**Reply form**

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

12 April 2023ESMA34-45-1218

**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](http://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]](#footnote-1). Further information on data protection can be found under the [Legal notice](http://www.eba.europa.eu/legal-notice) section of the EBA website and under the [Legal notice](https://eiopa.europa.eu/Pages/Links/Legal-notice.aspx) section of the EIOPA website and under the [Legal notice](https://www.esma.europa.eu/legal-notice) section of the ESMA website.

**General information about respondent**

|  |  |
| --- | --- |
| Name of the company / organisation | Schroders Investment Management (Europe) SA |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | Europe |

**Questions**

1. : 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>

In terms of the specific additional PAIs proposed, we recognise that the proposed topics are important factors in assessing sustainability and that the information they contain is likely to be of value to some fund investors, but also see practical challenges with measuring and disclosing:

* **Amount of accumulated earnings in non-cooperative tax jurisdictions for undertakings whose turnover exceeds € 750 million:** This information is currently rarely reported and while we recognise disclosure will improve in the future, it will continue to paint larger companies in a worse light, creating structural biases in performance based on the average size of companies held.
* **Exposure to companies involved in the cultivation and production of tobacco:** Relatively straightforward and easily measured. Recognising that tobacco is often excluded from sustainable portfolios, reflecting consumer expectations, information on this measure is likely to be of value.
* **Interference with the formation of trade unions or election worker representatives:** Very challenging to define and therefore measure consistently across companies. Any analysis is likely to have a bias toward greater penalty for large companies, where those issues are more frequently reported.
* **Share of employees earning less than the adequate wage:** Requires an agreed definition of adequate wages, which should ideally be assessed on a regional rather than national level.

As a general point, it needs to be highlighted that the proposed PAI are based on the draft ESRS under CSRD which leaves some gaps as regards EU companies covered and companies from third countries. This means that compliance with the proposed new RTS creates two significant challenges: How to assess (third country and EU) companies outside of the CSRD scope and how to address the data gap until full application of ESRS/CSDR (between 2024 and 2029).

We would also like to stress that the existing and new proposed PAI are incredibly hard to apply when investments are in small/unlisted companies (eg: VC/PA), real assets (eg: Infra/Real estate) or emerging markets, as a result of more limited data sets and/or indicators that are only available/applicable in publicly listed or large and established private companies (who are subject to existing ESG corporate reporting requirements). The latter strategies are also overwhelmingly only sold to sophisticated professional investors through unregulated AIFs and therefore the need for comparable data points is less relevant given that strategies are very bespoke and not frequently comparable between managers/products - ie: it’s unlikely that two managers will offer identical strategies.

Considering the challenges outlined above, we currently don’t see a meaningful and satisfactory solution other than an interim “best effort” approach and making PAI considerations for specific asset classes sold to professional investors optional in respect of Article 7 SFDR.

At this stage, we do not believe expanding the mandatory list of PAIs is helpful in driving transparency: The low data coverage and poor data quality of some of the existing PAIs mean that disclosed numbers are currently inconclusive and incomplete for the majority of the investable universe. As an example: Based on MSCI data, the level of coverage of existing mandatory PAI 12 “Unadjusted gender pay gap” for the MSCI All Countries World Index (ACWI) is only 24.6% (data at end April 2023). This, in our view, limits the added value of an extension of the PAI list at this stage. For the moment, we would therefore recommend to focus on improving corporate disclosure levels and data coverage before further expanding fund reporting.

We also believe that the use of a number of the metrics may result in significant unintended factor exposures that are not in the best interest of the client: for example, using EVIC as the denominator in a number of the metrics creates a tilt towards more expensive stocks. Also, for specific asset classes it makes more sense to use different denominators - NAV (net asset value) and total equity and debt, for example. For sustainable funds, we look at different measures, while they differ a bit in quantity depending on denominator, they do not contradict each other in scale or direction. PAI looks at GHG sales intensity as well, and that helps to see comparison of names within sector. To reduce market cap bias, absolute emissions metrics as well as some intensity metrics are both useful.

For sovereigns it might make sense to look at emissions per population etc and national targets. The implied temperature, which also takes into account current emisisosn as well as targets, and is updated yearly on emissions reduction progress is important to limit global warming, and could be considered in PAI.

Also, many of the current PAIs only meaningfully apply to a small proportion of companies, making fund profiles very sensitive to inclusion of specific companies or sectors.

There’s also a question of cultural bias: The proposed PAIs reflect a western, developed countries approach, not taking into account any regional/cultural specificities. For example, in the case of “unionisation” disclosures could refer to the proportion of companies with lower unionisation levels than their national averages. This would put the numbers disclosed in context and hence help investors interpreting the data presented to them.

