JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

Reply form

on the Joint Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures

JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

12 April 2023
ESMA34-45-1218

Responding to this paper

The ESAs invite comments on all matters in the Joint Consultation Paper and in particular on the specific questions in this reply form. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives the ESAs should consider.

ESMA will consider all comments received by **4 July 2023.**

Instructions

In order to facilitate analysis of responses to the Joint Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Joint Consultation Paper in this reply form.
- Please do not remove tags of the type <ESMA_QUESTION_SFDR_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP SFDR Review_nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP SFDR Review_ABCD.
- Upload the Word reply form containing your responses to ESMA’s website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESAs' rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the ESAs is based on Regulation (EU) 2018/1725[1]. Further information on data protection can be found under the Legal notice section of the EBA website and under the Legal notice section of the EIOPA website and under the Legal notice section of the ESMA website.

[1] Regulation (EU) 2018/1725 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC, OJ L 295, 21.11.2018, p. 39.

General information about respondent

Name of the company / organisation	Deutsche Börse Group
Activity	Regulated markets/Exchanges/Trading Systems
Are you representing an association?	☐
Country/Region	Germany

Questions

Q1 : Do you agree with the newly proposed mandatory social indicators in Annex I, Table I (amount of accumulated earnings in non-cooperative tax jurisdictions for undertakings whose turnover exceeds € 750 million, exposure to companies involved in the cultivation and production of tobacco, interference with the formation of trade unions or election worker representatives, share of employees earning less than the adequate wage)?

<ESMA_QUESTION_SFDR_1>

Deutsche Börse Group (DBG) appreciates the opportunity to provide a response to the ESA's Joint Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures. As an international exchange organization and innovative market infrastructure provider, DBG ensures capital markets that are transparent, reliable and stable. With its wide range of products, services and technologies, the Group organises safe and efficient markets for sustainable economies. Its business areas cover the entire financial market transaction process chain. This includes the provision of indices, data and analytical solutions as well as admission, trading and clearing. Additionally, it comprises services for funds, the settlement and custody of financial instruments as well as the management of collateral and liquidity. As a technology company, the Group develops state-of-the-art IT solutions and offers IT systems all over the world. With more than 10,000 employees, the Group has its headquarters in the financial centre of Frankfurt/Rhine-Main, as well as a strong global presence in locations such as Luxembourg, Prague, Cork, London, New York, Chicago, Hong Kong, Singapore, Beijing, Tokyo and Sydney. Our response reflects our general market observations and incorporates the diversity of the Group's practitioner views, particularly including DBG's subsidiaries ISS ESG, Eurex and STOXX. We hope that these elaborations are helpful for the process moving forward and remain at your disposal for further explanations and discussions.

The additional social and governance related PAI indicators proposed by the ESAs would be pertinent to sustainability-oriented investors who wish to understand the impacts of the companies to which they have exposure through investment products.

Nevertheless, we believe that the ESAs should only introduce additional social indicators as optional rather than mandatory. Particularly in view of the first set of draft European Sustainability Reporting

Standards (ESRS) proposed by the European Commission, according to which reporting against PAIs will be subject to a materiality assessment for companies. Alignment between the PAIs and the information that companies subject to the Corporate Sustainability Reporting Directive (CSRD) will be required to disclose under the ESRS is an important prerequisite for FMPs to be able to report. Alternatively, the PAI indicators could correspond to commonly collected data points or metrics. However, this is not universally the case for the additional PAIs proposed by the ESAs.

More broadly, we understand that the ESAs' proposals fulfill the mandate received from the European Commission in May 2022. However, since then, the latter has committed to review the Level 1 of the SFDR. The review process may imply significant changes to the SFDR framework and, accordingly, we believe that introducing too many changes, albeit of a technical nature, at this juncture will create further implementation challenges for FMPs and may create inconsistencies with the framework as applied until now.

Beyond the question if additional social indicators shall be optional, disclosures would benefit from further streamlining; in particular regarding increasing regulatory convergence and policy coherence between BMR and SFDR. As a benchmark administrator, we would support such convergence. Regulation 2020/1818 on the minimum requirements for CTB and PAB, states in Art. 12(1)(b): Administrators of EU Paris-aligned Benchmarks shall exclude all of the following companies from those benchmarks [CTB and PAB]: [...] (b) companies involved in the cultivation and production of tobacco. Hence, adding the proposed new indicator (companies involved in the cultivation and production of tobacco) in line with the exclusions under the Climate Benchmarks Delegated Regulation would increase regulatory convergence of BMR with SFDR. This highlights the need to review the EU sustainable finance regulatory framework in total in order to ensure policy coherence.

<ESMA_QUESTION_SFDR_1>

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

<ESMA_QUESTION_SFDR_2>

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<ESMA_QUESTION_SFDR_2>

Q3 : Do you agree with the newly proposed opt-in social indicators in Annex I, Table III (excessive use of non-guaranteed-hour employees in investee companies, excessive use of temporary contract employees in investee companies, excessive use of non-employee workers in investee companies, insufficient employment of persons with disabilities in the workforce, lack of grievance/complaints handling mechanism for stakeholders materially affected by the operations of investee companies, lack of grievance/complaints handling mechanism for consumers/ end-users of the investee companies)?

<ESMA_QUESTION_SFDR_3>

The proposed opt-in social indicators could be reported by companies subject to the CSRD, and, as such, used by FMPs for the purposes of their disclosures. Accordingly, we believe they could be included in Annex I, Table III.

