction of a common categorisation scheme. This scheme aims to facilitate the identification and differentiation of various types of sustainable products within the single market. Such a categorisation scheme would contribute to clarity, comparability, and consistency, promoting a more unified understanding of sustainable financial products across the European Union.

#### 4.1.2. Principle aspects for categorisation

The Platform recommends considering six aspects for determining potential approaches to categorisation:

1. **Use of Categorisation:** Clarify the intended audience or purpose, emphasising user-friendliness for retail investors while allowing flexibility for tailored products for institutional clients. Link categorisation to sustainability preferences.
2. **Clarity of Categorisation:** Ensure a clear and objective categorisation system using clear criteria, potentially measurable indicators, minimising doubts about product allocation. Evaluate the use of indicators and the data availability for clarity.

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<sup>50</sup> The Platform acknowledges that the entire SFDR labelling debate may not have occurred if the Ecolabel expansion would have been successful and regrets that this project has been halted.

3. **Impact of Categorisation:** Assess the impact on market perception and innovation, avoiding limitations on products that do not neatly fit into established categories but also ensure that the categorisation is in line with the overarching policy objective of financing the transition into a sustainable economy. Provide for a default category. Balance effective changes with feedback from stakeholders and consider the impact on existing systems.
4. **Optionality of Categorisation:** Consider giving FMPs the choice to use categorisation for non-retail market/non-tailored products. Propose a minimum disclosure requirement for all products in reporting in lines with the Platform's proposals for article 8 products and a categorisation system for the retail market.
5. **Committed vs. Actual-Based Categorisation:** Suggest categorising products based on marketed investment strategy and committed indicators with a simple grading system displaying performance against commitments for retail investors. Recognise the long-term perspective of financial product investments and the need for historical sustainability data.
6. **Accountability of Categorisation:** Any categorisation schemes ought to ensure that there is full transparency to the market on any negative or offsetting impact from the non-binding share of the product.

The Platform recommends that any chosen categorisation should *inter alia* be tailored for retail investors and applied to the retail investment market. Linking categorisation to sustainability preferences is essential. Such categorisation could take as a starting point Article 6, 7, 8 and 9 already embedded in the SFDR.

The Platform recognises that there are two possible pathways:

1. Setting a categorisation scheme through the establishment of prerequisites for such classification in both the SFDR and IDD/MiFID, and for those to be perfectly aligned.
2. Streamlining Article 8 required disclosures, as well as Article 6's, in line with the Platform's recommendations made in this paper; and then, develop a categorisation scheme for financial products with a meaningful sustainability related ambition. Such categorisation system should be reflected in and aligned with IDD/MiFID.

The Platform emphasises the importance of finding the right balance between defining clear measurable criteria and fostering innovation. Measurable indicators offer an objective way to determine a product's sustainability profile. However, the impact of any proposed categorisation on market perception and innovation should be carefully evaluated, and strict definitions should be applied cautiously to avoid unduly limiting products.

The Platform suggests categorising products based on committed indicators and marketed investment strategy, accompanied by a simple grading system for retail investors. Recognising the long-term perspective of financial product investments is crucial, and historical sustainability data should be accessible to investors. Investment advisors' offerings under IDD and MiFID, involving instruments without commitments, should be treated separately.

The principles outlined above can serve as a guide in the decision-making process, ensuring that the chosen approach aligns with the desired objectives and outcomes.

In addition, when developing the categorisation scheme, it is important to distinguish between:

- Content of categorisation: how the categories are defined.
- Process of categorisation: how products are allocated to each of the categories.

- Implementation of categorisation: how the legal text describes the categorisation.

In particular, the latter is relevant for the question of whether Article 8 and 9 should be retained or not.

### 4.1.3. Removing, amending or keeping the SFDR classification

The Platform welcomes the two approaches presented by the European Commission in the Consultation with regards to financial product categories and highlights that a hybrid option is also possible. The evaluation of these approaches is based on the three principles discussed earlier in the document.

Approach	Use	Clarity	Impact
1. Splitting differently than existing concepts (8/9),  e.g. by strategy of the product  or according to aspects relevant for the retail investor	Potentially helps increasing usability for retail investors, current Art. 8 only provides limited clarity on sustainability features of product.  Unclear whether retail investors understand different sustainability strategies available in the market, i.e. best in class vs. exclusion vs. impact vs. engagement.  Would best serve the purpose though identifying aspects relevant for retail investors is challenging (see below)	Depends on the distinction criteria used  Products often apply a mixture of strategies; objective distinction might not be easy.  Could be achieved by using certain objective indicators though mere display of indicators would probably be challenging for retail investors	Market perception seems to be that impact is high. This is probably correct with respect to data systems building on classification. Distinction should only be retained if useful for purpose.  Providing for certain strategies would probably limit innovation if there is no “other” category. However, introducing such category could have an impact on clarity.  Could potentially have significant impact on system and processes but would allow to reduce complexity (i.e. Art. 8/9 vs. sustainability preferences).
2. Converting Articles 8 and 9 into formal product categories	Art. 8 only provides limited clarity on sustainability features of product. Formal product categories should be able to convey relevant distinction to retail investors.  Art. 9 Products allow limited investments for companies in transition, as they do not fit the sustainable investment / DNSH definitions very well.	Could be achieved by using certain objective indicators though mere display of indicators would probably be challenging for retail investors	Could allow keeping some of the existing systems and processes but would still require adjustments given a different understanding of the products.  Conversion should ensure that product innovation is not limited.

Approach	Use	Clarity	Impact
3. Hybrid Option which integrates product/process categorisation into Article 8 & 9	Retains Article 9 while advancing the understandability and clarity of Article 8, especially for retail investors	Could be achieved by using certain objective indicators for product and process which repeated in an Article 8 (e.g. CTB) and an Article 9 version (e.g. PAB)	Offers a combination of both approaches as it guides clients in terms of (i) risks & opportunities of transparency and (ii) risks & opportunities of product process

In summary, the Platform recognises that both approaches share greater similarities than initially apparent. Adjustments are deemed necessary to improve efficiency and user-friendliness for retail investors, suggesting that the division should be maintained only if it doesn't add complexity. The Platform also acknowledges FMPs' reluctance to abolish Article 8 and 9, as it may entail substantial changes and costs. The Platform supports utilising the existing system sensibly as a base and provides potential implementation approaches in Annex 3.

An alternative to the mutually exclusive options of either continuing Article 8 or 9 or introducing a new product labelling scheme could be a **hybrid option**. Such a hybrid option would continue a transparency-based structure (i.e. Article 9 discloses adverse impacts on all PAIs 100% of the constituents, Article 8 disclose climate, taxonomy and fund objective related PAIs on 100% of the constituents) while introducing a product type classification that explains especially retail clients the underlying investment processes (e.g. best in class, climate transition, social impact focus etc). The advantage of such a system would be that it offers the best of both approaches as it guides clients in terms of (i) risks & opportunities of transparency and (ii) risks & opportunities of product process. Details of the potential implementation of such an approach are included in Annex 3.

The Platform appreciates that a recognisable number of FMPs seem not to be keen in abolishing Article 8 and 9.<sup>51</sup> This could also be based on the fear that abolishment would mean a complete overhaul or significant change of the current system which would trigger significant implementation efforts and costs. Therefore, the Platform supports the wish to use as much of the existing system as sensibly possible.

Annex 3 provides for potential ways of implementing a categorisation and develops further the hybrid option.

#### 4.1.4. Categorisation and sustainability preferences

The prior Platform, in its data and usability report<sup>52</sup>, acknowledged support for integrating sustainability preferences into investment advice and portfolio management services as a crucial step in reorienting the financial system towards sustainability. This legal requirement has been in force since August 2022.

<sup>51</sup> See e.g. the EC's webinar where the poll showed 43% percent of supporting a categorisation being built on Article 8 and 9 of the SFDR.

<sup>52</sup> Platform on Sustainable Finance's recommendations on data and usability of the EU taxonomy, available at: [https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability\\_en\\_1.pdf](https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf)



In 2023, ESMA conducted a call for evidence on sustainability in suitability and product governance<sup>53</sup> to gather insights on how sustainability preferences are assessed and explore potential alternative approaches. Analysing these results will be a crucial element in establishing a connection between sustainability preferences and a potential SFDR categorisation. Results of such exercise including any Common Supervisory Action should be analysed also with respect to a potential categorisation system.

In the light of the above, the Platform suggests:

- conducting a thorough analysis on the impact of sustainability preferences in MiFID and IDD.
- incorporating any categorisation in IDD and MiFID to ensure consistent understanding of the sustainability features of financial products.
- using the same understandings of the sustainability features of products in both IDD/MiFID and SFDR whether the full categorisation is detailed already in SFDR or developed further in level 2 or elsewhere.
- assessing how to best integrate the use of categorisations within the distribution of IBIPs and financial instruments, i.e. whether it should be part of the suitability assessment or should be explored independently.

#### 4.1.5. Potential approaches for categorisation

##### **Approaches for categorisation: pros and cons**

The Platform emphasises the importance of tailoring product categorisation to meet the needs of retail investors. With respect to the content of categorisation, the Platform has slight reservations about the proposed categorisation for retail clients since the distinction between the categories is not completely clear and it should be tested whether there is indeed a need to have a separate exclusion-based product.

It can be quite complex to explain to retail investors the intricacies of different investment strategies, such as whether they prioritise the selection of investments (e.g., best in class), reduce the investment universe through screenings or exclusions, or focus on transforming investee companies.

Assessing the impact of various investment strategies and universes on sustainability aspects is an even more complex task. Instead, clients often focus on specific themes or seek guidance on the sustainability aspect of a product.

The Platform envisions three possible approaches to categorisation:

- **Categorisation based on retail investors' needs, with an objective system for product allocation.**
- **Adaptation of the current market categorization (e.g., the Article 8/9 distinction or the EU Commission's proposed approaches) into a categorization system tailored for retail investors.**

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<sup>53</sup> ESMA (2023) Call for Evidence on sustainability in suitability and product governance available at: [https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability\\_en\\_1.pdf](https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf)

- **Hybrid approach offering a combination of both approaches as it guides clients in terms of (i) risks & opportunities of transparency and (ii) risks & opportunities of product process.**

The former approach, using a single system based on retail investors' needs, would be less complex as it avoids the need for translation between two categorisations. The second approach, adapting the current market categorisation, acknowledges market realities and may be easier to understand and implement for market participants. The third approach is the hybrid option. However, maintaining any categorisation system, especially in the case of innovations, could be challenging.