To summarise, we suggest to focus on core areas/PAIs that are, in our experience, resonating with investors and for which we have proper data. This includes GHG emissions (although showing absolute emissions plus carbon footprint plus carbon intensity is a lot to digest for end investors), share of non renewable energy consumption and production, GHG intensity for sovereigns, UNGC violators, board gender diversity, exposure to controversial weapons and countries subject to social violations.

<ESMA\_QUESTION\_SFDR\_1>

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

<ESMA\_QUESTION\_SFDR\_2>

No. The regulations particularly need to acknowledge that while PAI have been drafted in a way possibly consistent for large publicly listed company, they are much harder to adapt to private companies and real estate assets. Trying to create a list of PAI that works for every type of illiquid asset class is impossible in the short term but we would urge regulators to acknowledge that FMPs operating in these asset classes must adapt PAI reporting to best reflect the data and measurements available where third party data solutions are not available. Please see also our response to question 1.

<ESMA\_QUESTION\_SFDR\_2>

1. : 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>

We do not believe that the six opt-in indicators proposed in Annex 1, Table III are fitting for assessing ‘harm’ caused by a company.

Firstly, we believe that reliable and consistent data for the proposed indicators would be hard to gather as these data points are not consistently reported and will have low coverage, portfolio disclosure cannot be meaningfully applied until company disclosure standards result in more comprehensive reporting.

Secondly, it is difficult to define the word ‘excessive’, which can then result in different interpretations of the metric and in data points that are not comparable, amongst sectors and over time.

Thirdly, the indicators are inherently tied to individual business models and specific to sectors or business operations. We also believe these data points will vary across geographies and with low levels of reporting in emerging markets.   
  
Additionally, for private asset investee companies (for example in emerging markets or small scale/VC companies), these KPIs will not be representative. These indicators tend to lend themselves to more mature/listed companies.

<ESMA\_QUESTION\_SFDR\_3>

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

<ESMA\_QUESTION\_SFDR\_4>

No. While we welcome the proposal as a component of engagement activities, we do not believe that the introduction of other social indicators is helpful for the reasons outlined in Q1 and Q2. As regards particularly private assets, please also see our response to question 2.

<ESMA\_QUESTION\_SFDR\_4>

1. : 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 don’t see any issues with the proposed changes.

<ESMA\_QUESTION\_SFDR\_5>

1. : 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>

If social indicators are assessed at the level of the entity in charge of managing the investment rather than the specific investment, this would present a distorted picture of the overall impact of the investment. For example, the manager may have robust systems in places when it comes to its own employees and remuneration and inclusion practices. However, this wouldn't guarantee that the same practices are followed by relevant stakeholders (property managers, tenants, etc.) at individual asset level. Likewise, the energy emissions of a service provider have no bearing on the emissions of a property it manages.

The extension of scope to real estate managers, who are effectively just service providers to the asset, would be entirely inconsistent with how other service providers are treated from a PAI perspective for other asset classes and service providers to products in general.

From a practical perspective, the data availability for these service providers and ability to collect this data would be exceptionally difficult and limited as the service providers are not set up to provide this through any existing reporting. This will not be alleviated by CSRD/ESRS as the scope excludes most of the counterparties who wouldn’t be EU listed or domiciled and/or large enough. For example, real estate funds domiciled in the EU often have an investment scope outside of Europe (i.e.: US, UK, Asia) and therefore these funds wouldn’t be able to collect the data.

<ESMA\_QUESTION\_SFDR\_6>

1. : 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>

We agree that it is inconsistent to have two different EPC rating measurements to define inefficient assets. However, regarding the EU Taxonomy criteria applicable to DNSH of the climate change mitigation objective under the climate change adaptation objective there is no industry consensus on how to measure the "top 30% of the national or regional building stock expressed as operational primary energy demand (PED)" which will hinder comparability between financial products within and across European markets.

We believe that the PAI indicator 22 of Table 1 should provide for assets to meet the efficient asset test if it has at least an Energy Performance Certificate (EPC) class C. The current PAI definition of inefficient asset (i.e.: EPC of C or below) makes the test under SFDR considerably more restrictive than under the Taxonomy which is inappropriate.

<ESMA\_QUESTION\_SFDR\_7>

1. : 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>

There can often be timing differences between the most recent value of an investment and measures of enterprise value, which are often available with a lag, based on previously reported borrowing information and other balance sheet measures, for example. As a result, where the value of financial markets are generally rising or falling, comparing current investment values to historical enterprise values can created distorted views of the fund’s exposures.

<ESMA\_QUESTION\_SFDR\_8>

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

<ESMA\_QUESTION\_SFDR\_9>

The formula for the 'Exposure to energy-inefficient real estate assets' PAI in Annex I has not been adjusted in line with the proposed amendments.