<ESMA_QUESTION_SFDR_3>

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

<ESMA_QUESTION_SFDR_4>

With respect to interference in the formation of trade unions or election of worker representatives, the proposed PAIs would better align with existing PAIs if it asked about investments in companies without a policy rather than without a commitment.

<ESMA_QUESTION_SFDR_4>

Q5 : Do you agree with the changes proposed to the existing mandatory and opt-in social indicators in Annex I, Table I and III (i.e. replacing the UN Global Compact Principles with the UN Guiding Principles and ILO Declaration on Fundamental Principles and Rights at Work)? Do you have any additional suggestions for changes to other indicators not considered by the ESAs?

<ESMA_QUESTION_SFDR_5>

As a benchmark administrator under the EU BMR, we do not support this amendment. Regulation 2020/1818 on the minimum requirements for CTB and PAB, states in Art. 12(1)(c): Administrators of EU Paris-aligned Benchmarks shall exclude all of the following companies from those benchmarks [CTB and PAB]: […] (c) companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises. Hence, a criterion which was previously aligned with the Climate Benchmarks Delegated Regulation (violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises) will be replaced with a criterion which is not aligned with the Climate Benchmarks Delegated Regulation (Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights).

This would decrease the compatibility of SFDR with the Climate Benchmarks Delegated Regulation. We understand that the proposed new criteria are, however, mentioned in Art. 18(1) of the EU Taxonomy. Hence, the proposed change would decrease the compatibility of SFDR PAI criteria with the Climate Benchmarks Delegated Regulation but at the same time increase the compatibility with the EU Taxonomy. This is not in line with the ESAs' reasoning in Recital 20 of JC 2023 09 where the ESAs state that the proposed changes are to "ensure consistency with the other pieces of sustainable finance legislation (i.e. Taxonomy Regulation, Climate Benchmarks Regulation)".

We would like to warn that this proposed change can have severe unintended consequences: It may be that market participants subject to SFDR or MiFID have previously noted that CTB and PAB are by design (cp. current alignment of the Climate Benchmarks Delegated Regulation with the SFDR PAI criteria with regard to the violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises) compatible with at least PAI #10 under SFDR.

Market Participants may have concluded that financial products based on CTB and PAB can therefore, without further assessment of the CTB's or PAB's methodologies, be classified as "considering PAI" (#10). Based on this assumption, the proposed changes would have consequences for disclosure under Art. 7(1)(a) SFDR (financial product considers principal adverse impacts) and the assessment of whether a respective financial product can be classified under DR 2017/565 'sustainability preferences', financial instrument that considers principal adverse impacts on sustainability factors. The proposed change would create legal uncertainty. Further, the protection of confidence of such market participants requires, that the criteria are not changed as proposed.

<ESMA_QUESTION_SFDR_5>

Q6 : For real estate assets, do you consider relevant to apply any PAI indicator related to social matters to the entity in charge of the management of the real estate assets the FMP invested in?

<ESMA_QUESTION_SFDR_6>

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<ESMA_QUESTION_SFDR_6>

Q7 : For real estate assets, do you see any merit in adjusting the definition of PAI indicator 22 of Table 1 in order to align it with the EU Taxonomy criteria applicable to the DNSH of the climate change mitigation objective under the climate change adaptation objective?

<ESMA_QUESTION_SFDR_7>

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<ESMA_QUESTION_SFDR_7>

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

<ESMA_QUESTION_SFDR_8>

We have encountered major challenges due to the misalignment in the timing of the various assessments required under Article 4 of SFDR.

For instance, “enterprise value” must be calculated at Fiscal Year-end while the value of positions in the portfolio should be an average of each quarter end, and the assessment of principal adverse impact should be based on “latest available information”.

This results in 3 assessments being carried out at different points in time, rendering the aggregation of information on PAIs at entity level technically challenging. It also creates inconsistency as to the information reported on a portfolio holding at a specific point in time depending on whether it is based on “latest available information” rather than the point at which an investor was exposed to the portfolio. In our experience, this has proven particularly challenging for FMPs in the context of controversy-based assessments.

In our view, it would be more practicable to have all three assessments carried out together at a single point in time. However, we would like to highlight that we anticipate this amendment to the Delegated Regulation alone would imply significant cost and disruption to the established pattern of disclosures. Nevertheless, it would improve the quality, accuracy and comprehensibility of disclosures.

<ESMA_QUESTION_SFDR_8>

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

<ESMA_QUESTION_SFDR_9>

The development of new formulae is helpful in view of the forthcoming review of the SFDR. However, we believe that the ESAs should carefully consider whether the benefits of introducing new formulae at this juncture would outweigh the costs. If the new formulae are adopted FMPs will be required to adapt to the changes and the new formulae could create inconsistencies with the PAIs as applied and reported to date. As a result, we would encourage the ESAs to await the review of the SFDR before introducing the proposed changes.

In the interim we would encourage the ESAs to develop examples of how the new formulae would be applied to ensure a common understanding across the market.

In addition, we believe that the formulae could be improved if they were better able to reflect and/or account for limited data availability. For instance, where a weighted average is calculated, the denominator should reflect data coverage and should, ideally, be limited to positions with data. This would align with common market practice and avoid dilution of reported principal adverse impact due to the inclusion of non-eligible assets and assets (for which data is lacking) in the denominator.

Finally, almost all formulae propose using ‘all investments’ in the denominator except for those concerning real estate assets and debt securities not issued under Union legislation. The same approach could be taken for other PAIs.