In focusing on retail investors, the Platform has identified the following potential approaches to categorisation:

- **Scaling System:** A scaling system assists customers in choosing from various alternatives through ranking. It can utilise a signalling effect, such as a colour code from red to green, or a more neutral approach using letters from A to E. The methodology behind this scaling system should align with customer objectives while supporting the broader Sustainable Finance Agenda. Examples include Nutri-Score, Energy Performance Certificates (EPCs), traffic-light systems, or more neutral but similar approaches. It must be noted that EPCs are only looking at energy efficiency, whereas a scaling system for products would have to be multi-dimensional and include environmental, social aspects, positive contributions, negative impacts, as well as changes over time.
- **Measurement against Benchmarks:** Product performance could be measured against benchmarks. However, the Platform acknowledges that there are limitations, especially for investment strategies that deviate significantly from broad market indices. Committing to a benchmark deviation could significantly impact a product's financial performance. It should also be recognized that such a comparison would require sector and region neutrality. If products focus on certain sectors or regions, a comparison to a broad market index might not always be meaningful. It should also be clear for investors what the measurement against the Benchmark entails, i.e. sustainability performance and not financial performance.
- **Theme-Based Categorization:** This categorization could for environmental themes be based on EU Taxonomy objectives, which have traditionally been used to describe investment approaches. While the Taxonomy objectives could be used to categorize products, it might be worth merging climate change mitigation and adaptation into one overall climate change objective to make it easier for the end investor to identify. This would not mean merging such objective on the company reporting side where it is in line with international understandings. Additionally, social elements could be identified or be left to FMPs to define. Products that serve a broad range of objectives may be more difficult to explain and may need to be allocated to a multi-objectives category. Furthermore, an objective method of product identification, such as commitment and reporting on specific indicators, would be necessary.
- **Approach-Based Categorization:** This option is also proposed by the EU Commission. The Platform acknowledges that the EU Commission's approach aligns with existing market practices. Within this categorization, it's possible to distinguish between:
  - **Company Outcome:** Evidenced by a direct change in financial metrics like revenue, capital expenditure (capex), or operational expenditure (opex) associated with environmental or social objectives. It's worth noting that the term 'Impact Investing' is considered source of potential confusion by national authorities.<sup>54</sup>

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<sup>54</sup> ESMA30-1668416927-2498 Progress Report on Greenwashing, available at: [https://www.esma.europa.eu/sites/default/files/2023-06/ESMA30-1668416927-2498\\_Progress\\_Report\\_ESMA\\_response\\_to\\_COM\\_RfI\\_on\\_greenwashing\\_risks.pdf](https://www.esma.europa.eu/sites/default/files/2023-06/ESMA30-1668416927-2498_Progress_Report_ESMA_response_to_COM_RfI_on_greenwashing_risks.pdf)

- Improve/Transition: Evidenced through operational or financial metrics linked to environmental outcomes on investee company or portfolio level over time.
- Leader/Focus: Evidenced through the operational aspects of a company, such as entity-level water, waste, and carbon metrics (e.g., Best in Class, ESG Scores, etc.).
- Efficiency: This categorisation would in addition to an environmental target also take into account the cost perspective, i.e. take a measure of impact/ or risk per euro spent on the reduction of the impact or risk; e.g. GHG saved per Euro invested into GHG reduction or Expected GHG saved per Euro invested into GHG reduction. The categorization could work by defining minimum thresholds or by taking the best x% observed in a certain asset class etc. This measure could also play an important role for governments in selecting suitable targets for public support and addressing concerns of inefficient public spending.
- Exclusion Only: In this category, a minimum set of exclusions could be defined by law.

The approaches could also be combined, e.g., with the requirement of minimum standards such as minimum exclusions or based on measurable criteria, holdings that will never be part of a financial product portfolio (exclusion criteria) and how the remaining holdings differ from related benchmarks (inclusion criteria).

Annex 3 provides some illustrative examples of those approaches.

Approach	Pro	Con
Scaling System, e.g. Nutri-Score, traffic-light system or more neutral	<ul style="list-style-type: none"> <li>• Ensures Level Playing Field</li> <li>• Easy to use for distribution</li> </ul>	<ul style="list-style-type: none"> <li>• Setting up systematic behind scaling system to meet investors' needs can be quite complex.</li> <li>• Systematic would need to be monitored and possibly adjusted regularly.</li> <li>• Suggests that strategies ranked based on a judgment which is more sustainable than another.</li> <li>• Might be difficult to reflect the multi-dimensional measurement of sustainability (e.g. impact, transition) in a ranking system.</li> <li>• Unclear whether the end customer would understand such ranking.</li> </ul>
Measurement against Benchmark	<ul style="list-style-type: none"> <li>• Improvement against BM could be measured and standardised</li> <li>• Allows level playing field</li> </ul>	<ul style="list-style-type: none"> <li>• Not clear whether investors will be able to understand comparison with standard benchmark meaning</li> <li>• Some strategies do not provide for a market index.</li> <li>• Sector and region neutrality would be required in any benchmark comparison to mitigate some of</li> </ul>

Approach	Pro	Con
		the deviations from the benchmark allocation
Themes based approaches, e.g. climate solution fund	<ul style="list-style-type: none"> <li>• Addresses direct client demand</li> <li>• Works best for thematic and SI-based products</li> </ul>	<ul style="list-style-type: none"> <li>• Not clear how to ensure that the investor understands strategy</li> </ul>
Approaches based classification	<ul style="list-style-type: none"> <li>• Reflects market reality</li> <li>• eliminates the need for ordinal ranking/subjective judgement of what is more sustainable</li> <li>• supports international operability given that this approach is similar to the one chosen by other regulators, e.g. FCA and SEC.</li> </ul>	<ul style="list-style-type: none"> <li>• Not clear how to ensure that the investor understands details</li> </ul>

Regardless of the chosen approach, the Platform strongly recommends

- that in line with existing requirements – FMPs must substantiate the sustainability aspects using appropriate indicators. For instance, if a product has emission reduction targets as its investment objective, a link to benchmark disclosures explaining the methodology should suffice. In cases where the product does not replicate or link to a specific benchmark (e.g., active funds or absolute return funds), specific disclosures should be mandated to precisely demonstrate its development.
- the impression should be avoided that one product processes are ranked better than another (e.g. 'best in class better' than 'engagement' or vice versa), whereas a ranking according to the extent of transparency (e.g. Article 9 or 8) appears suitable from a precautionary principle perspective

### Establishing minimum criteria

The Platform acknowledges the EU Commission's inquiry into such categorisation and aims to offer its assessment on how minimum criteria should be applied to different types of strategies.

It's important to emphasise the **distinction between commitments and reporting**, which could be either mandatory or optional in both cases.

- **Mandatory Commitment (CM):** This necessitates that FMPs commit to specific criteria for a product. These commitments must be maintained throughout the product's lifecycle or within any timeframe specified by the law. The process for the commitment and the data availability ratio (coverage) are included. Commitments must always be reported on, reflecting actual results or adherence to the commitment.
- **Optional Commitment (CO):** FMPs have the choice to voluntarily commit to certain criteria for a product. These commitments also need to be upheld throughout the product's lifecycle or within any timeframe set by the FMP. The process for the commitment and the data

availability ratio (coverage) are part of this option. Commitments must always be reported on, reflecting actual results or adherence to the commitment.

- **Mandatory Reporting (RM):** This obliges FMPs to disclose the actuals of the criteria in periodic reports, such as Taxonomy alignment or adherence to exclusions.
- **Optional Reporting (RO):** This allows FMPs to disclose the actuals of certain criteria in periodic reports, which are not part of mandatory reporting.

It is also useful to **distinguish between process/practice-based commitments/reporting** (such as engagement, exclusions, and best-in-class selection) **and outcome-based commitments/reporting** (taxonomy-alignment, GHG reduction target).

Outcome-based commitments are typically much trickier to make (which explains why current levels of taxonomy commitments at the fund level are so low) - but periodic reporting of outcome on them is essential and hence should be mandatory, especially if they claim to contribute to a specific outcome (e.g., with a net-zero global equity fund).

The Platform presents the following recommendations for the strategies under consideration:

Product Type	Minimum criteria				
	Taxonomy alignment	Engagement strategies	Exclusions	Measurable, positive outcome	Other
A targeted, measurable solutions to sustainability related problems	CO, RM	CO, RO	CM for ASH, RM	CM, RM	e.g. SI share (CO, RM), PAIs (CO, RM)
B - credible sustainability standards or specific sustainability-related theme	CO, RM	CO, RO	CM for ASH, RM	CO, RM	e.g. SI share (CO, RM), PAIs (CO, RM)
C - Products that exclude activities and/or investments involved in activities with negative effects on people and/or the planet.	CO, RM	CO, RO	CM, RM	CO, RM	e.g. SI share (CO, RM), PAIs (CO, RM)
D - transition focus (measurable improvements)	CO, RM	CM, RM	CM for ASH, RM	CO, RM	e.g. SI share (CO, RM), PAIs (CO, RM)

CM = pre-contractual commitment mandatory  
CO = pre-contractual commitment optional  
RM = reporting mandatory  
RO = reporting optional



## 4.2. Evolution of SFDR concepts and KPIs

The Platform strongly advocates to further evolve SFDR concepts such as SI, DNSH Safeguards and Governance with a focus of streamlining these concepts between the Taxonomy and other KPIs. Having different approaches to a similar idea (like e.g. Taxonomy and SI) creates confusion and inefficiencies.

The above is in line with the Platform's response<sup>55</sup> to the Joint ESAs Consultation on SFDR RTS and latest briefing on SFDR<sup>56</sup>. For a more in-depth exploration of these concepts, the Platform directs the European Commission to refer to those reports, where the ideas are expounded in greater detail.

*This chapter will be finalised based on the Final Report of the ESAs regarding the joint consultation on the review of SFDR Delegated Regulation.<sup>57</sup>*

### 4.2.1. Evolution of environmental and social characteristics

The term 'promotion of environmental and social characteristics' was intended to encompass a broad range of managed strategies, particularly those that are process-based. The word "promotion" is confusing as it is unclear whether it refers to the commercialisation or the strategy of the product. The European Commission clarified that promotion means that a financial product complies with certain environmental, social or sustainability requirements or restrictions laid down by law, including international conventions, or voluntary codes, and these characteristics are "promoted" in the investment policy.<sup>58</sup>

Once clarified, the Platform does not necessarily see the need to revise this term but rather considers that this could be used as default term for any product that does not fall under any other category. This could for example be relevant for multi-asset products or multi-option products which include strategies with very different sustainable features.

In general, the Platform supports an approach where characteristics are clearly supported by specific indicators. For instance, if a product's strategy is focusing on water as a theme, it should always report on the relevant PAIs for the whole product besides the disclosure of the Taxonomy share.

