

Reply form

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

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) 2018/1725¹. 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	Morningstar Sustainalytics
Activity	Regulated markets/Exchanges/Trading Systems
Are you representing an association?	<input type="checkbox"/>
Country/Region	Other

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>

The upcoming reviews of SFDR (level 1 and 2) should be used as an opportunity to improve the usability and relevancy of the PAI reporting.

In the short term, we invite regulators to prioritise implementation challenges over adding new indicators (e.g., PAI calculation distorted by asset allocation). This pause is also justified by the fact that it's still unclear if CSRD's sustainability standards will close the PAI data gap, as both qualitative and quantitative information may be subject to materiality assessment.

In the medium/long term, provided that the issue of disclosure misalignment has been resolved, we are not opposed to adding new indicators such as the new mandatory social indicators proposed.

We would also encourage regulators to review the PAI concept more fundamentally. For instance, PAI are, exclusively focused on negative impacts and backward looking and therefore offer a partial story to investors, who also consider positive impacts (e.g., SDGs) and forward-looking elements (e.g., pathway to net-zero).

Addressing both technical and fundamental issues identified above should allow the PAI reporting to become investment decision-useful, going beyond the current compliance exercise. |

<ESMA_QUESTION_SFDR_1>

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

<ESMA_QUESTION_SFDR_2>

Please see response to question 1. |

<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>

Please see response to question 1. In addition, we would like to point out that some data points can be misleading without context (e.g., temporary contract for Ukrainian war refugees). |

<ESMA_QUESTION_SFDR_3>

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

<ESMA_QUESTION_SFDR_4>

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<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>

We do not support this amendment because the UNGC is more holistic and widely used by FMPs. There is also no absolute need to secure alignment of regulations in this specific case as the UN Human Rights Council already declared in 2011 that the UN Guiding Principles are of direct relevance to the Global Compact and provide further conceptual and operational clarity for the two human rights principles of the Global Compact. A change would therefore not result in a different approach or interpretations but could lead to confusion. |

<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>

|In the delegated regulation, the timing of the size of the current investments in the company (holding date) and the enterprise value (company's fiscal year end) are not aligned. Given market movement between those dates, the calculation of the percent owned will be inaccurate. Article 6 (3) states for the PAI indicators it is an average of the impacts on four dates, therefore this will cause in some cases to over/underrepresentation of PAI. Using the enterprise value at the holding date and use the latest ESG data available would produce more accurate and meaningful figures for investors. |

<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>

PAI 1.9 (Hazardous waste and radioactive waste ratio): the consultation paper mentions hazardous waste and radioactive waste as two separate indicators with two different calculation formulae. However, there is only one formula provided in annex I.

PAI 1.13 (Board gender diversity): the consultation paper mentions “board members mean members of management and supervisory bodies” instead of current wording “board means the administrative, management or supervisory body of a company”. It would be helpful to clarify, in the case of two-tier systems where you have both a management board and a supervisory board, if the PAI should be calculated at aggregated level considering both boards. Usually, the board is the body with supervisory power over management and would be the one considered for board gender diversity. We also note that the description in table 1 and the formula do not match. The formula refers to male in the numerator instead of female. The description in table 1 refers to male board members as the numerator instead of total number of board members.

PAI 1.16 (Country Social Violations): we believe that limiting this PAI to ‘investigations’ makes it too narrow. It does not correspond to current ESG practice and expectations from investors who cannot always afford to wait for official ‘investigations’ to apply exclusions or divest to mitigate sustainability risks and impacts of their portfolios.