On gender board diversity: The proposal is to use male board members % of total board members. This is different to the previously required formula which specified the metric interms of the % of female members. This means that a board previously described as as being 30% female will now be described as 70% male. While this alteration may appear to be a minor technical adjustment, we believe it carries the potential to cause confusion among our clients, particularly considering that the original formulation aligns with common industry practices. Considering the potential for misunderstanding and the fact that the proposed change does not result in a more insightful metric, we do not consider this change necessary or beneficial.

<ESMA\_QUESTION\_SFDR\_9>

1. : 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>

As an investment manager, Schroders receives the necessary information on public assets from a third-party data provider (NB: such providers are not able to provide data for private assets): this fact is not restricted to the PAIs. The PAI indicators lack consistent data, as data is not reported on all indicators, and often coverage is low and non-existent. One example, in particular, is reporting on the 'unadjusted gender pay gap', as a result of the difference in regional approaches - e.g., it is mandatory in the UK, but not required in most countries.

There are challenges in the coverage of certain PAIs due to low levels of reporting from portfolio companies. Examples, PAI relating to Emissions to Water is reported by only 100 companies. Similarly, PAI related to Hazard waste ratio has poor coverage.

Additionally with regards to the voluntary PAIs, there have, been data availability issues with obtaining data for our optional social PAI on, 'Share of investments in companies without any supplier code of conduct, and lack of data doesn’t allow for quantitative assessment of measuring harm. We believe as such taking a qualitative approach via engagement could be more effective.

We would therefore ask for respective amendments of the proposal.

Please see also our comments on questions 1-4, particularly on the difficulties of reporting for private asset products

<ESMA\_QUESTION\_SFDR\_10>

1. : 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>

We believe providing disclosure on the use of third-party or proprietary data allows investors to gain a better understanding of data quality used for assessment of the PAI indicators. However, it's worth noting that this already forms a part of SFDR Article 10 website disclosures for in-scope funds. In cases where third party data providers are used, the data comes directly from sources reported by the company. This information is then fed into the data providers' databases.

To ensure consistency over time, we do believe that companies should be encouraged (e.g. through engagement) to provide the necessary data for reporting. We do not, however, believe that reporting on the percentage of information for each PAI indicator that is obtained directly from investee companies is useful, additive, or a comparable measure. Additionally, tracking, capturing, and monitoring this data in systems would add further operational burden.

Instead, we would recommend requiring FMPs to split out the proportion of data that is reported vs estimated, regardless of whether it was sourced directly or from a third-party data provider.

<ESMA\_QUESTION\_SFDR\_11>

1. : 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>

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<ESMA\_QUESTION\_SFDR\_12>

1. : 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>

Schroders would not be supportive of this approach as we believe that if we aggregate the measures and do not indicate where companies have included value chain emissions, we may end up penalising companies that have reported on their value chain adverse impacts, which is arguably penalising more advanced companies.

However, it has to be acknowledged that for some investment areas disclosing scope 3 emissions are incredibly challenging, e.g. forcing tenants of real estate assets to provide data is neither contractually enforceable nor commercially acceptable.

Our suggestion would be to require the reporting of value chain adverse impacts as a separate metric, not aggregated (i.e., how Scope 1+2 emissions and Scope 3 emissions are often reported separately).

<ESMA\_QUESTION\_SFDR\_13>

1. : 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 agree in principle that derivatives with an equivalent long net exposure should be included in the numerator of the PAI indicator as this follows the UCITS and AIFMD frameworks that derivatives are converted into an equivalent position in the underlying asset to measure a fund's exposure to the underlying assets. However, and noting the proposal to exclude a derivative from the numerator where the FMP can show that it does not ultimately result in a physical investment in the underlying security, it is typically impossible to demonstrate that a derivative has or has not ultimately resulted in a physical investment in the underlying security by the counterparty or any other intermediary in the investment chain. The counterparty or intermediary is under no obligation to report or disclose information on where the capital has been deployed, including if such proceeds have resulted in a physical investment in the underlying issuer.

As such we would suggest that derivatives counterparties should be required to report this information throughout the chain, so that FMPs have the requisite assurance to include or exclude a derivative from the numerator of the PAI indicator. In our view this is the only way to ensure consistency in the treatment of derivatives with an equivalent long net exposure across FMPs and whether they can be treated as resulting in an adverse impact or not.

Alternatively, given the challenge noted, derivatives with an equivalent long net exposure should be excluded from the numerator of the PAI indicator, but a rule could be introduced that such derivatives cannot be used to artificially lower PAIs and therefore circumvent PAI reporting.