### 4.2.2. Evolution of Sustainable Investments

The Platform strongly advocates that the Taxonomy should be the sole recognised standard for defining environmentally sustainable economic activities. Coexisting with market definitions, that is,

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[https://www.esma.europa.eu/system/files/webform/200622/94818/Platform\\_Response\\_to\\_the\\_ESAs\\_Consultation\\_on\\_SFDR\\_RTS\\_03072023\\_vf.docx](https://www.esma.europa.eu/system/files/webform/200622/94818/Platform_Response_to_the_ESAs_Consultation_on_SFDR_RTS_03072023_vf.docx)

<sup>56</sup> EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS (July 2023).

<sup>57</sup> <https://www.esma.europa.eu/document/joint-consultation-paper-review-sfdr-delegated-regulation-regarding-pai-and-financial>

<sup>58</sup> JC 2023 18 Consolidated JC SFDR QAs (europa.eu), Q&As V.2.

having multiple definitions on whether and how an economic activity can be deemed sustainable, creates confusion, inefficiencies and ultimately undermines the overarching goal of the sustainable finance package to channel capital towards genuinely sustainable investments.

The unique definition of environmentally sustainable economic activities based on the Taxonomy does not prevent sustainable investments based on the improvement of positive impact or reduction of negative impact focused on specific aspects of environmental sustainability (e.g., energy efficiency or energy savings) based on entity-level metrics (e.g., % of energy efficiency gained).

The Platform appreciates that the Taxonomy is not yet complete; therefore, it suggests that, until then, economic activities that have not been analysed could be considered sustainable if their contribution to one of the environmental objectives is substantiated by Financial Market Participants (FMPs). In order to substantiate it, FMPs should apply minimum safeguards (as they remain unchanged) and set technical criteria for both Significant Contribution (SC) and 'Do No Significant Harm' (DNSH). The Platform also recognises a need for guidance on issuances by the public sector.

The Platform reiterates its support for the development of a social taxonomy that could play the same role as the EU Taxonomy does but for social objectives and to define socially sustainable economic activities.

The above is in line with the Platform's response<sup>59</sup> to the Joint ESAs Consultation on SFDR RTS and latest briefing on SFDR<sup>60</sup>. For a more in-depth exploration of these concepts, the Platform directs the European Commission to refer to those reports, where the ideas are expounded in greater detail. Your consideration of these documents will provide comprehensive insights into the Platform's perspective on the matter.

**IMPORTANT NOTICE:** This section does not incorporate the Final Report of the ESAs regarding the joint consultation on the review of SFDR Delegated Regulation. As of the completion of this report, the SFDR RTS had not been published. The Platform commits to analysing the regulatory standards and will provide updates to this document or its perspectives in a new publication in 2024.

In the meantime, please refer to the Platform's response to the Joint ESAs Consultation on SFDR RTS and latest briefing on SFDR where the Platform makes concrete proposals to enhance consistency between SFDR and the other Sustainable Finance Legislation, including CSRD/ESRS, Benchmarks Regulation.

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[https://www.esma.europa.eu/system/files/webform/200622/94818/Platform\\_Response\\_to\\_the\\_ESAs\\_Consultation\\_on\\_SFDR\\_RTS\\_03072023\\_vf.docx](https://www.esma.europa.eu/system/files/webform/200622/94818/Platform_Response_to_the_ESAs_Consultation_on_SFDR_RTS_03072023_vf.docx)

<sup>60</sup> EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS (July 2023).



### 4.2.3. Evolution of DNSH, Safeguards and good Governance

The Platform refers to its response<sup>62</sup> to the Joint ESAs Consultation on SFDR RTS and latest briefing on SFDR<sup>63</sup>.

### 4.2.4. Quality and Assurance – governance system

The Platform discourages self-declaration by the product manufacturer and then supervised by National Competent Authorities (NCAs). The Platform is more inclined to have third-party verification.

The Platform believes external assurers play an important role in providing assurance on various aspects of the sustainable finance regulatory framework, including CSRD/ESRS reporting, EU Taxonomy, and EUGBS. The Platform reiterates its position expressed in its response to the ESRS consultation where it stressed the need for detailed guidance on assurance. If external assurance was required, the European Commission (delegated or not to the ESAs) should develop detailed guidance that would ensure consistency in providing limited assurance and would reduce costs.

External assurance is more likely to ensure consistency and the same level of robustness in applying the required criteria when verifying to financial products.

The Platform acknowledges the downside of external assurance, acknowledging the associated costs that come with it.

## 4.3. Marketing communication and product names

Product names are a crucial way to convey core messages to investors. The Platform is therefore fully supportive of clarifying which product names can be used for what types of funds. Product names and marketing communication should be in line with the types of products. In case a scaling system is used, a product should generally only reflect a sustainability-related term in its name if it can evidence that the large part of the product is indeed following the approach and supporting the aim of the term.

ESMA consulted on draft guidelines for investment fund names with ESG or sustainability-related terms in November 2022 to address greenwashing concerns stemming from the use of misleading terms in fund names with insufficient substance. ESMA proposed certain restrictions for specific terms used in the names, including thresholds for investments used to meet sustainability characteristics or objectives and exclusion criteria drawn from those used by Paris-aligned Benchmarks. ESMA is considering the feedback to the consultation and is aiming to announce the next steps by the end of 2023.

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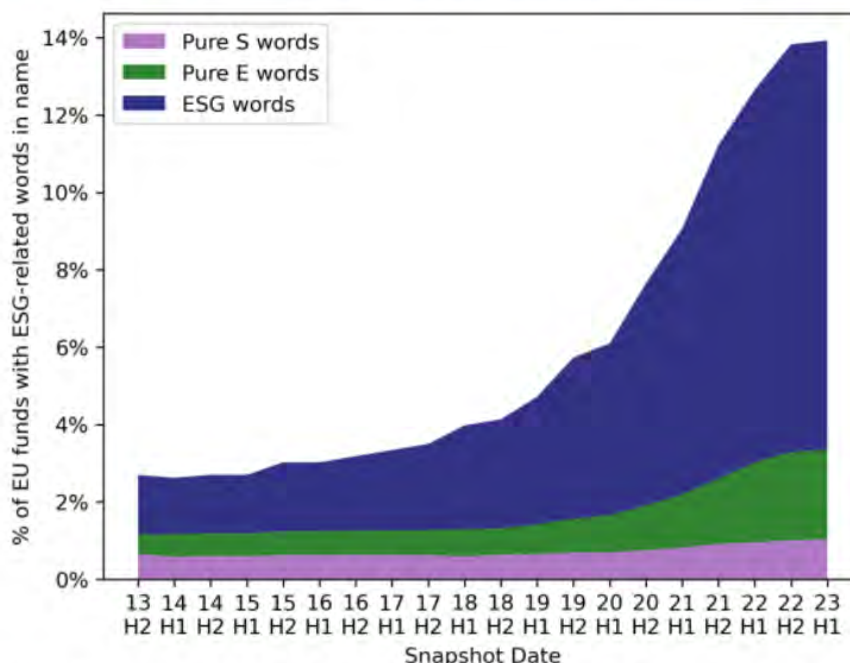
<sup>62</sup>

[https://www.esma.europa.eu/system/files/webform/200622/94818/Platform\\_Response\\_to\\_the\\_ESAs\\_Consultation\\_on\\_SFDR\\_RTS\\_03072023\\_vf.docx](https://www.esma.europa.eu/system/files/webform/200622/94818/Platform_Response_to_the_ESAs_Consultation_on_SFDR_RTS_03072023_vf.docx)

<sup>63</sup> EU Platform on Sustainable Finance briefing on SFDR and summary of its response to the joint ESAs consultation on SFDR RTS (July 2023).

The Platform supports ESMA’s view<sup>64</sup> that there is a need for reliable guidance on Fund names. Fund names are an important element to communicate fund strategies to retail investors. Also, there has been a significant increase in the use of ESG words in fund names:

Chart 3  
**Evolution of ESG names across EU funds**  
**Less specific ESG words used in names**



Note: Cumulative use of ESG word types across actively managed equity, bond, and mixed asset investment funds domiciled in the EU, the names of which include at least one ESG-related word, relative to all investment funds domiciled in the EU, at each specific snapshot date. Each snapshot date contains a full sample of EU investment funds, with names extracted at that particular date. The three-word categories are mutually exclusive: for example, words deemed to be ‘E’ words are not included in words deemed to be ‘ESG’ words, and ‘ESG’ words are not included in ‘E’ words. Words originally tagged IIS’ and ‘SG’ are mapped to ‘S’.

Sources: Refinitiv Lipper, ESMA.

Figure 14: Evolution of ESG names across EU Funds (Refinitiv, ESMA)

The Platform sees a merit in having an EU wide understanding of how fund names in relation to sustainability features can be used. The Platform would also see a merit in extending such understanding to other SFDR products, where appropriate.

<sup>64</sup> See ESMA’s Consultation on Guidelines on funds’ names using ESG or sustainability-related terms, available at: [https://www.esma.europa.eu/sites/default/files/library/esma34-472-373\\_guidelines\\_on\\_funds\\_names.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf)

Despite the fact that sectorial legislation already provides guidance on marketing material to be required as clear and not misleading<sup>65</sup>, inspiration can also be drawn from the Green Claims Directive as an example how to restrict false environmental claims in consumer (retail) marketing.

The Platform believes that it is essential to establish a precise alignment between the product's name, its sustainability marketing claims, declared sustainability contributions, and the actual investment strategy, particularly when it comes to the stock selection process and defining the investment universe. This alignment should encompass the substantial majority of the product and account in full transparency for any negative or offsetting impact from the non-binding share of the product.

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<sup>65</sup> For example for UCITS, AIFs, see Art. 4 Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings (OJ L 188, 12.7.2019); for MiFID services, see Art. 44 of the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017).

# Annex 1: SFDR 7(1) Estimation and Threshold Setting Guidance excluding SMEs

Please note that the assessment of data availability does not distinguish between availability resulting from company reporting or from third-party data providers estimating such data (in the absence of reporting). Furthermore, this assessment does not express a view on the "quality" of estimates because estimation methodologies were not reviewed. In particular with regards to non-listed assets, further specifications might be required to reflect limited data availability (e.g. for issuers outside the EU) in contrast to listed issuers. Additionally, the Platform welcomes further collaboration between data providers, research institutions and FMPs to identify robust linkages as a basis for aligned approaches on estimation methodologies, especially for social indicators and quantitative environmental PAI (like PAI 8 & 9).