PAI 3.5 (Lack of grievance/complaints handling mechanisms related to employee matters): we note that there is a change in the PAI by reducing the grievance/complaints handling mechanisms to only discrimination related to employee matters. Currently, the PAI looks at grievance/complaints handling mechanism related to employee matters at large. This appears to be a significant reduction in scope for the PAI. Yet there is no rationale provided by the ESAs. |

<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>

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<ESMA_QUESTION_SFDR_10>

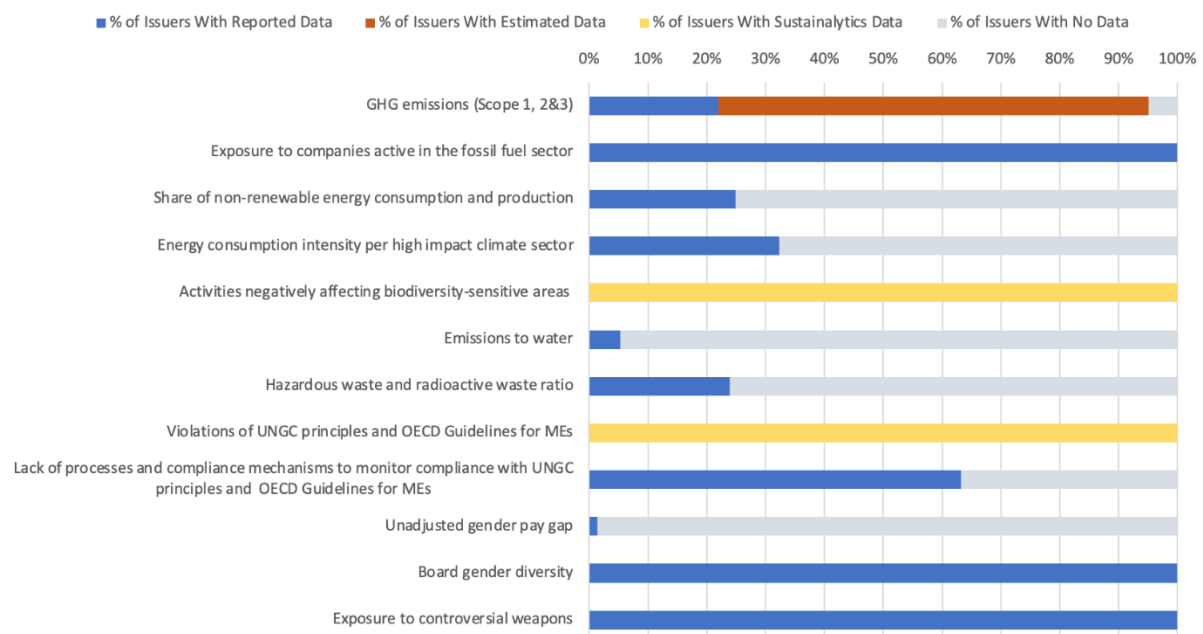
Q11 : Do you agree with the proposal to require the disclosure of the share of information for the PAI indicators for which the financial market participant relies on information directly from investee companies?

<ESMA_QUESTION_SFDR_11>

Yes, we are supportive of this proposal given the PAI data gap observed and the need to use estimates to account for non-EU holdings of FMPs.

Our analysis shows indeed that the data available for mandatory PAIs ranges from extremely limited to high. For example, less than 10% of issuers have reported data for gender pay gap and emissions to water (see Figure 1). Only 162 issuers disclosed relevant information regarding gender pay gaps, while 621 disclosed information related to emissions to water.