<ESMA\_QUESTION\_SFDR\_14>

1. : 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>

We consider that derivatives with an equivalent long net exposure could in principle be considered Taxonomy-aligned investments (noting recital 33 of the SFDR Delegated Regulation and the current lack of reliable methodologies to determine to what extent exposures achieved through derivatives are exposures to environmentally sustainable economic activities) or sustainable investments (NB: based on the most recent Commission’s Q&A, taxonomy-aligned investments are automatically considered as SI), as this follows the UCITS and AIFMD frameworks that derivatives are converted into an equivalent position in the underlying asset to measure a fund's exposure to the underlying assets. This approach would also better align with the proposed approach for including derivatives with an equivalent long net exposure in the numerator of the PAI indicator: If long net exposure achieved through derivatives can be considered as investing in the underlying for the purpose of the PAIs, we are not clear why it would not be the case for the purpose of Taxonomy-alignment or sustainable investments. If this was the approach taken, then we agree that the numerator should take into account short positions achieved through derivatives to reduce the long net exposure on a given issuer (to mitigate the risk of greenwashing from trying to maximise the numerator). We consider that netting should be performed with respect to shares and sovereign debt instruments as well as other asset classes such as corporate bonds.

However, as noted in our response to question 14, it is often impossible to demonstrate that a derivative has or has not ultimately resulted in a physical investment in the underlying security by the counterparty or any other intermediary in the investment chain. We consider the counterparty or intermediary should be under an obligation to report or disclose information on where the capital has been deployed, including if such proceeds have resulted in a physical investment in the underlying issuer. This would mean FMPs would have the requisite assurance to include or exclude a derivative from the numerator of Taxonomy-aligned investments, sustainable investments and/or PAI indicators.

<ESMA\_QUESTION\_SFDR\_15>

1. : 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>

We consider that it would make sense 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, such as corporate bonds.

<ESMA\_QUESTION\_SFDR\_16>

1. : Do you agree with the ESAs’ assessment of the DNSH framework under SFDR?

<ESMA\_QUESTION\_SFDR\_17>

We believe that in the context of a disclosure regime FMPs should have discretion as to how they take into account PAIs as part of the DNSH assessment, which may be via quantitative or qualitative criteria or both. While we acknowledge that this could make comparability between FMPs products more difficult, this is the same position for other SFDR concepts, such as the consideration of PAIs more generally, the good governance assessment and sustainable investments themselves.

We consider this is appropriate given SFDR is a disclosure regime and note this approach has been endorsed by the Commission in its recent Q&A responses of 14 April 2023. We do not agree that this discretion afforded to FMPs could lead to greenwashing of sustainable investments in SFDR: It has been made clear by the Commission in its Q&A responses from 2022 that PAIs must in fact be considered as part of the DNSH assessment.

Further, we consider building out a definition of DNSH that works for every asset class, each sector within that asset classs, across all jurisdictions and to cater for each stage of an asset’s life cycle (particularly in private assets) as rather impossible. Trying to standardise, especially benchmarked against public assets, would effectively make Article 9 unusable for private asset funds – especially those delivering impact in real assets, emerging markets and social impact finance.

For these reasons, we consider that maintaining the status quo is the most viable approach at this time, especially given the first PAI statements under the SFDR Delegated Regulation are yet to be published, and while availability of data to report Taxonomy-alignment improves. We do not think the proposed alternatives of providing more specific disclosures and introducing an optional safe harbour for environmental DNSH of Taxonomy-aligned activities is the silver bullet (see our response to question 19). The priority to protect investors should remain transparency rather than trying to enforce standardisation.

<ESMA\_QUESTION\_SFDR\_17>

1. : 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>

We don’t seen an issue with disclosing the quantitative thresholds used by the FMP. However we would like to stress that setting the threshold should be left to the FMP as this is inherently a very subjective exercise which will be subject to change as the availability and quality of the data evolves. In addition, depending on the PAI, quantitative thresholds are not necessarily the best way of conducting the DNSH assessment and a qualitative assessment is more appropriate. As acknowledged by the consultation, FMPs have discretion about the criteria they will apply when conducting the DNSH assessment and such criteria could be quantitative, qualitative or both. This is particularly warranted in view of the importance of active ownership as a qualitative factor. As such, disclosures of quantitative thresholds could require some explanation/putting into context when qualitative or mixed approaches are used.

<ESMA\_QUESTION\_SFDR\_18>

1. : 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 such a safe harbour could make sense, however there is a risk of confusing end investors and of reducing the level of consistency and comparability between products. In addition, as the safe harbour for environmental DNSH would apply only to the part of investee companies’ activities that are aligned with the EU Taxonomy, most products will struggle with 100% taxonomy alignment and therefore will always be using a combination of the two regardless of a safe harbour, adding practical complexity.

<ESMA\_QUESTION\_SFDR\_19>

1. : 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 do not agree that the Taxonomy Technical Screening Criteria should form the basis of DNSH assessments.

Firstly, the Taxonomy and the TSCs have been designed with environmentally sustainable economic activities in mind rather than sustainable investments more broadly, which may include socially sustainable investments, and it is difficult to see how the TSCs could be usefully applied to socially sustainable economic activities in order to conduct the DNSH assessment.