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
GHG Emissions: Scope 1	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Agriculture, Utilities and Transport.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding Scope 1 GHG data availability.	If information is not (yet) readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 1 GHG emissions.	If information is not readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 1 GHG emissions.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 1 GHG emissions.	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 1 GHG emissions.	Should information be unavailable as an ESRS issuer has decided to consider GHG emissions Scope 1 to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as GHG Emissions Scope 1, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	EU Paris Aligned Benchmarks (EU PAB) can offer suitable guidance to scale and set thresholds for GHG Emissions Scope 1, whereby significant harm might be attributed to those issuances which are very unlikely to feature in an EU PAB

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
GHG Emissions: Scope 2	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Construction, Energy, Industrials, Materials and Transport.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding Scope 2 GHG data availability.	If information is not (yet) readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 2 GHG emissions, whereby market-based emissions should only be used where the estimated parties are likely to employ equivalent purchase power agreements than the parties whose GHG emissions underly the estimation.	If information is not readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 2 GHG emissions, whereby market-based emissions should only be used where the estimated parties are likely to employ equivalent purchase power agreements than the parties whose GHG emissions underly the estimation.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 2 GHG emissions, whereby market-based emissions should only be used where the estimated parties are likely to employ equivalent purchase power agreements than the parties whose GHG emissions underly the estimation.	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 2 GHG emissions, whereby market-based emissions should only be used where the estimated parties are likely to employ equivalent purchase power agreements than the parties whose GHG emissions underly the estimation.	Should information be unavailable as an ESRS issuer has decided to consider GHG emissions Scope 2 to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as GHG Emissions Scope 2, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	EU Paris Aligned Benchmarks (EU PAB) can offer suitable guidance to scale and set thresholds for GHG Emissions Scope 2, whereby significant harm might be attributed to those issuances which are very unlikely to feature in an EU PAB
GHG Emissions: Scope 3	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Agriculture, Automobiles, Construction, Energy, Financials, and Materials.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding Scope 3 GHG data availability, although disclosure quality is still improving.	If information is not (yet) readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 3 GHG emissions, whereby FMP may want to reflect which categories are best estimated on economic activity and which on company basis while assessing the completeness of reported data where necessary.	If information is not readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Scope 3 GHG emissions, whereby FMP may want to reflect which categories are best estimated on economic activity and which on company basis while assessing the completeness of reported data where necessary.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 3 GHG emissions, whereby FMP may want to reflect which categories are best estimated on economic activity and which on company basis while assessing the completeness of reported data where necessary.	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Scope 3 GHG emissions, whereby FMP may want to reflect which categories are best estimated on economic activity and which on company basis while assessing the completeness of reported data where necessary.	Should information be unavailable as an ESRS issuer has decided to consider GHG emissions Scope 3 to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as GHG Emissions Scope 3, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	EU Paris Aligned Benchmarks (EU PAB) can offer suitable guidance to scale and set thresholds for GHG Emissions Scope 3, whereby significant harm might be attributed to those issuances which are very unlikely to feature in an EU PAB

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Carbon Footprint	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Energy, Materials, Utilities and Transport.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding Carbon Footprint data availability.	If information is not (yet) readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Carbon Footprints.	If information is not readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of Carbon Footprints.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Carbon Footprints.	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of Carbon Footprints.	Should information be unavailable as an ESRS issuer has decided to consider Carbon Footprint to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as Carbon Footprint, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	EU Paris Aligned Benchmarks (EU PAB) can offer suitable guidance to scale and set thresholds for Carbon Footprints, whereby significant harm might be attributed to those issuances which are very unlikely to feature in an EU PAB
GHG Intensity of Investee Companies	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Energy, Materials, Utilities and Transport.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding GHG Intensity of Investee Companies data availability.	If information is not (yet) readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of GHG intensities.	If information is not readily available at sufficient quality, FMP could estimate issuer or issuance information in house using the Precautionary Principle to avoid underestimation of GHG intensities.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of GHG intensities	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of GHG intensities	Should information be unavailable as an ESRS issuer has decided to consider GHG intensity to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as GHG intensities, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	EU Paris Aligned Benchmarks (EU PAB) disclosures can offer suitable guidance to scale and set thresholds for GHG intensities.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Exposure to companies active in the fossil fuel sector	Specific Sectors [zero is a credible value for issuers in unaffected sectors]	Particularly relevant for Energy sector	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding exposure to companies active in the fossil fuel sector data availability.	If information is not (yet) readily available but third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle.	If information is not readily available but third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle.	If information is not (yet) readily available but third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP could use a third party's data feed,	If information is not readily available but third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP could use a third party's data feed,	If information is not readily available and no third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP can reasonably assume the exposure to be zero.	If information is not readily available and no third-party sources or the company's domain indicate exposure to fossil fuel sectors, FMP can reasonably assume the exposure to be zero.	FMP may want to reflect to what extent these exposure thresholds should be operationalize as relative or absolute revenue, Capex and/or weight units (e.g. tons of coal) and consider defining the sufficient threshold levels for activity in the fossil fuel sectors in line with EU Paris-Aligned Benchmarks.
Share of non-renewable energy consumption	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for heavy sectors as defined within EU Paris-Aligned Benchmarks, especially Energy, Industrials and Materials.	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding share of non-renewable energy consumption data availability.	If information is not (yet) readily available at sufficient quality, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby Scope 2 location-based data should may be considered useful.	If information is not readily available, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby Scope 2 location-based data should may be considered useful.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of the Share of non-renewable energy consumption	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of the Share of non-renewable energy consumption	Should information be unavailable as an ESRS issuer has decided to consider Share of non-renewable energy consumption to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the quantities usually reported for such an issuer is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as Share of non-renewable energy consumption, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may want to consider scaling and setting thresholds for the Share of non-renewable energy consumption informed by the Scope 2 location-based data of relevant peers with comparable activities and geographic exposure.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Energy consumption intensity per high impact climate sector	Specific Sectors [zero is a credible value for issuers in unaffected sectors]	Only relevant for high impact climate sectors	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding energy consumption intensity per high impact climate sector data availability.	If information is not (yet) readily available at sufficient quality, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby proxies for corporate operating volume (e.g. revenue, stockpile) maybe considered useful.	If information is not readily available, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby proxies for corporate operating volume (e.g. revenue, stockpile) maybe considered useful.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of the Energy consumption intensity per high impact climate sector.	If information is not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid underestimation of the Energy consumption intensity per high impact climate sector.	Should information be unavailable as an ESRS issuer has decided to consider Energy Consumption intensity per high impact climate sector to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement given the sector is (i) in line with SFDR 2(1)'s requirement for information to be not misleading and/or (ii) its investment beliefs regarding climate science. If the issuer judgement is seen as conflicting, the FMP is recommended to use one of the estimation approaches.	Should information be unavailable, the FMP is recommended to use one of the estimation approaches as an energy consumption of zero in a high impact climate sector cannot be considered a reasonable assumption	FMP may want to consider scaling and setting thresholds for the Energy consumption intensity per high impact climate sector informed by relevant IPCC scenarios and/or trajectories of energy intensity in GJ per tonne of product.
Activities negatively affecting biodiversity-sensitive areas	Specific Sectors [zero is a credible value for issuers in selected unaffected activities]	Particularly relevant for high ecosystem use sectors (e.g. land use) such as Agriculture, Construction, Food, Forestry or Mining	The Data Availability Annex to the PSF's July 2023 SFDR briefing noted as follows with respect to biodiversity, "data vendors have the ability to map company location and biodiversity controversies to areas of biodiverse sensitivity and thus are able to provide better estimate coverage for PAI 7, as a result of bringing together different data sets. Companies themselves do not yet too frequently report operations in or near biodiverse sensitive areas and the respective impact those operations have on their surroundings. The example data vendor in Table 1 has near 100% available data coverage with this method as do others in the market."	If information is not readily available, then FMP would be able to estimate issuer exposure to and potential harm to biodiversity sensitive areas through in-house research of asset registries which provide the location and nature of a particular economic activity. Using the Precautionary Principle, an economic activity can then be estimated as potentially harmful to biodiversity.	If information is not readily available, then FMP would be able to estimate issuer exposure to and potential harm to biodiversity sensitive areas through in-house research of asset registries which provide the location and nature of a particular economic activity. Using the Precautionary Principle, an economic activity can then be estimated as potentially harmful to biodiversity.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to classify economic activities which lead to harm to biodiversity.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to classify economic activities which lead to harm to biodiversity.	Should information be unavailable as an ESRS issuer does not disclose the list of material sites in its own operation/operational control, nor how these sites are linked to biodiversity impacts and dependencies, then the FMP is recommended to classify the economic activities that an issuer is undertaking as either potentially harming to biodiversity or unlikely of concern using publicly available tools (e.g. ENCORE methodology) and Precautionary Principle.	On a metric as crucial as biodiversity, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may consider pathways to a no exposure to harm (zero tolerance) to biodiversity sensitive areas in accordance with the targets of the EU Biodiversity Strategy (by 2030) and the Kunming-Montreal targets by 2050.



PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Emissions to water	Economy Wide [zero is not a credible value for any issuer]	Particularly relevant for high water use sectors (e.g. land use) and for all those sectors and companies that produce or release substances that are included in the 'list of priority substances' according to the Water Framework Directive (Annex X) such as Agriculture, Aquaculture; Chemicals, Energy or Utilities, Mining & Quarrying, Shipping & Cruise; Construction & Buildings;	The Data Availability Annex to the PSF's July 2023 SFDR briefing noted as follows with respect to Emissions to Water: "Emissions to Water is a new data point available through the CDP questionnaire in 2023 but was already reported by some European companies in previous years. CDP saw in 2022 responses from 1,300 companies on water data points (~20% by count of MSCI ACWI) and expects 1,500-2,000 companies responding on the exact Emissions to Water question by July 2023 (~30% by count of MSCI ACWI)."	If information is not readily available, then FMP would be able to estimate issuer emissions to water footprints by applying the Precautionary Principle, particularly for issuers linked to economic activities with economic activities covered in general by pollution registries.	If information is not readily available, then FMP would be able to estimate issuer emissions to water footprints by applying the Precautionary Principle, particularly for issuers linked to economic activities with economic activities covered in general by pollution registries.	If information is not (yet) readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to model the magnitude of emissions to water and consider retrieval of data from pollution registries.	If information is not (yet) readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to model the magnitude of emissions to water and consider retrieval of data from pollution registries.	Should information be unavailable as an ESRS issuer has decided to consider emissions to water to be immaterial under both double materiality concepts, the FMP is recommended to use one of the estimation approaches for economic activities which are generally covered by emissions to water disclosures in pollution registries, as zero emissions assumption likely not reasonable.	On a metric as crucial as Emissions to Water, making reasonable assumptions instead of estimating is not recommended for Non- ESRS issuers.	FMP may consider thresholds consistent with eliminating substances of concern by 2030 and reaching concentration levels for release of other substances that ensure good status of water bodies by 2050.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Hazardous and radioactive waste ratio	Specific Sectors [zero is a credible value for issuers in selected unaffected activities]	Particularly relevant for goods instead of services and physical economy instead of digital economy and sectors such as Construction, Energy, Industrials, Materials, Mining and Utilities	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns hazardous waste ratio.	If information is not readily available, then FMP would be able to estimate hazardous waste by applying the Precautionary Principle.	If information is not readily available, then FMP would be able to estimate hazardous waste by applying the Precautionary Principle.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to model the magnitude of hazardous waste ratio and consider retrieval of data from pollution registries.	If information is not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to model the magnitude of hazardous waste ratio and consider retrieval of data from pollution registries.	Should information be unavailable as an ESRS issuer has decided to consider the hazardous waste ratio to be immaterial under both double materiality concepts, the FMP is recommended to use one of the estimation approaches for economic activities which are generally covered by hazardous waste ratio disclosures in pollution registries, as zero hazardous waste assumption likely not reasonable.	On a metric as crucial as Hazardous Waste ratio, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may consider thresholds consistent with eliminating substances of concern by 2030.
Share of investments in investee companies that have been involved in violations of the UNGP principles or OECD Guidelines for Multinational Enterprises	Economy Wide [zero is technically a credible value]	Relevant across any sector and jurisdiction	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding violations data availability, although violations are naturally more prevalent in the media for larger than for smaller issuers.	If reliable information is not (yet) readily available as investee firms prefer to deprioritize bad news and prioritize good news, FMP may want to estimate issuer or issuance information precautionary principle based in house using (social) media monitoring techniques while acknowledging that (social) media may focus particularly on large and consumer serving companies.	If reliable information is not readily available as investee firms prefer to deprioritize bad news and prioritize good news, FMP may want to estimate issuer or issuance information precautionary principle based in house using (social) media monitoring techniques while acknowledging that (social) media may focus particularly on large and consumer serving companies.	If reliable information is not (yet) readily available as investee firms prefer to deprioritize bad news and prioritize good news, FMP could use a third party's data feed,	If reliable information is not readily available as investee firms prefer to deprioritize bad news and prioritize good news, FMP could use a third party's data feed,	Should reliable information be unavailable as an ESRS issuer has decided to consider UNGP Principles and OECD Guidelines to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement risk for the information to be considered misleading and therefore fail the SFDR 2(1) requirement. If there is a conflict between issuer judgement and investment beliefs, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as compliance with UNGP Principles and OECD Guidelines, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may want to consider a zero or low tolerance approach to violations of the UNGP Principles or OECD Guidelines which are not adequately remediated within a reasonable time frame that ensures alignment with the precautionary principle.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Share of investments in investee companies without policies to monitor compliance with the UNGP principles or OECD Guidelines for Multinational Enterprises or grievance/co complaints handling mechanisms to address violations of the UNGP principles or OECD Guidelines for Multinational Enterprises	Economy Wide [zero is technically a credible value]	Relevant across any sector and jurisdiction	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding policies to monitor compliance data availability.	If information is not (yet) readily available at sufficient quality and in house research cannot identify the relevant policies, the Precautionary Principle would suggest considering the policies inexistent.	If information is not readily available and in house research cannot identify the relevant policies, the Precautionary Principle would suggest considering the policies inexistent.	If information is not (yet) readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to avoid rewarding issues for policies that cannot be evidenced.	If information is not readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to avoid rewarding issues for policies that cannot be evidenced.	If information is not readily available, it can reasonably be assumed that the policies do not exist.	If information is not readily available, it can reasonably be assumed that the policies do not exist.	FMP may want to consider if there can be any outcome lesser than the entire lack of policies and due diligence processes for all relevant aspects of the UNGP Principles or OECD Guidelines.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Gender pay gap	Economy Wide [zero is not a credible value for any issuer]	Relevant across any sector and jurisdiction	The Data Availability Annex to the PSF's July 2023 SFDR briefing noted as follows with respect to Gender Pay Gap: "Gender Pay Gap, as mandatory or voluntary disclosed by companies can vary to the methodology prescribed by PAI 12 and sometimes only relates to one geography or one business line and not the full global operations of large, listed companies. MSCI ACWI coverage of company self-reported Gender Pay Gap in line with the EU's definition is about 19% by weight of MSCI ACWI and 6% by count according to another data vendor. In absolute numbers, an alternative vendor currently observes over one thousand corporations to report available gender pay gap data by EU definition. Beyond the specific EU definition, another data vendor observes 40% coverage of MSCI ACWI by weight and 18% by count. Similarly, a new vendor finds available gender pay gap data for about 35% of the MSCI World portfolio weight. Studying 3,787 companies globally, Equileap notes that "22% of companies [by count] globally publish their gender pay gap (up from 17% in 2022 and 15% in 2021)".	If information is not (yet) readily available at sufficient quality, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby peer group averages as well as top executive diversity may be useful.	If information is not readily available, FMP may want to estimate issuer or issuance information in house using the Precautionary Principle, whereby peer group averages as well as top executive diversity may be useful.	If information is not (yet) readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to avoid underestimating the gender pay gap.	If information is not readily available, FMP could use a third party 's data feed that employs the Precautionary Principle to avoid underestimating the gender pay gap.	Should information be unavailable as an ESRS issuer has decided to consider the gender pay gap to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement is in line with its investment beliefs regarding societal inequalities. If there is a conflict between issuer judgement and investment beliefs, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as gender pay gap, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may want to reflect on SFDR's social cohesion objectives and consider an absolute threshold for gender pay gap beyond which the inequality is defined as significant harm.

PAI	PAI Scope [Credibility of a zero value]	Contextual Relevance of PAI	Data Availability	Estimation methods of SFDR 7(2) for any issuer except SMEs [Please note that SFDR 2(1) requires information to be presented "fair, clear and not misleading".]						Threshold Setting Guidance
				[1] Carrying out additional in-house research		[2] Cooperating with third party		[3] Making reasonable assumptions		
				ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	ESRS issuer	Non-ESRS issuer	
Board gender diversity	Economy Wide [zero is technically a credible value]	Relevant across any sector and jurisdiction	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding board gender diversity data availability.	If information is really not (yet) readily available, FMP may want to estimate information in house using the Precautionary Principle, whereby company domain and report information should be useful.	If information is really not readily available, FMP may want to estimate information in house using the Precautionary Principle, whereby company domain and report information should be useful.	If information is indeed not (yet) readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid overestimating board gender diversity	If information is indeed not readily available, FMP could use a third party's data feed that employs the Precautionary Principle to avoid overestimating board gender diversity	Should information be unavailable as an ESRS issuer has decided to consider the board gender diversity to be immaterial under both double materiality concepts, the FMP may want to reflect if this judgement is in line with its investment beliefs regarding societal inequalities. If there is a conflict between issuer judgement and investment beliefs, the FMP is recommended to use one of the estimation approaches.	On a metric as crucial as board gender diversity, making reasonable assumptions instead of estimating is not recommended for Non-ESRS issuers.	FMP may want to consider if just 0% board gender diversity constitute significant harm or (in some contexts) higher thresholds are justified and reflect that new EU Directive 2022/2381 requires at least 40% of non-executive director posts or 33% of all director posts at large issuers to be occupied by the under-represented sex by the end of June 2026.
Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	Economy Wide [zero is technically a credible value]	Relevant across any sector and jurisdiction	The Data Availability Annex to the PSF's July 2023 SFDR briefing did not identify any significant concerns regarding exposure to controversial weapons data availability.	If reliable information is not (yet) readily available but third-party sources or the company's domain indicate exposure to controversial weapons, FMP may want to estimate information precautionary principle based in house using inter alia (social) media monitoring techniques while acknowledging that (social) media may focus particularly on large and consumer serving companies.	If reliable information is not readily available but third-party sources or the company's domain indicate exposure to controversial weapons, FMP may want to estimate information precautionary principle based in house using inter alia (social) media monitoring techniques while acknowledging that (social) media may focus particularly on large and consumer serving companies.	If reliable information is not (yet) readily available but third-party sources or the company's domain indicate exposure to controversial weapons, FMP could use a third party's data feed,	If reliable information is not readily available but third-party sources or the company's domain indicate exposure to controversial weapons, FMP could use a third party's data feed,	If reliable information is not readily available and no third-party sources or the company's domain indicate exposure to controversial weapons, FMP can reasonably assume the exposure to be zero.	If reliable information is not readily available and no third-party sources or the company's domain indicate exposure to controversial weapons, FMP can reasonably assume the exposure to be zero.	FMP may want to consider a zero-tolerance approach to exposure to controversial weapons and need to reflect on EU member state bans on the financing of controversial weapons.

## Annex 2: Examples of labelling regimes and categorisation approaches by NCAs or label providers

### A. Examples of existing labelling/categorisation regimes

#### 1. Examples of NCA practices

NCA (Jurisdiction)	Scope	Criteria
<b>AMF (France) Doctrine<sup>66</sup></b>	<ul style="list-style-type: none"> <li>• Mandatory for retail funds established in France.</li> <li>• Non-French funds have to include a disclaimer in their marketing material if they do not comply</li> </ul>	<p>Three types of funds, depend on how active product provider can communicate around ESG:</p> <ul style="list-style-type: none"> <li>• Category 3: funds which do not take into account (or lightly) non-financial criteria required to limit the communication around extra-financial criteria to their prospectus;</li> <li>• Category 2: funds which take extra-financial criteria into account without taking a significant commitment require               <ul style="list-style-type: none"> <li>- measurable objectives for consideration of non-financial criteria (a discretionary rate of exclusion for the selectivity approach)</li> <li>- higher rating indicator or extra-financial analysis than investment universe</li> <li>- minimum of 90% of the assets must be provided with extra-financial ratings and analysis or 75% for emerging markets.</li> </ul> </li> <li>• Category 1: funds which significantly commit to take into account extra-financial criteria requires specific binding measurable objectives for consideration of non-financial criteria (20% exclusion of the worst assets for the selectivity approach for instance) and a minimum of 90% of the assets must be provided with extra-financial ratings and analysis.</li> </ul>
<b>BaFin (Germany) Guidance</b> (no published final version; administrative practice similar to consultation paper) <sup>67</sup>	<p>German retail funds which</p> <ul style="list-style-type: none"> <li>• use an ESG related term in the name or</li> <li>• are marketed explicitly as sustainable</li> </ul>	<ul style="list-style-type: none"> <li>• Alternative 1               <ul style="list-style-type: none"> <li>- Compliance with a minimum investment ratio in sustainable assets (75 %)</li> <li>- DNSH including specified exclusions (e.g. &lt; 10% fossil fuels (ex gas); &lt; 5% coal, oil; 0% oil sand / shale)</li> <li>- Good governance</li> </ul> </li> <li>• Alternative 2               <ul style="list-style-type: none"> <li>- Adherence to a sustainable investment strategy, e.g. best in class (75%)</li> </ul> </li> </ul>

<sup>66</sup> <https://www.amf-france.org/en/regulation/policy/doc-2020-03>

<sup>67</sup>

[https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Konsultation/2021/kon\\_13\\_21\\_WA4\\_Leitlinien\\_nachhaltige\\_Investmentvermoegen.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Konsultation/2021/kon_13_21_WA4_Leitlinien_nachhaltige_Investmentvermoegen.html)