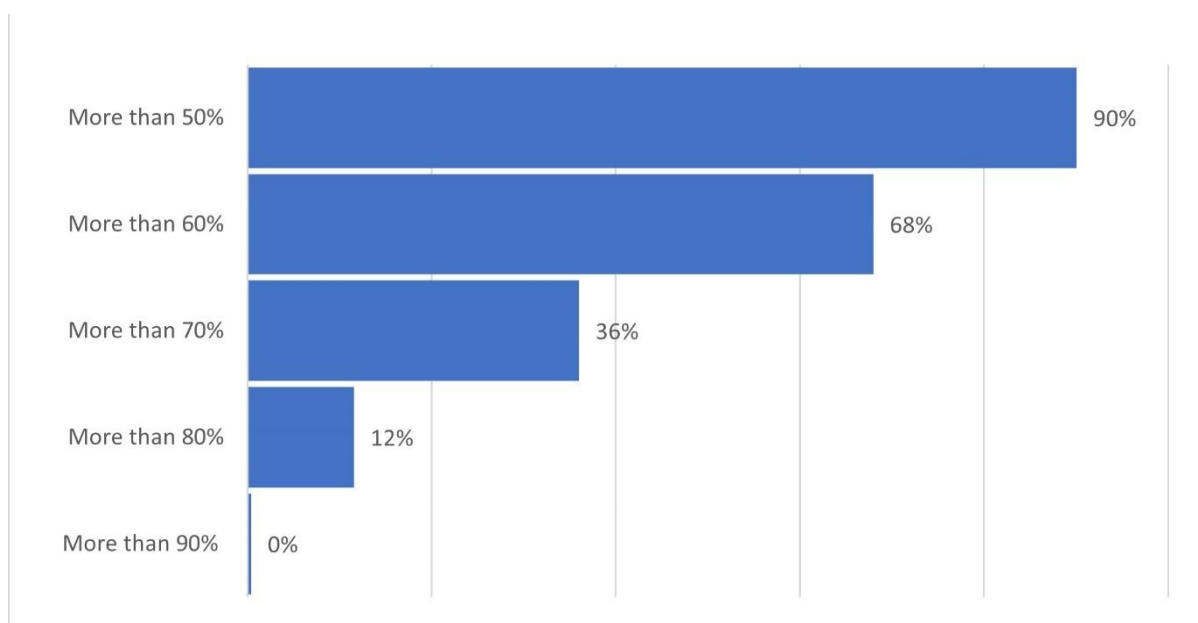
Figure 1. Issuers' Data for Mandatory PAI Reporting



Source: Morningstar Sustainalytics. For informational purposes only.

The gaps in reporting for mandatory PAIs are particularly notable. Our analysis revealed that there was no single issuer with available data across all mandatory PAIs. Furthermore, only 44 issuers had relevant data that covered more than 90% of the mandatory indicators (see Figure 2).

Figure 2. Number of Companies Covering the Mandatory PAI Indicators



Source: Morningstar Sustainalytics. For informational purposes only.

<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>

Different PAIs focus on different types of eligible holdings. The investee company PAIs are for equity and corporate bond holdings, the sovereign/supranational ones are for government, some agency, and supranational bonds, and the real estate ones are for direct physical property holdings. Other types of securities (e.g., cash, commodities) should always be considered as non-eligible holdings and moving forward should be disregarded from both the numerator and the denominator of PAI calculations. We believe indeed that only eligible holdings should be accounted for each PAI reporting and that breakdown of eligible versus non-eligible holdings and covered versus non-covered holdings should be provided at entity level to provide an accurate picture to investors (covered holdings mean those holdings for which the relevant underlying data has been obtained or estimated).

<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 would argue that it depends on the type of PAI and whether a credible proxy or estimation methodology is available. In some cases, PAIs can be more or less relevant in context of the value chain of investee companies but are not always reported and cannot be estimated. In other instances, some PAIs like scope 3 emissions are only relevant in context of value chains and can actually be estimated.]

<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>

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<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>

[TYPE YOUR TEXT HERE]

<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>

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<ESMA_QUESTION_SFDR_16>

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

<ESMA_QUESTION_SFDR_17>

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<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>

[Yes, we would support additional transparency such as the use of PAI thresholds rather than standardisation by leveraging Taxonomy technical screening criteria (also see response to question 20). FMPs have had to define their sustainability investment framework for SFDR and should be able to disclose this type of information to investors.]

<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 agree with the proposal set by the ESAs but would suggest taking advantage of the SFDR review to go one step further: a Taxonomy-aligned investment should be recognised as satisfying the entire sustainable investment definition 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>

[We believe it’s premature to initiate such convergence. The EU Taxonomy is still nascent and has yet to cover several activities left out of TSCs such as Agri-food and Mining (not to mention social objectives). Furthermore, the Taxonomy DNSH is prone to data gaps and challenges. The need to maintain the broader SI framework with its own DNSH will therefore persist for the foreseeable future.

At this stage, enhancing transparency of SFDR DNSH assessment is the best way forward (please see also our response to question 38). |

<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>

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<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>

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<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>

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<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>

|No, this could potentially lead to greenwashing and volatility of figures provided to investors. For instance, the fluctuation of cash holdings at fund level could affect the level of GHG emissions. We therefore suggest establishing a clear list of eligible holdings (e.g., equities, corporate bonds, sovereign and SSA bonds, real estate). Please see our response to question 12. |

<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>

| Yes absolutely, we support the reference to the GHG Protocol Corporate Accounting and Reporting Standard and PCAF and agree that it should be the only standard to be used for the pre-contractual and periodic disclosures. |

<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 ERS E1? Please explain your answer.