Secondly, the TSC apply at economic activity level whereas the SFDR DNSH test applies at the sustainable investment level – reconciling this, especially in the light of DNSH disclosures which will have been made to date (including in periodic reports and PAI statements) will be difficult.

Thirdly, the taxonomy definition of DNSH is highly specific to certain acitivites and therefore the subsequent restrictions to only assets falling within the definition would make Article 9 redundant for a majority of investment strategies.

<ESMA\_QUESTION\_SFDR\_20>

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

<ESMA\_QUESTION\_SFDR\_21>

We strongly believe that transparency is the best mitigator of greenwashing. Too strong a focus on comparability risks oversimplifying and disconnecting from practical application challenges, particularly on more complex asset classes which don’t have overlapping investible universes with other products.

<ESMA\_QUESTION\_SFDR\_21>

1. : 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>

We would like to stress that for professional investors in unauthorised funds (AIFs) current disclosures have limited usefulness: SFDR is the only piece of regulation impacting AIFs that requires publication of website disclosures (in contravention of marketing rules), specific template disclosure and reporting and translations.

As far as retail investors are concerned, the current form of disclosures doesn’t provide them with meaningful and easy to understand information. Solutions such as the dashboard are therefore a step in the right direction towards enhancing transparency for investors (bearing in mind that the European Commission has recently suggested a similar approach as part of amending the PRIIPs KID, hence coordination and alignment is necessary).

Schroders welcomes increasing transparency regarding our S&I methodology and investment aspirations, but creating one single regime for both public and private assets is fundamentally incompatible, as demonstrated by our comments on PAI and DNSH disclosures.

Any increases in scope, standardisation of metrics or restrictions without acknowledging the different requirements and asset class natures of less liquid assets will make the regime entirely unusable for the private asset classes which will disincentivise investment solutions in this space although they are crucial for the transition of our economies.

<ESMA\_QUESTION\_SFDR\_22>

1. : 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>

We prefer a hyperlink to the benchmark disclosure: This enables a wider understanding of the approach to the benchmark formation and the climate-related criteria that is used. However, additional disclosures by the product should also be required in terms of how the product’s climate mitigation efforts are attached to that benchmark (i.e. in terms of a binding criteria to be below the benchmark’s emissions), such as how often this comparison is checked e.g. monthly, yearly and which metric is used for this comparison. Given it is a benchmark comparison, this could potentially not be based on financed emissions but rather on a weighted average carbon intensity where the attribution to emissions is completely different.

<ESMA\_QUESTION\_SFDR\_23>

1. : 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>

We welcome the distinction between the two product strategies to lower financed emissions given that for many investors they will have a preference in terms of the specific strategy. Generally the type of strategy aimed at lowering emissions will form part of the product and development of investible universes etc. However, these two strategies are not mutually exclusive - many investors may use a mixture of approaches to achieve an emissions reduction. An example being that active ownership may be used in the first instance to attempt to encourage investee companies to lower their emissions but where little action is witnessed, an FMP may take the action to then divest as a last resort. In doing so, an FMP may struggle to only align to one of the two product level strategy options.

<ESMA\_QUESTION\_SFDR\_24>

1. : 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>

Whilst the use of metrics pointing to the degree of Paris-alignment are useful and widely requested there is a wide variety of alignment methodologies for public markets, making comparisons between products for investors more complicated and confusing.

Within private markets there are less available methodologies for temperature alignment compared to public markets. Hence whilst such disclosures could be useful at present for public market investments, they should not be a binding requirement at present for private markets. For example for real estate, alignement with target benchmarks (i.e. CRREM) and an expected intensity pathway over time based on emissions and energy intensities (which are themselves Paris-aligned) is more fitting and would be the expected route of tracking decarbonisation performance.

<ESMA\_QUESTION\_SFDR\_25>

1. : 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>

We generally agree that targets should be calculated on the basis of all investments of the financial product. This enables a standardised calculation for financed emissions/carbon footprint. The only circumstance where this may be more difficult is in the case of multi-asset based solutions where, as an option, it should be allowed to set targets at the asset class level without attempting to aggregate this to total portfolio level given that the asset allocation to specific asset classes may change overtime and in-doing so that % of emissions reduction dynamic of the total portfolio could change.

As regards real estate, it is important to understand the full scale of emissions to be tackled. In absence of actual data, potentially the PCAF hierarchy could be used to identify proxys. Again for real estate, it could be envisaged to require whole building assessments across both LL and tenant controlled assets: Excluding tenant properties may lead to misleading performance results for portfolios and does not encourage the very much needed tenant engagement to add to data availability and transparency.