		- DNSH including specified exclusions (e.g. < 10% fossil fuels (ex gas); < 5% coal, oil; 0% oil sand / shale)
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## 2. Examples of existing national Labels<sup>68</sup>

Name (Region)	Products	Criteria
<b>CDP Climetrics</b> <sup>69</sup>	Funds	<ul style="list-style-type: none"> <li>- Rating based on the environmental impact, transparency, and performance of their portfolio companies.</li> <li>- Score components relate to climate, water, and forest.</li> <li>- A fund's portfolio score is the portfolio weighted average of the underlying holdings' company scores.</li> </ul>
<b>Ecolabel UZ 49 (Austria)</b> <sup>70</sup>	Funds, IBIPs, Green Bonds, savings products	<ul style="list-style-type: none"> <li>- Exclusion relating to nuclear, armaments, fossil fuels, genetic engineering, human rights violations, lack of minimum commitment to labour standards. Note: separate criteria for public issuers and real estate</li> <li>- Investment policy and selection criteria, survey, evaluation, and selection processes of sustainable investment products must be above average or contribute to present/future problem or exclude certain issues on environmental or social aspects. Other criteria apply for Real estate and Bonds.</li> </ul>
<b>FNG-Siegel (Germany)</b> <sup>71</sup>	Funds	<ul style="list-style-type: none"> <li>- Exclusions relating to nuclear, armaments, fossil fuels, fracking and oil sand, tobacco, human rights violations, corruption lack of minimum commitment to labour standards. Note: separate criteria for public issuers</li> <li>- SFDR Art. 8 &amp; 9, analysis of ESG criteria of all holdings</li> <li>- EuroSIF Transparency Codex</li> <li>- Enhancements through additional requirements including investment approaches, credibility of institution and product standards (research, communication)</li> </ul>
<b>Greenfin (France)</b> <sup>72</sup>	Climate oriented products	<ul style="list-style-type: none"> <li>- Investment in EU issuers, Green bonds or certain other debt securities.</li> <li>- Detailed exclusions related to fossil fuel</li> <li>- Monitoring mechanism for ESG controversies</li> <li>- Measurement of positive impact</li> </ul>

<sup>68</sup> Please also see for more information: A Comparative Study of European Sustainable Finance Labels by Karina Megaeva, Peter-Jan Engelen, Luc Van Liedekerke, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3790435](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3790435), and Sustainable investment fund labelling frameworks: An apples-to-apples comparison available at: <https://qontigo.com/sustainable-investment-fund-labeling-frameworks-an-apples-to-apples-comparison/>. Plus de 2 000 fonds labellisés aux promesses confuses (October 2023) shows a table with AuMs of such labels (<https://www.novethic.fr/finance-durable/publications/etude/fonds-durables-labellises-en-europe.html>).

<sup>69</sup> <https://www.cdp.net/en/investor/climetrics>

<sup>70</sup> [https://www.umweltzeichen.at/file/Guideline/UZ\\_49/Long/UZ49\\_Sustainable\\_Financial\\_Products\\_2020\\_EN.pdf](https://www.umweltzeichen.at/file/Guideline/UZ_49/Long/UZ49_Sustainable_Financial_Products_2020_EN.pdf)

<sup>71</sup> <https://fng-siegel.org/kriterien/>

<sup>72</sup> <https://www.ecologie.gouv.fr/label-greenfin>

Name (Region)	Products	Criteria
<b>ISR Label (France)</b> <sup>73</sup> (soon to be revised <sup>74</sup> )	Financial Products	Label does not set per se criteria of what is considered sustainable but is focusing on assessing policy vs. results as follows: <ul style="list-style-type: none"> <li>- Assessment of the objectives targeted by the fund.</li> <li>- Assessment of the analysis and rating methodology used by the asset manager.</li> <li>- Assessment of inclusion of criteria in the portfolio construction</li> <li>- Engagement policy &amp; Transparency.</li> </ul>
<b>LuxFLAG</b> <sup>75</sup>	Financial products	Diverse range of labels distinguishing between: <ul style="list-style-type: none"> <li>- Impact: Microfinance, Environment, Climate Finance, Green Bond.</li> <li>- Sustainability Transition Labels: ESG, ESG Insurance Products, ESG Discretionary Mandate.</li> </ul>
<b>Nordic Swan Ecolabel</b> <sup>76</sup>	Funds & Investment Products	<ul style="list-style-type: none"> <li>- Exclusion relating to coal, oil, gas, nuclear, tobacco, weapons, and non-compliance with international norms.</li> <li>- Assessment of ESG &amp; EU Taxonomy performance on all holdings</li> <li>- Investment in companies with high GHG emission only if company meets strict reduction requirements.</li> <li>- Analysing biodiversity performance and engagement with companies performing poorly.</li> <li>- 70% in holdings with strong sustainability practices.</li> <li>- Promoting companies with clear environmental objectives.</li> <li>- Active Ownership.</li> </ul>
<b>Towards Sustainability Initiative (Belgium)</b> <sup>77</sup>	Financial products	<ul style="list-style-type: none"> <li>- Exclusion regarding weapons, tobacco, coal, unconventional oil &amp; gas and laggard oil &amp; gas and electricity utilities, non-violation of international norms and standards.</li> <li>- Investment is screened for potential positive or negative impact on sustainability issues. Additionally, the possible impact of sustainability events like climate change, social unrest or legal controversies is analysed.</li> <li>- Positive impact through additional strategy like best in class, sustainability themed, impact investing, outperforming a benchmark, overweighting and underweighting positions, engagement.</li> </ul>

<sup>73</sup> <https://www.llabelisr.fr/>

<sup>74</sup> <https://presse.economie.gouv.fr/06112023-bruno-le-maire-annonce-les-contours-du-nouveau-label-investissement-socialement-responsable-isr/>

<sup>75</sup> <https://luxflag.org/>

<sup>76</sup> <https://www.nordic-swan-ecolabel.org/criteria/investment-funds-and-investment-products-101/>

<sup>77</sup> <https://towardssustainability.be/>



## **B. Examples of proposed categorisation approaches (EU & non-EU)**

### **1. SEC - Proposed categorisation for disclosure requirements**

On 25 May 2022, the US SEC proposed amendments to rules and disclosure to promote consistent, comparable, and reliable information for investors regarding integration of ESG factors. The proposal identifies the following three types of ESG funds:

- **Integration Funds.** Funds that integrate ESG factors alongside non-ESG factors in investment decisions would be required to describe how ESG factors are incorporated into their investment process.
- **ESG-Focused Funds.** Funds for which ESG factors are a significant or main consideration would be required to provide detailed disclosure, including a standardized ESG strategy overview table.
- **Impact Funds.** A subset of ESG-Focused Funds that seek to achieve a particular ESG impact would be required to disclose how it measures progress on its objective.

Source: <https://www.sec.gov/files/ia-6034-fact-sheet.pdf>

## 2. FCA

In November 2023, the UK FCA published standards for sustainability-related funds to improve the sustainability information consumers have access to. This includes the following categories:

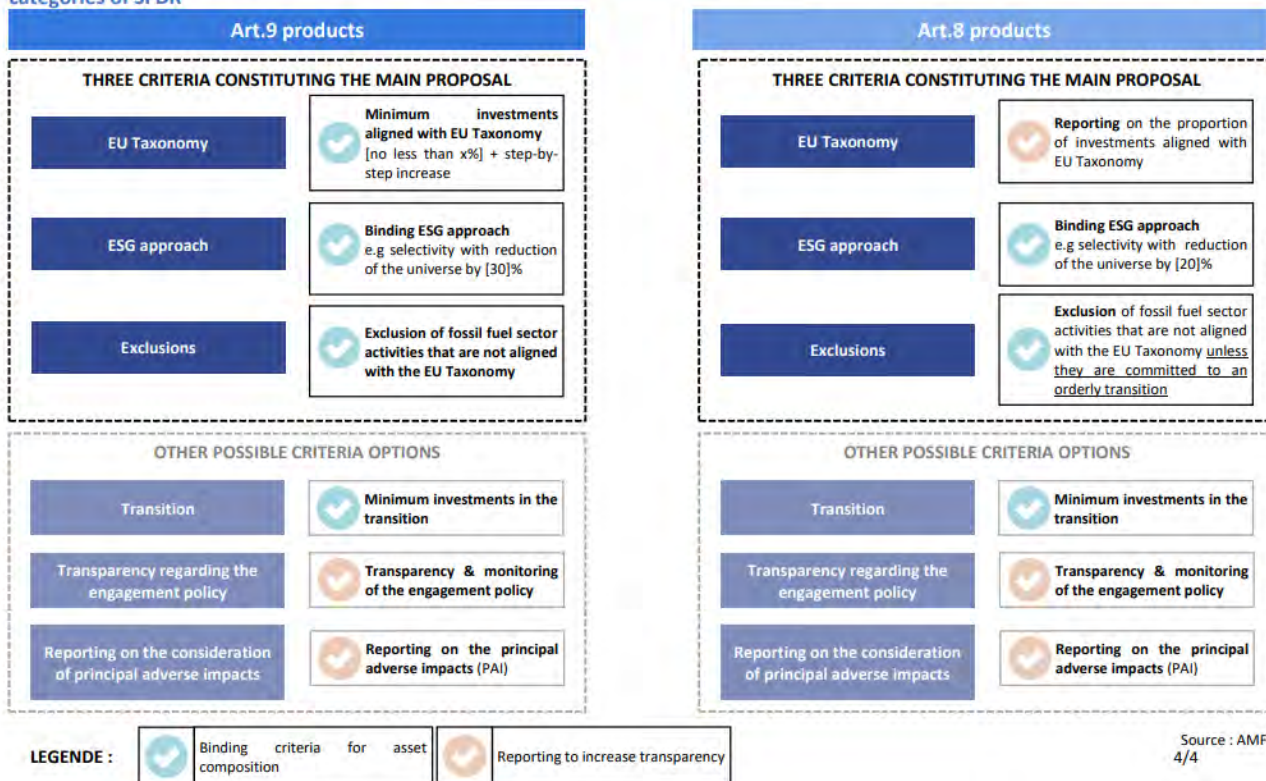
	Sustainability Focus	Sustainability Improvers	Sustainability Impact	Sustainability Mixed Goals
<b>Objective</b>	To invest in assets that are environmentally or socially sustainable determined by a robust, evidence-based standard of sustainability	To invest in assets that have the potential become more sustainable over time, determined by their potential to meet a robust, evidence-based standard of sustainability over time	To achieve a predefined, positive, measurable environmental and/or social impact	To invest in assets that meet or have the potential to meet a robust, evidence-based standard for sustainability, and/or invest with an aim to achieve positive impact.
<b>Link to positive environmental or social outcome</b>	Indirect	Indirect	Direct	Indirect and direct.
<b>Standard of sustainability</b>	Product's assets are determined using the standard	Product's assets have the potential to meet the standard	Can be used to select assets that have the potential to contribute to positive, measurable impact	Combination
<b>KPIs</b>	Measure the sustainability of the assets	Measure the assets' sustainability improvements	Measure the positive impact (both the impact of the assets and the investor's contribution)	Measure the sustainability and improvement of the assets, and/or impact of both the assets and investor contribution
<b>Stewardship [and escalation plan]</b>	To support assets in remaining sustainable/ delivering long-term value	To support and accelerate improvements over time	To support assets in delivering positive impact	To support assets in remaining sustainable/ accelerate improvements over time/ delivering positive impact