<ESMA_QUESTION_SFDR_9>

Q10 : Do you have any comments on the further clarifications or technical changes to the current list of indicators? Did you encounter any issues in the calculation of the adverse impact for any of the other existing indicators in Annex I?

<ESMA_QUESTION_SFDR_10>

In our experience, the persistent uncertainty around how to apply the term 'all investments' has been a significant challenge to FMPs. We welcome the ESAs' efforts to provide clarity and would like to highlight that different approaches are currently applied across the market.

In addition, as is well known by the ESAs, there is limited data available on certain PAIs and the materiality of the various PAIs can differ considerably depending on the investment.

<ESMA_QUESTION_SFDR_10>

Q11 : Do you agree with the proposal to require the disclosure of the share of information for the PAI indicators for which the financial market participant relies on information directly from investee companies?

<ESMA_QUESTION_SFDR_11>

In general, we believe that the ESAs should refrain from introducing too many additional mandatory requirements for FMPs at this juncture, in view of the forthcoming review of SFDR. As a result, any changes introduced to the SFDR Delegated Regulation should be largely optional for FMPs. More broadly, they should avoid creating inconsistencies with the framework as applied until now.

At present, the availability of data on PAIs is limited, with companies under no legal obligation to disclose said information. This situation is likely to persist if the first set of draft ESRS proposed by the European Commission are enacted; as they envisage making reporting against the PAIs largely voluntary for companies in scope of the CSRD.

As a result, "information directly from investee companies" may continue to be difficult for FMPs to obtain. Disclosure of the limited availability of data "directly from investee companies" may undermine the confidence of investors in the reliability of the PAI reporting. It would also represent a departure from how Taxonomy-alignment data is treated according to the European Commission's response to the ESAs' queries (published 14/04/23), whereby FMPs are prohibited from indicating a lack of data to explain low alignment lest it undermine the confidence of investors.

Accordingly, it may be more appropriate to allow FMPs the option of disclosing the proportion of companies for which data on the PAI indicators is available. This could be expressed in the form of a 'coverage figure'.

However, there would have to be clarity as to how to calculate the 'coverage figure'. For instance, it should be clear whether the numerator includes only positions for which PAI data has been reported or whether it also includes estimated data. Additionally, it should be clear whether the denominator includes all assets or only those eligible to PAI reporting in general or eligible to the specific PAIs in view of their materiality.

Finally, as a complement, it may be worth considering a further optional disclosure that would allow FMPs to highlight the materiality of different PAIs or their applicability to certain sectors.

<ESMA_QUESTION_SFDR_11>

Q12 : What is your view on the approach taken in this consultation paper to define ‘all investments’? What are the advantages and drawbacks you identify? Would a change in the approach adopted for the treatment of ‘all investments’ be necessary in your view?

<ESMA_QUESTION_SFDR_12>

Based on our experience, both approaches have their own advantages and disadvantages, and each approach has its own proponents in the market.

The current interpretation of ‘all investments’ makes sense in the context of PAI calculations when asking for a ‘share of investments in…‘, but is not appropriate for calculating weighted averages. With the current interpretation, adverse impact can be reduced year-on-year by shifting portfolios away from assets with data (either eligible assets for which no data is available or assets which are not eligible for the PAI indicators).

In either case, the numbers can only be fully understood in combination with the eligibility ratio (which share of the portfolio is eligible for the PAI calculation and proportion of the investments for which there is PAI data).

<ESMA_QUESTION_SFDR_12>

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

<ESMA_QUESTION_SFDR_13>

We believe that FMPs would benefit from greater flexibility to avail of reasonable estimates to address gaps in corporate reporting. Such estimates may still be valuable to end investors in assessing the sustainability of investment products and need not rely on information reported by investee companies.

<ESMA_QUESTION_SFDR_13>

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

<ESMA_QUESTION_SFDR_14>

We do not agree with the proposed initiatives on PAIs. We suggest methods below in detail.

I. ESAs take initiative to reflect derivatives equally in sustainable investment ratios: Until now, derivatives have not been taken into account holistically and we commend the ESAs for taking the initiative to include derivatives in sustainable investment ratios in an equal manner, namely, by including derivatives in both the numerator and the denominator of the relevant ratios. In this regard, we fully support the direction the ESAs are taking.

II. Derivatives are considered as sustainable investment vehicles per se: This notion is further substantiated regarding the PAI calculations, where the ESAs accept derivatives to "also constitute investment decision on sustainability factors" according to the proposed draft RTS recital (4) in this consultation. This further encourages the progress that derivatives themselves are also considered to contribute to sustainable investments. As a consequence, and next step, alignment in taxonomy aligned ratios would be required, to reflect derivatives proportionately.

III. Careful scrutiny and further consultation with the market is required before taking the final decision on the netting approach: In the current proposal, the ESAs suggest including only "net long positions" of derivatives into numerators of PAI ratios. In our experience, netting is a difficult approach, and it can be complex. We would abstain from mandating its use before scrutinizing it extensively with market players who might need more time for reflection in view of the difficulty distinguishing between long and short positions.

One aspect raised in the consultation under the netting methodology is the initiative proposing to disallow the outcome of netting to be below zero. We cannot assess the immediate consequences of this rule. We would suggest the ESAs not to dive into too many technicalities before concluding on the discussion about net long/short positions. We would rather suggest taking this "zero flooring" approach as a second step discussion afterwards. In addition, we would appreciate if the ESAs could provide more examples on the zero-flooring initiative because the various approaches discussed render it difficult to imagine immediately how to make all these calculations practically, given the introduction of multiple new technical amendments in this consultation.