<ESMA\_QUESTION\_SFDR\_26>

1. : 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>

We believe that PCAF could be a suitable starting point, however it needs to be considered that PCAF doesn’t cover all financing types particularly within private assets. Despite this, we believe that it’s the best standardising framework available in the market. It is important, however, to consider the potential impacts of enforcing the use of a methodology that is yet to cover all asset classes. The benefit of using PCAF is that they are evidently partnering with specific asset class initiatives to garner more support. For instance, with CRREM and GRESB for Real Estate.

<ESMA\_QUESTION\_SFDR\_27>

1. : 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>

We agree that removals and use of carbon credits should be reported seperately and not form part of the binding emissions reduction targets. This approach would align with the updated PCAF (Partnership for Carbon Accounting Financials) guidance that asks for these to be separate emissions reporting lines - a further distinction would be in terms of the carbon credits sold vs used: An FMP may be invested in natural capital projects that generate carbon credits but if these are sold to another party whilst the investment may have generated the removal the right to the carbon credit has been sold to another party to report.

<ESMA\_QUESTION\_SFDR\_28>

1. : 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>

Generally we believe such disclosures will be useful where it is indeed possible to link the efforts at product-level to the wider-commitments and transition planning on entities. However, the difficulty with such disclosures will be that for some FMPs their main strategy is built at the company level as opposed to at a specific entity and so displaying the direct linkage between a single product and an ultimate corporate strategy may be too separated from one another. In any case we consider that SFDR is not the right place to consider such disclosures (and we don’t think such disclosures are covered by the Level 1 text), they seem more appropriately discussed in the context of corporate reporting such as CSRD.

<ESMA\_QUESTION\_SFDR\_29>

1. : 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>

We would like to point out that the recently published Retail Investment Strategy also includes an ESG Dashboard for retail clients as part of the amendments to the PRIIPs KID. While we understand that the PRIIPs KID and SFDR are not entirely aligned on products in scope, we urge the ESAs to coordinate timelines and content of any ESG Dashboard or similar with the Commission’s proposal (and the final outcome thereof). Once again, it doesn’t help clarity and trust of retail investors in this market to be faced with potentially two differing dashboards.

That being said, we support the inclusion of a dashboard at the top of Annexes II-V of the SFDR Delegated Regulation as a summary of the key information for retail investors (and to replace the ‘boxes’ at the beginning of the existing templates) in principle; the current form of disclosures doesn’t provide retail investors with meaningful and easy to understand information. The dashboard is therefore a step in the right direction towards enhancing transparency for investors.

It also provides a good summary on whether the product meets a client’s sustainability preferences. We also support the removal of the graph currently present in the “Asset allocation” section of the templates as this would be superfluous in light of including the dashboard. We have some comments on the dashboards as follows. The dashboard should not be overly complex to complete or reproduce nor should it significantly add to the file size of the Microsoft Word prospectus document. With the existing pre contractual disclosures and the size of the fund range we have reached a level where the word document, required for regulatory filing, is unmanageable.

We would prefer that only a single neutral coloured icon is used for the different boxes in the dashboard, rather than choosing green or grey depending on whether the product in question makes Taxonomy-aligned investments, sustainable investments, or considers PAIs. Inclusion of the grey icons which are shown as ‘struck-through’ could suggest that the product is not sustainable in some way, which we consider could be misleading for investors, especially for products disclosing under Article 9.

In the Annex II and III pre-contractual disclosure templates, we do not think the dashboard disclosures ‘*include the environmental and/or social characteristic(s) promoted by the product and the [X]% of the product's investments that promote those characteristics*’ and ‘*include the product’s sustainable investment objective*’ are necessary given the inclusion of the questions immediately below the dashboard, respectively ‘What are the environmental and/or social characteristics of this product?’ and ‘What is the sustainable investment objective of this product?’. In addition, a 250 character limit with spaces in this section of the dashboard seems unduly restrictive and would seem to undermine the purpose of the question immediately beneath. The same comments apply to the dashboards in the Annex IV and V periodic reporting templates.

We do not consider that it is essential to include PAI consideration and GHG emissions reduction (i.e. decarbonisation targets) in the dashboards. In particular, there are some asset classes where it is not possible to consider the PAIs, so it would not seem fair to require the punitive disclosure of ‘*This product does not consider the most significant negative impacts of its investments on the environment and society*’ in such cases. This addition might also be confusing when considering that the Taxonomy Regulation requires a disclaimer according to Art. 6 and 7; understanding the difference between these disclaimers requires expert knowledge which shouldn’t be expected from retail investors in particular.