Source: PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels (<https://www.fca.org.uk/publication/policy/ps23-16.pdf>)

### 3. French AMF's proposal for minimum environmental standards for Art. 8 and 9 products

The French AMF published proposals to evolve SFDR on 13 February 2023. This includes ideas of minimum requirements for products disclosing under Article 8 and 9 SFDR as follows:

Synoptic table of the proposal for minimum environmental standards for financial products belonging to the Art.9 and 8 categories of SFDR



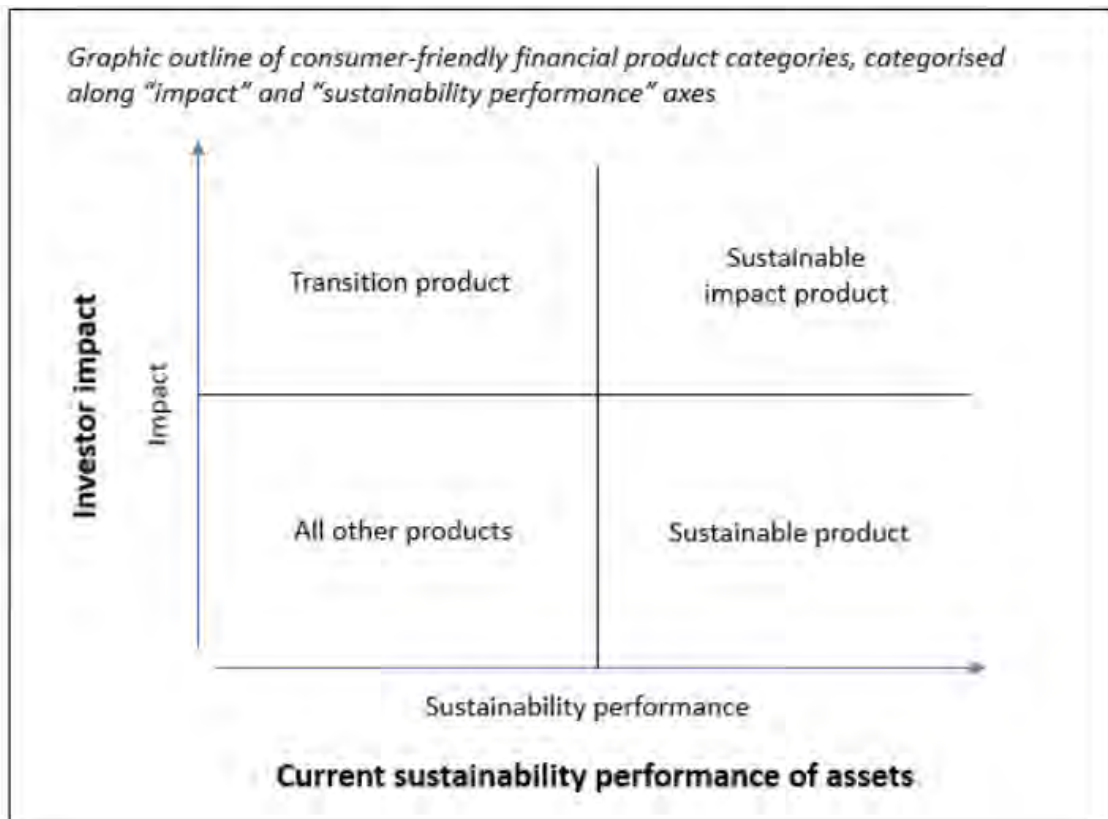
Source: AMF SFDR minimum standards ([https://www.amf-france.org/sites/institutionnel/files/private/2023-02/AMF SFDR minimum standards EN.pdf](https://www.amf-france.org/sites/institutionnel/files/private/2023-02/AMF_SFDR_minimum_standards_EN.pdf) )

### 4. Dutch AFM's position on improving the SFDR

The Dutch AFM published proposals to evolve SFDR on 2 November 2023. This includes ideas of categorisation as follows:

- Transition products: products that invest in companies that are not yet sustainable (but plan to become so) and aim to create impact through active management of the investments. These products are well-suited to investors who seek to make sustainable impact but are open to investing in assets that have yet to make the transition.
- Sustainable products: products that do not necessarily make measurable, active impact through the investment but are intended to cater to investors that demand investments in sustainable assets only. These products are suitable mostly for investors who seek to invest in assets that are aligned with their values.
- Sustainable impact products: products that seek to make direct and measurable impact through investments, by financing underserved markets or companies that have a tangible positive impact on sustainability factors. In these products, underlying assets would have to qualify as already sustainable; the focus is on growth of these markets or companies. This category would be well suited to investors who favour positive sustainability impact over return, due to the scarcity of suitable investments and high risks

associated with this profile. In current market practice, only a limited number of products would qualify for this category.



Source: AFM position paper on SFDR (<https://www.afm.nl/en/sector/actueel/2023/november/position-paper-sfdr>)

## Annex 3: Examples of implementation of potential SFDR advancements

### 1. Use of existing disclosure types under SFDR:

#### a. Approach 1 (Hybrid Model with disclosure and product/process regime combined)

	Current regime	Potential future regime
<b>Article 8</b>	Promoting environmental or social characteristics	<p>Generally, disclosure regime would be retained through Article 8 (1) but different approaches would be outlined, similarly to the approach in the current Article 9 (3), in different paragraphs with a revised numbering, e.g. as follows:</p> <p>Art. 8 (3): transition product e.g. with capex-alignment taxonomy/capex taxonomy targets and transition plans, passive products tracking CTB, etc.</p> <p>Art. 8 (4): process-based products such as best in class</p> <p>Art. 8 (5) specified social or governance characteristics-based products.</p> <p><i>Further processes could be specified in specific paragraphs of Article 8</i></p>
<b>Article 9</b>	Sustainable investments as only investments except for hedging and liquidity instruments For passive products: tracking of PAB or CTB	<p>Generally, disclosure regime would be retained through Article 9 (1) would outline the different approaches, similarly to the approach in the current Article 9 (3), in different paragraphs with a revised numbering, e.g. as follows:</p> <p>Art. 9 (3): Passive products tracking PAB or proposed TABs or a benchmark based on one or more environmental or social objectives.</p> <p>Art. 9 (4): Outcome focused products based on Taxonomy-alignment (revenues and/or capex).</p> <p>Art. 9 (5) Other outcome focused products that commit to specific social activity-based contribution.</p> <p><i>The product/process connection across Article 8 and 9 could be simplified by making Article 9(3) the advancement of Article 8(3), Article 9(4) the advancement of Article 8(4), Article 9(5) the advancement of Article 8(5) and so on.</i></p>

b. Approach 2

	Current regime	Potential future regime
<b>Article 7</b>	Consideration of PAI on a comply or explain basis on product level	Process-based sustainability features without specific commitments to outcome, e.g. best in class, exclusions.
<b>Article 8</b>	Promoting environmental or social characteristics	Products requiring change over time based mainly on transformation of underlying investments. These could include transition (to net zero and other environmental objectives, including social goals) products.
<b>Article 9</b>	Sustainable investments as only investments except for hedging and liquidity instruments	Outcome focused products based on Taxonomy-alignment or social objectives.

2. Changing disclosure types under SFDR:

	Future regime
<b>Alternative 1</b>	Use of e.g. Art. 8 as the basis for one single set of disclosure requirements. Add and amend subsequent Article(s) for a categorisation.
<b>Alternative 2</b>	Use of e.g. Art. 8 as the basis for disclosure requirements. Rephrasing of e.g. Art. 9 to develop a categorisation regime with certain elements.

# Annex 4: Examples of scaling Systems

Below examples are only for illustrative purposes. Each example is a standalone but could also be combined with others.

## 1. Scaling systems

### Example 1: German Sustainable Finance Council – ESG Scale

## ESG Scale: Key features






**Products of categories A – D consider sustainable investments, reflect sustainability preferences according to MiFID II/IDD:**

- A:** High proportion of environmentally sustainable investments acc. to Taxonomy regulation and/or sustainable investments acc. to SFDR
- B:** Medium proportion of environmentally sustainable investments acc. to Taxonomy regulation and /or sustainable investments acc. to SFDR
- C:** Low proportion of environmentally sustainable investments acc. to Taxonomy regulation and /or sustainable investments acc. to SFDR
- D:** Products that consider principal adverse impacts of investment decisions on sustainability factors acc. to Article 4 SFDR

**Products that fall under the scope of PRIIP regulation but cannot reflect sustainability preferences acc. to MiFID II/IDD, should be included in categories E and F:**

- E:** Product follows a ESG strategy and/or ensures transparency on sustainability risks, yet does not comply with ESG target market under MiFID II/IDD
- F:** Non-ESG product: No data or product is indicated as „not sustainable“

## Draft ESG Scale: Definitions of categories



A	B	C	D	E	F
Products containing Taxonomy-aligned environmentally sustainable investments (Article 2 no. 7a MiFID II/Deleg. Act or Article 2 para. 4a IDD/Deleg. Act) with a minimum share of x% <b>and / or</b> sustainable investments acc. to Article 2 no. 17 SFDR (Article 2 no. 7b MiFID/Deleg. Act or Article 2 para. 4b IDD/Deleg Act) with a minimum share of x% PAI <b>must</b> be considered (Article 2 no. 7c MiFID II/Deleg. Act or Article 2 para. 4c IDD/Deleg. Act).	Products containing Taxonomy-aligned environmentally sustainable investments (Article 2 no. 7a MiFID II/Deleg. Act or Article 2 para. 4a IDD/Deleg. Act) with a share of > y% to < x% <b>and / or</b> sustainable investments acc. to Article 2 no. 17 SFDR (Article 2 no. 7b MiFID/Deleg. Act or Article 2 para. 4b IDD/Deleg Act) with a share of > y% to < x% PAI <b>must</b> be considered (Article 2 no. 7c MiFID II/Deleg. Act or Article 2 para. 4c IDD/Deleg. Act).	Products containing Taxonomy-aligned environmentally sustainable investments (Article 2 no. 7a MiFID II/Deleg. Act or Article 2 para. 4a IDD/Deleg. Act) with a share of > 0% <b>and / or</b> sustainable investments acc. to Article 2 no. 17 SFDR (Article 2 no. 7b MiFID/Deleg. Act or Article 2 para. 4b IDD/Deleg Act) with a share of > 0% PAI <b>can</b> be considered (Article 2 no. 7c MiFID II/Deleg. Act or Article 2 para. 4c IDD/Deleg. Act).	Products which consider PAI (Article 2 no. 7 c MiFID II/Deleg Act or Article 2 para. 4c IDD/Deleg Act)	Products follow a ESG strategy and/or provide transparency on sustainability risks, but do not comply with MiFID II / IDD target market criteria	Non-ESG products: No ESG data available or product is indicated as „not sustainable“