Our suggestion is taking into consideration both benefits and drawbacks for both approaches and coming to a conclusion which fits the entire market before mandating the current proposals. For the moment, we do not see merit in imposing a single approach but, instead prefer a flexible approach, especially when considering the different dynamics of various asset classes.

IV. Scope of derivatives: On top of the netting discussion above, we would also like to state that we find it reasonable to include underlyings in companies' "equity" and "debt" asset classes of the derivatives into PAI ratios. Companies are real actors of the economy able to influence the re-allocation of capital flows toward green sectors and they are capable of ESG assessments. Hence, equity and debt instruments are the most obvious asset classes that can create impact on company financing and are assessable against the EU Taxonomy/sustainability objectives, more so than other derivatives. However, the inclusion of these asset classes should be reflected proportionate to the other sustainable ratios i.e., taxonomy alignment and sustainable investment, for equal treatment and harmonization purposes.

V. Flexible methodologies are proposed to convert derivatives positions into equivalent underlying positions in the portfolios: We commend the ESAs for proposing calculation methodologies to convert derivative positions into equivalent underlying positions to reflect derivatives' exposures in portfolios. Until now, derivatives have not been the focus and therefore the approach as to how they could be captured has been neglected. With the proposal at hand, the ESAs provide a very good basis to allow for flexibility in the market with the proposed conversion methodology regulations per different asset/sub-asset classes referenced under AIFMD. Nonetheless, we would like to highlight that extending conversion methodologies are a good starting point and mostly fit for purpose, we would also strongly encourage including risk-based methodologies regarding bond futures and interest rate futures such as delta approach or DV01 (dollar duration). The reason is that specifically for bond futures and interest rate futures, risk-based methodologies reflect the sustainable investment exposures of derivatives in the portfolios in a way that is closest to actual exposure. Given that the aim is to provide market participants with methodologies to be used in the most meaningful way to reflect sustainable investment exposures of derivatives, we would ask for the ESAs to take this point into consideration. In addition, we would like to have more clarification regarding the notion of "plain vanilla" derivatives mentioned in the methodologies list. Even if the industry has a general understanding, the corresponding law itself does not specify objectively which exact product falls into the plain vanilla category and which does not. For example, it is not clear to distinguish if an option on ETFs falls under the category of plain vanilla equity options or if equity total return futures fall under the category of single stock futures. We would appreciate some clarity on that point as well.

VI. Derivatives should not be looked at as causing potential greenwashing but in a comprehensive manner, including the contribution side: As expressed before, we strongly agree that derivatives should be included in sustainable investment ratios. We advocate this position because derivatives often contribute positively to sustainable investment and are not used exclusively by FMPs to distort sustainable investment ratios or PAI calculations. However, the approach chosen by the ESAs is one-sided and focuses only on the negative potential use of derivatives due to the ESAs' greenwashing concerns. The ESAs seem to insinuate greenwashing risks are caused by derivatives only, which appears to be the motivation for the proposed inclusion of derivatives into PAI ratios. To us, this is an unfortunate and false premise. This motivation might contribute to persistent misapprehensions with regards to derivatives at the very outset of the discussion of greenwashing under the SFDR/taxonomy framework. If the motivation is to solve the greenwashing issue in the entire sustainable finance framework, the discussion should encompass a more comprehensive approach and should not lead to the misrepresentation of a certain asset class. Overall, we advocate that the ESAs should broaden their perspective also in the direction of derivatives' positive contribution to sustainable investments, not only of potential greenwashing risks they could cause. In this way, the general asymmetry problem with derivatives' inclusion into the sustainable investment ratios occurring due to a one-sided representation towards negatively contributing derivatives in this consultation could be solved.

VII. It is misleading to include derivatives with any kind of underlyings into PAI calculations: The PAI calculations include "any derivative" (consultation document page 16, item 34) which seems rather misleading. The predominant reason is that some underlying asset classes are not included in the taxonomy and SFDR scope since they are considered taxonomy-neutral, such as interest rates, commodities, and foreign exchange. There might be limited or no KPIs identified for these asset classes by market players. Hence, it is questionable to include those derivatives into PAI ratios since they are not considered in any other sustainable ratios currently. A clarification and harmonization of scope is recommended.

VIII. ”All” derivatives should be included in PAI ratios, not just the physically-delivered ones: In the current proposal by the ESAs, derivative exposures which do not ultimately result in a physical investment in the underlying security by the counterparty – or any other intermediary in the investment chain – the FMP would be allowed to consider that a derivative investment does not result in an adverse impact and should therefore be allowed to exclude it from the numerator (consultation document page 16, item 34). However, this approach should be reconsidered by the ESAs, first of all for harmonization reasons, since there is no similar approach described for any other sustainable investment ratios. Secondly, the argument that including all derivatives, not only physically delivered ones, would be less limiting given the type of derivatives they are using currently. Based on the derivatives' mechanism when deploying strategies and the purpose of their use, they contribute to sustainable investments i.e., the proceeds received from a cash derivatives transaction might in turn be used to invest in green companies.

In our view, physical ownership is not a necessary criterion and/or evidence to demonstrate the sustainable impacts. Therefore, its inclusion or exclusion should not be a condition for the calculation of ESG indicators such as PAI, taxonomy alignment or Sustainable Investment. Furthermore, derivatives help to diffuse corporates' business risk by modifying the cost of capital (via changing the amount of capital available at a given cost). Whether cash or physically settled derivatives are used, they are optimizing the cost of capital of firms which is equally important. Without enough capital, investors would not be able to make sustainable investments. Ultimately, effectively using derivatives allows for efficient allocation of capital, this holds true for general investments, but also in particular for sustainable investments.