<ESMA\_QUESTION\_SFDR\_30>

1. : 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>

We agree there is a real need to simplify the language in the templates to enhance comprehensibility for retail investors. We do not believe retail investors engage with the whole of the pre contractual disclosure template as it is too long and too complex and we question if it should be included in the prospectus given the website disclosures. In January 2023, we provided a note to ESMA detailing the challenges faced upon implementing SFDR regulation (see attached), and in that note advised that prior to SFDR, retail investors only had to understand 2-3 pages of prospectus disclosures mainly related to the respective fund’s general terms. Post SFDR they have to understand 10-11 pages of disclosure. The SFDR template seems disproportionate in volume to the overall fund level disclosure. In our view the templates are more akin to the initial disclosure documentation we would provide to our local regulator as part of a new fund questionnaire rather than a document to be read and digested by a retail audience, in particular due to the technical aspects of sustainability. The website disclosures are currentlyh more in keeping with the type of disclosure with which retail investors can meaningfully engage with.

We welcome the removal of reference to ‘sustainability indicators’ in the questions. There is significant repetition in sufficiently answering the questions in the template on a stand alone basis. Therefore, we also support the removal of any unnecessary repetition in the templates and encourage the ability to cross refer to other sections within the template and prospectus (as further described below).

<ESMA\_QUESTION\_SFDR\_31>

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

<ESMA\_QUESTION\_SFDR\_32>

In addition to our recommendations above, we have set out some further suggestions as follows:

In Annex II, regarding the question ‘*What investment strategy does this product follow?*’, we suggest that this forms the very first question as an important “scene setting”. In this question, we would welcome the inclusion of a cross-reference to the relevant fund details (investment objective and policy) elsewhere in the prospectus and/or it to be clarified that only the product’s sustainable investment strategy should be included. In addition we do not think the question ‘*What is the committed minimum rate of reduction of investments according to the investments strategy?*’ is needed, any such commitment should be included under the question ‘*What commitments are made in the investment strategy regarding the environmental or social characteristics of the product?*’ and this should therefore be included in the guidance notes in red i.e. to include any minimum rate to reduce the scope of investments in the response to this question. ‘*What is the asset allocation planned for this product?’* could then be moved entirely as a sub-question to the second question ‘*What are the environmental and/or social characteristics of this product?*’. Please see our proposed re-ordering of the questions for Annex II below.

In Annexes II and III, we consider the following questions ‘*What is the minimum share of sustainable investments with an environmental objective that do not meet the criteria of the EU Taxonomy?*’, ‘*What is the minimum share of socially sustainable investments?*’ and ‘*What investments are not promoting the product’s environmental or social characteristics, what is their purpose and are there any minimum environmental or social safeguards?*’ / ‘*What investments are not sustainable, what is their purpose and are there any minimum environmental or social safeguards?*’ are not needed in the templates. This is to avoid repetition, as these questions will already be covered under the question ‘*What is the asset allocation planned for this product?*’ (and the guidance notes in red could be updated accordingly to specify this).

For **Annex II** (pre-contractual disclosure template for Article 8 products], we would propose the following order of questions after the dashboard:

* What are the environmental and/or social characteristics of this product?

How do you measure how each of the environmental or social characteristics are met?

What commitments are made in the investment strategy regarding the environmental or social characteristics? *[cross-reference to the investment objective and policy of the fund and include any committed minimum rate to reduce the scope of investments]*

What is the asset allocation planned for this product? *[include the minimum proportion of the investments of the financial product used to meet the environmental or social characteristics, the minimum share of sustainable investments (and where applicable the minimum share of Taxonomy SIs, non-Taxonomy SIs and social SIs) and describe what investments are not promoting the product’s environmental or social characteristics, their purpose and if there are any minimum environmental or social safeguards]*

How does the use of derivatives contribute to the promotion of environmental or social characteristics?

How is it assessed whether the companies which are invested in follow good governance practices, such as tax compliance or employee matters?

* This product makes a minimum of [x]% sustainable investments. What are the objectives of the sustainable investments?

How do they not cause significant harm to any environmental or social objective?

How are the indicators to assess the most significant negative impacts of the investments on the environment and society taken into account?

How are the sustainable investments consistent with the relevant international standards?

* What is the minimum proportion of EU Taxonomy investments?

We would suggest to remove a specific emphasis on nuclear and gas, given that such investments are allowed, under certain circumstances, under the Taxonomy Regulation. In our view, it doesn’t make sense to separate them from others. What is the minimum share of investments in transitional and enabling activities?

* Does this product consider the most significant negative impacts of its investments on the environment and society (principal adverse impacts)?
* [Does this product have a greenhouse gas (GHG) emission reduction target?]
* Is a specific index used as a reference benchmark and how is this index monitored to ensure consistency with the environmental and/or social characteristics of the product?
* Where can I find more product specific information online?

Similarly, for **Annex III** (pre-contractual disclosure template for Article 9 products), we would propose the following order of questions after the dashboard:

* What is the sustainable investment objective of this product?

How do you measure how the sustainable investment objective of this product will be met?