Source: German Sustainable Finance Council

## Example 2: MSCI ESG Fund Rating – ESG Risk rating

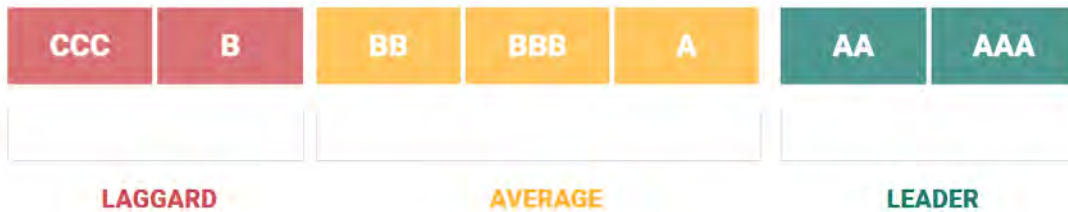


Figure 15: MSCI ESG Fund Ratings (MSCI Research)

The MSCI ESG Fund Rating, is designed to assess the resilience of a fund’s aggregate holdings to long-term ESG risks. Highly rated funds consist of issuers with leading or improving management of key ESG risks. The rating is based first on the weighted average score of the holdings of the fund.

### Example 3:

1	2	3	4	5
Standard Exclusions + Commitment to Positive Contribution of more than class 2 products + DNSH in the whole portfolio	Standard Exclusions + Commitment to Positive Contribution of more than class 3 products + DNSH in the whole portfolio	Standard Exclusions + Commitment to positive Contribution of Y %	Standard Exclusions + Commitment to PAI category improvement of X% year on year	Standard Exclusions

### Example 4:

Allocate a weighing to each of the amount of (i) positive contribution (e.g. 100%) and (ii) negative impact (e.g. – 100%). Neutral activities (e.g. low environmental activities as identified by the previous Platform) are allocated a weighing of 0%.

X	Y	Z
Products with an overall score of 75% or more.	Products with an overall score of 50% or more.	Products with an overall score of 25% or more.
Always significantly harmful activities are excluded.		



## 2. Measurement against Benchmark

Below is a comparison of S&P 500 ESG Index (USD) against the S&P 500 INDEX (USD) showing performance of PAIs regarding emissions and selected social PAIs.

Average PAI's							
1. Scope 1		1. Scope 2		1. Scope 3		1. Total Emissions	
Portfolio	2,156.89	Portfolio	649.16	Portfolio	38,747.02	Portfolio	41,552.06
Benchmark	3,286.29	Benchmark	607.34	Benchmark	35,063.08	Benchmark	38,774.43
Difference	-1,129.40	Difference	41.82	Difference	3,683.94	Difference	2,777.63
PAI 10. UNGC Violations		PAI 11. Lack of UNGC Monitoring		PAI 11. Compliance Score			
Portfolio	2.68	Portfolio	4.66	Portfolio	77.45		
Benchmark	3.92	Benchmark	7.90	Benchmark	73.98		
Difference	-1.24	Difference	-3.24	Difference	3.46		

source: Bloomberg

## 3. Thematic based approaches

Environmental (or more focused, e.g. climate)		Social (or more focused, e.g. inclusive society)		E&S	
Already green	Transitioning	Already social	Transitioning	Already green and social	Transitioning
At least X%	Improvement y-o-y of at least X%, e.g. against BM  Capex & transition plans based	At least X%	Improvement y-o-y of at least X%, e.g. against BM	At least X%	Improvement y-o-y of at least X%, e.g. against BM  Capex & transition plans based

#### 4. Approaches-based classification

	<b>Environmental and/or social characteristics</b>	<b>Transition</b>	<b>Measurable Outcome</b>
Types of strategies covered	This category would be the default category including approaches based on ESG scores, screening, engagement or a combination of such	The vast majority of underlying investments follow a transition/alignment target.	The vast majority of underlying investments provide a positive contribution e.g. Taxonomy alignment
Minimum criteria	e.g. exclusion criteria for CTBs	e.g. exclusion criteria for CTBs	e.g. exclusion criteria for PAB but limited to products with climate focus or DNSH criteria for the whole product.

## Annex 5: Principles for disclosure requirements

### 1. The Principle of Relevance:

One main objective of Financial Market Participants` (FMPs) reporting is to provide meaningful information to investors so that those investors that have a sustainability preference or also seek environmental and/or social returns can make informed investment decisions. Another key objective is to assess the robustness of the Sustainability credentials of the financial product and the impact of the financial product on sustainability. The disclosure can also help FMPs with their own strategic and management decisions. The ultimate goal is to mobilise and direct additional finance towards sustainable activities and investments.

This principle aims to ensure that any reporting requirement brings about real value, that is meaningful and follows a robust methodology or approach. Requirements should be focused on the supply of the most relevant information for the purpose of measuring sustainability and impact, and for the benefit of investors in green and sustainable activities.

With regard to specific indicators, the principle of relevance dictates that (1) each indicator in isolation ought to be meaningful and well capture the adverse impact, and that the underlying proposed method to calculate it is robust and accurate, and that (2) each indicator adds meaning and value when considered together with other indicators or data points.

### 2. The Principle of Consistency:

The SFDR does not operate in a regulatory vacuum. It is intrinsically related to the Corporate Sustainability Reporting Directive (CSRD), the Taxonomy and Benchmarks Regulations. It might also be affected by other pieces of regulation which include rules regarding disclosure or duties around sustainability such as the AIFMD, UCITS-Directive, MiFID, IDD and EU GBS. The success of the entire regulatory package will be determined by how interconnected, consistent, aligned, and complementary the different regulatory pieces are in practice. A success of the regulatory package will allow to align or diminish relevance of requirements on national level thereby facilitating the capital markets union.

Reporting should be anchored as much as possible in European sustainability reporting standards (ESRS) and other existing practices when appropriate – accounting and sustainability. The focus should be on the end goal, thus requiring information that is necessary and material rather than simply “good to have”.

In relation to the selection of indicators, the principle of consistency calls for each indicator or the underlying methodology to be consistent or conceptually consistent with (i) the minimum safeguards and the DNSH assessment of the Taxonomy Regulation, (ii) the CSRD (i.e. ESRS) and (iii) the broader sustainable finance framework, e.g. the Paris-aligned and Climate Transition Benchmarks (PABs and CTBs).

### 3. The Principle of Proportionality:

The disclosure burden ought to be evenly distributed among the different players taking into consideration their different capabilities and responsibilities. The benefits of the reporting should outweigh the burden. Simplification is sought wherever possible.

The SFDR RTS aims at providing the necessary information to investors so that they can make informed investment decisions when investing in ESG or sustainability-related financial products.

However, FMPs might find difficult even to estimate the PAIs for certain corporates and asset classes. Reporting charges should avoid or minimise unintended consequences like creating barriers or increasing the cost of financing for those that need it most such as SMEs and investments in developing countries, notably development finance bearing in mind all other principles.

Implementing the detailed framework of Sustainable Finance is perceived as particularly challenging for smaller FMPs and those that finance start-ups and SMEs. This is due to the necessity of collecting, assessing, and processing data for various indicators across different asset classes and portfolios. While the comply or explain mechanism of Article 4 SFDR provides some relief, the PAI indicators hold significant relevance for products addressing sustainability preferences or those where the FMP considers PAI, as outlined in Article 7 SFDR, that in turn can qualify as financial products falling under either Article 8 or 9 SFDR. Consequently, the disclosure burden for these FMPs should also be taken into consideration.<sup>4</sup> Principle of Applicability:

Indicators ought to be easily estimated or a proxy should be available as part of an international reporting standard and allow for comparability wherever possible, including for non-EU and/or non-/not-yet CSRD investments (e.g. alternative asset classes, SMEs, developing countries). While we appreciate the EU Commission's clarification in the Q&A on this matter, it would be ideal for the ESRS materiality assessment approach to align with the way in which FMPs are permitted by the SFDR rules to determine the PAI indicators for disclosure. An updated SFDR framework must avoid situations where disclosures at the level of financial products could be misleading or become difficult to interpret, because neither estimates or proxies can be used for non-reporters and, as a consequence, product level disclosures only refer to an unrepresentative part of portfolio holdings.

Careful consideration should be given when using EU-specific criteria or references that cannot easily translate into an international standard or be estimated. It should also consider the different contexts in which it might be applied. However, enabling its use should not come at the expense of reducing the ecological ambition set by the EU.

It was mentioned above the importance of applying the principle of proportionality for disclosures regarding investments made in SMEs and start-ups, developing and least-developed countries, or in certain contexts.

#### 5. The Principle of Precaution:

Every disclosure should not overestimate positive and should not underestimate negative information. This principle is considered overarching in order to protect the environmental integrity.

The precautionary approach shall be applied whenever the interpretation of the regulatory requirements or the data available to assess compliance is discretionary. Several aspects of the SFDR and Taxonomy legislations are qualitative rather than quantitative and hence can be interpreted with discretion. Even with respect to clearly defined quantitative thresholds, the data available to FMPs or their service providers may have limitations requiring assumptions to be made and hence discretionary.

The guidance of the interpretation of discretion based on these precautionary principles can be summarised as “if in doubt, err on the side of the planet instead of the side of the company”.<sup>78</sup> This means, in the case of the Taxonomy for example, that activities which are not strictly meeting the Technical Screening Criteria (TSC) of the EU Taxonomy should not be classified and reported as aligned or potentially aligned with the EU Taxonomy.

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<sup>78</sup> A precedent for such interpretation in European Commission sustainable finance legislation has been set by the Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. In Article 13 1a(i) and 1b(ii) the legislation clarifies that precautionary principles shall be applied when estimating greenhouse gas emissions. In Article 13 2a(i) and 2b(ii), the legislation clarifies that precautionary principles shall be applied when estimating if a company does “significantly harm [on] one or more of the environmental objectives referred to in Article 9 of Regulation (EU) 2020/852 of the European Parliament and of the Council,” As such, Article 13 2a(i) and 2b(ii) directly related to the taxonomy legislation itself and offer a welcome precedent.

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