<ESMA_QUESTION_SFDR_14>

Q15 : What are your views with regard to the treatment of derivatives in general (Taxonomy-alignment, share of sustainable investments and PAI calculations)? Should the netting provision of Article 17(1)(g) be applied to sustainable investment calculations?

<ESMA_QUESTION_SFDR_15>

First of all, we would like to repeat that we welcome the ESAs' initiative to address the treatment of derivatives in sustainable finance. Until now, the understanding of whether and how derivative instruments can contribute to sustainable objectives has been neglected. We consider this consultation a step in the right direction toward the gradual development of a comprehensive and proportionate approach to the inclusion of derivatives in the sustainable investment framework.

From our perspective, the consultation provides a good starting point by addressing the issue through the inclusion of derivatives in sustainable ratios but, there seems to be an underlying bias towards derivatives in general addressing PAI ratios vs. taxonomy-alignment ratios and sustainable investment ratios. The proposed initiatives in this consultation do not treat derivatives making negative contributions and derivatives making positive contributions to sustainable investment equally and fairly across different sustainable investment ratios. To us, this is a prior problem to be solved before delving into the netting and conversion methodology discussions. ESAs' one-sided consideration of negatively contributing derivatives into sustainability, PAIs, seems to disregard all the past work done by the industry, i.e., ad hoc sustainable finance platform group, to show how derivatives positively contribute to and facilitate the sustainable and green transition.

ESAs need to be aware that derivatives form part of the tool kit of a modern portfolio manager both to hedge risks and, also to implement investments. In the latter use case, derivatives are frequently employed as a substitute for the equivalent underlying cash basket or ETF, hence the omission of derivatives would be inconsistent from the perspective of the end client.

According to our understanding, the ultimate goal of the sustainable finance framework is to increase the level of sustainable investments and decrease adverse impacts of investments on the environment. All financial instruments, without exception, have the potential to serve this goal. Accordingly, the various sustainable investment ratios cannot be treated separately. More specifically, PAI ratios, taxonomy-alignment ratios and shares of sustainable investment should be considered as different sides of the same coin.

In our view, this fundamental point is missing in the overall sustainable finance framework and creates an artificial gap between derivatives that contribute positively or negatively to sustainable investment ratios.

When we zoom into the approach suggested by the ESAs for taxonomy-alignment ratios and shares of sustainable investments, we see certain shortcomings. Derivative exposures are not treated as instruments contributing to sustainable investments if they amount to an equivalent long net exposure and it is deemed that they are being used only to inflate taxonomy-alignment and/or sustainability ratios artificially. Contrarily, net short positions of derivatives are considered in taxonomy and sustainable investment ratios to reduce the long net exposure on a given taxonomy alignment / SFDR sustainable investment issuer. This is an unfair approach and one based on the view that derivatives in these ratios are used exclusively by FMPs to distort or make misleading claims about the ESG performance of their investment portfolio. As discussed in our response to Q14, further intelligence gathering on the netting approach for any derivatives, not only for PAIs or for taxonomy alignment ratios is required. Including only net long positions or both net long or short positions of derivatives into the numerators of sustainable investment ratios should be further scrutinized and tested. Once, a conclusion is reached, ideally the same approach should be reflected for both PAIs, taxonomy-alignment ratios and sustainable investment ratios for harmonization and equal treatment. Thus, the current artificial gap created between the approaches taken towards the negatively and positively contributing derivatives could be closed.

Lastly, we would like to highlight that the conversion methodologies proposed to translate derivatives into equivalent underlyings in PAI calculations are considered as an adequate starting point to be applied on taxonomy-alignment and sustainable investment ratios. This would provide the same flexibility also for taxonomy-alignment and sustainable investment ratios. Importantly, first the netting methodology shall be identified, and once this has been established, we would support the proposal by the ESAs to use the conversion methodologies under AIFMD for all derivatives in sustainable ratios in general, however, would also strongly recommend augmenting them with risk-based methodologies described in Q14, such as delta and DV01 approaches.

All in all, our general opinion of the treatment of derivatives is that an alignment in the netting and conversion methodologies for all sustainable investment ratios would be imperative to reflect both sides of the coin appropriately. Currently, we see an asymmetric approach. We understand how the ESAs' concerns over greenwashing have informed the current initiative but, to ensure an accurate reflection of derivative exposures in all sustainable investment ratios, more holistic approach(es) should be considered. We would like emphasise that the potential negative contribution of derivatives is only one side of the coin and that the ESAs should also consider the positive contribution of derivatives. Addressing the subject only with regards to greenwashing and PAI overlooks other functions/purposes of derivatives.

<ESMA_QUESTION_SFDR_15>

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

<ESMA_QUESTION_SFDR_16>

As mentioned in our responses to Q14 and Q15, we see both benefits and shortcomings of including net short positions into the numerators of sustainable investment ratios, and we see merit in further discussing the issue with industry players. Provisions of point g of paragraph 1 of Article 17 of the SFDR Delegated Regulation is cross-referencing the Short-Selling Regulation ((EU) 236/2012) where netting methodologies for short positions are laid out. Before deciding on the appropriate legal cross references to the Short Selling Regulation, we propose to first focus on deciding on the final netting methodology once more details have been clarified. Once it has crystallized which direction on netting to take, it then makes sense to refer to the appropriate laws and regulations.