What commitments are made in the investment strategy regarding the product’s sustainable investments? *[cross-reference to the investment objective and policy of the fund]*

What is the asset allocation planned for this product? *[include the minimum proportion of the investments of the financial product used to meet the sustainable investment objective (and where applicable the minimum share of Taxonomy SIs, non-Taxonomy SIs and social SIs) and describe what investments are not sustainable, their purpose and if there are any minimum environmental or social safeguards]*

How do sustainable investments not cause significant harm to any environmental or social sustainable investment objective?

How are the indicators to assess the most significant negative impacts of the investments on the environment and the society taken into account for this assessment?

How are the sustainable investments consistent with relevant international standards?

We would suggest to delete the question “How does the use of derivatives contribute to the sustainable investment objective?” as we consider this may confuse retail investors.

How is it assessed whether the companies which are invested in follow good governance practices, such as tax compliance or employee matters?

* What is the minimum proportion of EU Taxonomy investments?

Does the product invest in fossil gas and/or nuclear energy related activities that comply with the EU Taxonomy? We would suggest to remove a specific emphasis on nuclear and gas, given that such investments are allowed, under certain circumstances, under the Taxonomy Regulation. In our view, it doesn’t make sense to separate them from others

What is the minimum share of investments in transitional and enabling activities?

* Does this product consider the most significant negative impacts of its investments on the environment and the society (principal adverse impacts)?
* [Does this product have a greenhouse gas emission reduction target?]
* Is a specific index used as a reference benchmark and how is the benchmark monitored to ensure consistency with the sustainable investment objective of the product?
* Where can I find more product specific information online?

We have proposed the above amendments to Annex II and Annex III (the pre-contractual templates). We propose similar amendments to align Annex IV and Annex V (the periodic reporting templates), to align these as per Annex II and Annex III.

<ESMA\_QUESTION\_SFDR\_32>

1. : 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>

In our view the investment tree in the asset allocation section is not necessary if the dashboard shows the proportion of sustainable and taxonomy-aligned investments and we would strongly agree with its removal and any further reference in the template to a minimum commitment to environmental and/or social investments for funds making a minimum commitment to sustainable investments.

<ESMA\_QUESTION\_SFDR\_33>

1. : 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>

Formatting should be consistent throughout the template per FMP. Provided the colours are sufficiently differentiated and appropriately labelled the ESAs should not be overly prescriptive regarding shading. However, in the context of machine readable formats (see question 42), the effect of colours becomes obsolete. Particularly for retail investors, the relevant question is not the colouring and shading of the templates, but how we can move to a format such as ESG Dashboards which are more likely to be meaningful to this group of investors.

<ESMA\_QUESTION\_SFDR\_34>

1. : 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>

Yes, we agree with any disclosure requirements which aid investor understanding, reduce complexity and volume of disclosure, are simple to maintain and don’t materially add to the significant volume of disclosure and IT systems functionality already required under SFDR.

<ESMA\_QUESTION\_SFDR\_35>

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

<ESMA\_QUESTION\_SFDR\_36>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_SFDR\_36>

1. : 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>

No, instead we strongly believe that transparency is the best mitigator of greenwashing. Too strong a focus on comparability risks oversimplifying and disconnecting from practical application challenges particularly on more complex asset classes which don’t have overlapping investible universes with other products. A review against SDG principles or equivalent would be a much stronger tool to mitigate greenwashing.

<ESMA\_QUESTION\_SFDR\_37>

1. : 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>

We consider that the calculation of the proportion of sustainable investments of financial products should include all investments of the financial product in the denominator and we would support a rule clarifying this. As far as the numerator is concerned, we believe FMPs should have discretion over the calculation provided, to the degree possible, the elements are clearly disclosed in the template. In the overall context of the calculation, we would like to highlight the particular difficulties for closed-ended funds in ramp up periods and illiquid funds that don’t have frequently calculated NAVs.

<ESMA\_QUESTION\_SFDR\_38>

1. : 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>

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

<ESMA\_QUESTION\_SFDR\_40>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_SFDR\_40>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_SFDR\_41>

1. : 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>

The standard formats for machine-readable data include Comma-separated variables (CSV): The CSV is a standard format representing machine-readable data. The most common database software and systems, such as Microsoft Excel, provide this format. Images such as charts would be challenging to put into machine-readable format.

<ESMA\_QUESTION\_SFDR\_42>

1. : 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>

It’s not possible to provide a reliable estimation of costs but we would urge the ESAs to run a proper cost-benefit analysis of the proposals which are certainly going to be very demanding on resources and will require adequate implementation time. As we outline in our responses, many of the suggestions will not improve clarity or meaningfulness of information shared with investors. Constant “chopping and changing” does not instil confidence in sustainable finance products, particularly considering that with a SFDR Level 1 review ahead of us, requirements are likely to change yet again within a very short time.

<ESMA\_QUESTION\_SFDR\_43>

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. [↑](#footnote-ref-1)