<ESMA_QUESTION_SFDR_28>

| Yes, we support breaking down the disclosure of reduction of GHG emissions in three categories: (1) tCO₂-eq/€M without removals, storage and credits, (2) GHG removals and storage and (3) carbon credits. We would also suggest disclosing whether removals are technology-based or nature-based. |

<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>

| Yes, some company policies can be particularly relevant for retail investors. For instance, stewardship activities are often carried at entity level rather than product level. Disclosures on the consistency between the broad sustainability products offering and stewardship activities carried at company level would be helpful. |

<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>

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<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>

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<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>

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<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>

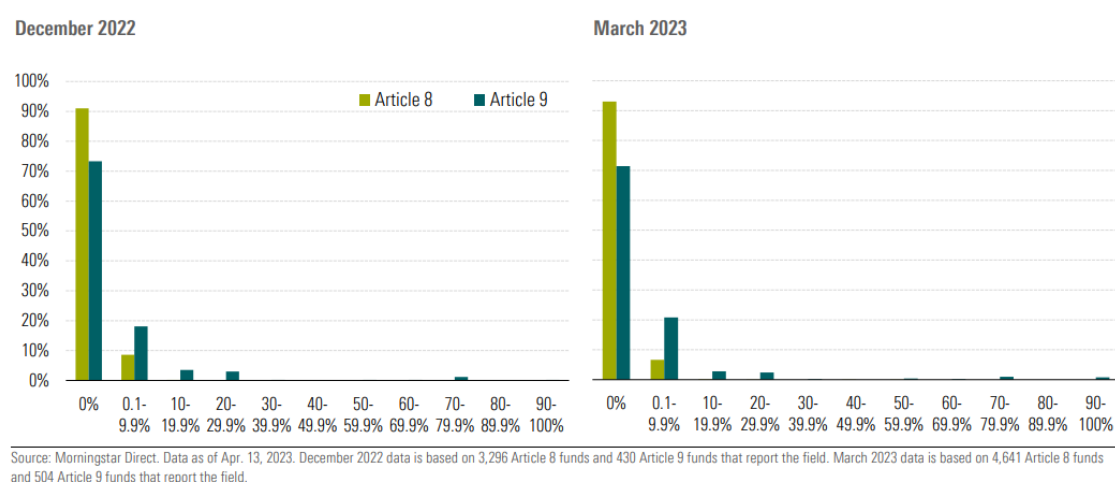
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<ESMA_QUESTION_SFDR_35>

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

<ESMA_QUESTION_SFDR_36>

It is our understanding that the PSF is planning on issuing dedicated guidance on the use of estimates. While we share the need to converge practices, we urge the ESAs not to pre-empt the PSF report and further constrain the use of estimates at this stage. We see no immediate greenwashing risk related to the Taxonomy. On the contrary, after more 1 year of implementation, 0% values continue to account for 93% of Article 8 funds and 71% of Article 9 funds (see figure below).

Exhibit 24 Proportion of Article 8 and Article 9 Funds (Y-axis) With Various Commitments to Taxonomy-Aligned Sustainable Investments (X-axis)

<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>

|Please see our response to question 36. |

<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 SI calculation should ideally follow a revenue-weighted approach to ease comparison, but the expectation for article 9 to be 100% SI has forced investors to adopt their own revenue threshold approach which is causing greenwashing concerns. Unless this expectation is changed, the use of revenue thresholds will remain the only viable approach. Like for PAIs/DNSH, we think it is difficult for regulators to mandate a specific revenue threshold which is timeproof and relevant across sectors and sustainability objectives. We also worry that it would take to look to adapt this regulatory threshold given the pace of legislative cycle and the evolving sustainability landscape. We would strongly support however enhanced public disclosure on thresholds chosen by investors. |

<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>

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<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>