<ESMA_QUESTION_SFDR_16>

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

<ESMA_QUESTION_SFDR_17>

We generally agree with the ESAs' assessment of the DNSH framework under SFDR.

Overcoming the challenges associated with applying the SFDR DNSH will be crucial to enhancing the usability of the EU sustainable finance framework. As the ESAs have outlined, the SFDR DNSH is a key element in qualifying 'sustainable investments' under Article 2(17) and thus, in the absence of a clear framework to determine 'significant harm', the concept of 'sustainable investment' itself cannot be considered robust.

We share the ESAs' view that solutions for fundamental issues in SFDR will only be delivered by a Level 1 review. Accordingly, we welcome the announcement by the European Commission that it would be undertaking a public consultation later this year to prepare such a review.

While the current SFDR DNSH framework has its limitations, we believe that intervention by the ESAs at this juncture may create additional implementation hurdles for the market without adequately addressing the framework's shortcomings.

Accordingly, we believe that any changes introduced by the ESAs in the form of additional disclosures should be largely optional for FMPs.

<ESMA_QUESTION_SFDR_17>

Q18 : With regard to the DNSH disclosures in the SFDR Delegated Regulation, do you consider it relevant to make disclosures about the quantitative thresholds FMPs use to take into account the PAI indicators for DNSH purposes mandatory? Please explain your reasoning.

<ESMA_QUESTION_SFDR_18>

In view of the forthcoming review of SFDR, we do not believe it would be appropriate for the ESAs to make the disclosure of quantitative thresholds, linked to PAI indicators, (for the assessment of DNSH) mandatory at this juncture.

As outlined in the consultation paper, FMPs would ultimately still have discretion as to the PAI indicators they consider and the quantitative thresholds they set for them. Moreover, in most instances, the thresholds introduced by FMPs are likely to be sector-agnostic and thus inadequate to reflect sectoral specificities. This may lead, inadvertently, to incoherences with the technical screening criteria (TSC) of the EU Taxonomy and undermine the usability or comprehensibility of the EU sustainable finance framework.

In addition, while mandating the disclosure of quantitative thresholds may provide greater insight into the approaches applied by FMPs in assessing DNSH, it would also create a superficial comparability between products that may actually heighten the risk of end-investors believing certain concepts in SFDR are being applied uniformly across the market.

Ultimately, we believe that the ESAs should maintain the status quo and avoid the risk of further disruption as the market adapts to the new requirements pending the review of SFDR.

<ESMA_QUESTION_SFDR_18>

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

<ESMA_QUESTION_SFDR_19>

We believe that the ESAs should refrain from introducing an optional “safe harbour” for Taxonomy-aligned activities at this juncture. The definition of “sustainable investment” under SFDR is likely to be addressed in the forthcoming review of SFDR level 1 and we believe that such a fundamental question should be reserved for the European Commission and the co-legislators.

Furthermore, if introduced as an element of the current SFDR framework, we believe that an optional “safe harbour”, whereby Taxonomy-aligned investments would not be subject to an environmental DNSH assessment, would increase complexity and create further inconsistencies across the market.

We recognize that Taxonomy-aligned activities already satisfy rigorous, sector-specific DNSH criteria in accordance with the Technical Screening Criteria (TSC). Accordingly, subjecting Taxonomy-aligned investments to another, potentially divergent environmental DNSH assessment under SFDR is duplicative and unnecessary. However, leaving the application of a “safe harbour” to the discretion of

FMPs will result in divergent approaches being adopted across the market, rendering it less navigable for end-investors.

Moreover, the proportion of Taxonomy-aligned investments in a portfolio should be reflected in the Green Asset Ratio (GAR). According to our understanding of existing requirements, the GAR would not be reduced in cases where divergent environmental DNSH criteria under SFDR were applied to Taxonomy-aligned investments.

The ”safe harbour” would thus appear more relevant in cases where Taxonomy-aligned investments were to be treated as a subcategory of “sustainable investments” within the meaning of Article 2(17). In such instances, the “safe harbour” would avoid divergences between the environmental DNSH in SFDR and the TSC resulting in Taxonomy aligned investments being disqualified as “sustainable investments”.

However, for practical reasons, the “safe harbour” would not fully address potential inconsistencies between how the environmental DNSH is applied by the Taxonomy and SFDR for the purposes of qualifying “sustainable investments”. This is primarily due to the fact that, while the Taxonomy carries out an assessment at the level of economic activities, qualifying ‘sustainable investments’ typically involves assessing an entity in its entirety. As a result, while the “safe harbour” may prevent Taxonomy-aligned investments from being disqualified as “sustainable investments” it will not prevent other activities carried out by the same entity from being subject to the environmental DNSH under SFDR and potentially disqualified as a ‘sustainable investment’ on that basis (despite the entity also carrying out Taxonomy-aligned activities).

We would also like to highlight that, in a recent FAQ document published on 13th June 2023, the European Commission stated that exposures to Taxonomy-aligned investments could be considered as ‘sustainable investments’ within the meaning of Article 2(17). The Commission specifies that the social elements of the DNSH principle under SFDR are considered to be adhered to at entity level for an undertaking that discloses activities as “environmentally sustainable” under the EU Taxonomy. In effect, the European Commission has clarified that satisfying Article 18(1) of the Taxonomy Regulation on Minimum Safeguards automatically qualifies an exposure as a ‘sustainable investment’ pursuant to Article 2(17).

The European Commission’s clarifications as to the interaction between Taxonomy-aligned activities and ‘sustainable investments’ appear to create a form of “safe harbour” insofar as SFDR DNSH is satisfied with respect to social and governance matters at entity level by any entity with Taxonomy-aligned activities. However, the FAQ does not state that other activities carried out by an entity would not be subject to environmental DNSH under SFDR.

<ESMA_QUESTION_SFDR_19>

Q20 : Do you agree with the longer term view of the ESAs that if two parallel concepts of sustainability are retained that the Taxonomy TSCs should form the basis of DNSH assessments? Please explain your reasoning.

<ESMA_QUESTION_SFDR_20>

Ideally, the two parallel concepts of sustainability embedded in the EU sustainable finance framework should be reconciled or more clearly differentiated.

The Taxonomy TSC could form the basis for SFDR DNSH assessments where environmental matters are concerned. However, the concept of 'sustainable investment' contained in SFDR is far broader, encompassing social and governance matters as well as environmental.

Moreover, the Taxonomy TSC are limited in scope, being applicable only to those activities that are deemed most relevant to attaining the environmental objectives enshrined in the Regulation. Accordingly, the Taxonomy TSC could only be used to assess DNSH for activities covered by the Taxonomy. Sector or activity-specific criteria would have to be developed to assess DNSH for non-Taxonomy eligible activities. This would imply substantial technical work that would require a reasonable timeframe to deliver.

Whether and, if so, the precise way the PAI indicators would be taken into account for the purposes of DNSH will also require careful consideration. For instance, the ESAs could contemplate whether sector-specific, quantitative thresholds for environmental PAIs could be developed based on the Taxonomy TSC and for Taxonomy non-eligible activities for which no TSC have been developed. That said, in the interest of simplicity, it may be advisable to decouple the concept of DNSH in SFDR and the PAIs entirely so as to avoid the need to make the Taxonomy TSC 'interoperable' with quantitative PAI thresholds.

The prospect of developing intermediate performance, limited impact, significant harm and social Taxonomies has been explored by the Platform on Sustainable Finance. A more expansive Taxonomy framework, encompassing a broader range of economic activities and assessing social as well as environmental activities, could offer a solution and allow for the divergent concepts of 'sustainability' contained in the EU sustainable finance framework to be reconciled. This would ultimately result in the concept of sustainability contained in the Taxonomy being broadened to match the scope of 'sustainable investment' in SFDR. However, expanding the Taxonomy framework in this manner would likely require substantial time and resources and may not be feasible. Moreover, it would ultimately be dependent on a political decision by the European Commission.

<ESMA_QUESTION_SFDR_20>

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

<ESMA_QUESTION_SFDR_21>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_21>

Q22 : Do you agree that the proposed disclosures strike the right balance between the need for clear, reliable, decision-useful information for investors

and the need to keep requirements feasible and proportional for FMPs? Please explain your answers.

<ESMA_QUESTION_SFDR_22>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_22>

Q23 : Do you agree with the proposed approach of providing a hyperlink to the benchmark disclosures for products having GHG emissions reduction as their investment objective under Article 9(3) SFDR or would you prefer specific disclosures for such financial products? Do you believe the introduction of GHG emissions reduction target disclosures could lead to confusion between Article 9(3) and other Article 9 and 8 financial products? Please explain your answer.

<ESMA_QUESTION_SFDR_23>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_23>

Q24 : The ESAs have introduced a distinction between a product-level commitment to achieve a reduction in financed emissions (through a strategy that possibly relies only on divestments and reallocations) and a commitment to achieve a reduction in investees' emissions (through investment in companies that has adopted and duly executes a convincing transition plan or through active ownership). Do you find this distinction useful for investors and actionable for FMPs? Please explain your answer.

<ESMA_QUESTION_SFDR_24>

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<ESMA_QUESTION_SFDR_24>

Q25 : Do you find it useful to have a disclosure on the degree of Paris-Alignment of the Article 9 product's target(s)? Do you think that existing methodologies can provide sufficiently robust assessments of that aspect? If yes, please specify which methodology (or methodologies) would be relevant for that purpose and what are their most critical features? Please explain your answer.

<ESMA_QUESTION_SFDR_25>

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<ESMA_QUESTION_SFDR_25>

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

<ESMA_QUESTION_SFDR_26>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_26>

Q27 : Do you agree with the proposed approach to require that, at product level, Financed GHG emissions reduction targets be set and disclosed based on the GHG accounting and reporting standard to be referenced in the forthcoming Delegated Act (DA) of the CSRD? Should the Global GHG Accounting and Reporting Standard for the Financial Industry developed by PCAF be required as the only standard to be used for the disclosures, or should any other standard be considered? Please justify your answer and provide the name of alternative standards you would suggest, if any.

<ESMA_QUESTION_SFDR_27>

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<ESMA_QUESTION_SFDR_27>

Q28 : Do you agree with the approach taken to removals and the use of carbon credits and the alignment the ESAs have sought to achieve with the EFRAG Draft ESRS E1? Please explain your answer.

<ESMA_QUESTION_SFDR_28>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_28>

Q29 : Do you find it useful to ask for disclosures regarding the consistency between the product targets and the financial market participants entity-level targets and transition plan for climate change mitigation? What could be the benefits of and challenges to making such disclosures available? Please explain you answer.

<ESMA_QUESTION_SFDR_29>

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<ESMA_QUESTION_SFDR_29>

Q30 : What are your views on the inclusion of a dashboard at the top of Annexes II-V of the SFDR Delegated Regulation as summary of the key information to complement the more detailed information in the pre-contractual and periodic disclosures? Does it serve the purpose of helping consumers and less experienced retail investors understand the essential information in a simpler and more visual way?

<ESMA_QUESTION_SFDR_30>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_30>

Q31 : Do you agree that the current version of the templates capture all the information needed for retail investors to understand the characteristics of the products? Do you have views on how to further simplify the language in the dashboard, or other sections of the templates, to make it more understandable to retail investors?

<ESMA_QUESTION_SFDR_31>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_31>

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

<ESMA_QUESTION_SFDR_32>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_32>

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

<ESMA_QUESTION_SFDR_33>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_33>

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

<ESMA_QUESTION_SFDR_34>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_34>

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

<ESMA_QUESTION_SFDR_35>

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<ESMA_QUESTION_SFDR_35>

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

<ESMA_QUESTION_SFDR_36>

We welcome the recognition that FMPs need to complement reported data with estimates if the Taxonomy is to serve as a meaningful assessment and steering tool. Permitting the use of estimates of Taxonomy-alignment also allows for a wider investment universe to be considered by FMPs by accounting for SMEs and non-EU companies.

With respect to the criteria proposed by the ESAs, we would like to emphasize that it should be possible for estimates to be based on proxy information related to the activity-specific criteria and not dependent on reporting on key environmental metrics by companies.

<ESMA_QUESTION_SFDR_36>

Q37 : Do you perceive the need for a more specific definition of the concept of "key environmental metrics" to prevent greenwashing? If so, how could those metrics be defined?

<ESMA_QUESTION_SFDR_37>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_37>

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

<ESMA_QUESTION_SFDR_38>

The market would benefit from greater clarity as to how the proportion of sustainable investments of financial products should be calculated. In addition, end-investors would benefit from greater consistency in the approaches applied by FMPs across the market.

As mentioned earlier, it is a widespread market practice for FMPs to assess 'sustainable investment' at entity level, taking into consideration the entirety of an investee company's operations and activities. This approach is appropriate in cases where the FMP holds general equity or debt in their portfolio.

However, it also results in the entire value of an equity or debt holding in a company being counted as a 'sustainable investment', regardless of how the three qualifying criteria (contribution, DNSH and good governance practices) have been applied.

By contrast to the entity-level approach, the activity-level approach typically results in a certain proportion of a holding qualifying as a 'sustainable investment' as opposed to the holding in its entirety. Logically, this typically leads to the portfolio having a lower share of 'sustainable investments'.

The entity-level approach has recently been validated in the European Commission's response to the ESAs' queries of 9th September 2022. As per the answer to the first of the ESAs' questions; "… the notion of sustainable investments' can therefore also be measured at the level of a company and not only at the level of a specified activity". The European Commission has thus indicated that both the entity-level approach and an activity-level approach are permissible.

Nevertheless, according to Article 2(17), a sustainable investment is "an investment in an economic activity that contributes to an environmental objective, … or … a social objective" provided those activities avoid significant harm and the investment is in investee companies that follow 'good governance practices'.

Two of these criteria appear to apply at the level of economic activities; (i) the need for an activity to contribute to a sustainability objective and, (ii) do no significant harm to others. The third and final criteria, that investee companies follow good governance practices', appears to apply at the entity level, to investee companies as a whole.

Accordingly, the ESAs could consider whether it is necessary to clarify how the three qualifying criteria should apply in the context of the entity-level approach. For instance, the ESAs' could consider whether a threshold linked to activities contributing to a sustainability objective should be introduced. Under this approach, for example, if a company derived 15% or 20% of its revenues from activities contributing to a sustainability objective then the entirety of the holding in that company could qualify as a 'sustainable investment' provided none of its activities caused significant harm and the company followed good governance practices.

Alternatively, it should be clarified whether "sustainable investments" should be calculated at the level of activities. However, we would highlight that if the assessment of sustainability is carried out at the level of economic activities, then only individual activities that make a contribution to sustainability objectives and avoid significant harm would be counted. This approach may result in, for example, fossil fuel companies with significant operations in renewables, being eligible for inclusion in the calculation of 'sustainable investments'.

The ESA should carefully consider which of these approaches adheres to the spirit of Art. 2(17) and how the SFDR framework could be reformed in future to ensure greater consistency across the market when it comes to calculating 'sustainable investment'.

Finally, with respect to derivative instruments, we do not see the need to set out specific rules on the calculation of the proportion of sustainable investments. As we explained in detail in our responses to Q14 and Q15, we propose to use a single methodology applicable to derivatives in all sustainable investment ratios without exemption. After agreeing on the right netting approach, that approach can also be used for the calculation of the proportion of the sustainable investments of derivatives. The AIFM directive-based conversion methodologies to convert these derivatives into equivalent underlyings and augmented by risk-based methodologies as put forward in the response to Q14, could similarly also be used for these ratios. Different treatments in different ratios undermines the fair approach and holistic structure of the overarching sustainable investment framework.

<ESMA_QUESTION_SFDR_38>

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

<ESMA_QUESTION_SFDR_39>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SFDR_39>

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

<ESMA_QUESTION_SFDR_40>

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<ESMA_QUESTION_SFDR_40>

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

<ESMA_QUESTION_SFDR_41>

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<ESMA_QUESTION_SFDR_41>

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

<ESMA_QUESTION_SFDR_42>

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<ESMA_QUESTION_SFDR_42>

Q43 : Do you have any views on the preliminary impact assessments? Can you provide estimates of costs associated with each of the policy options?

<ESMA_QUESTION_SFDR_43>

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<ESMA_QUESTION_SFDR_43>