



Consultation paper on the review of the SFDR Delegated Regulation

April 2023

On April 12, 2023, the European Supervisory Authorities (ESAs) published a consultation paper on the proposed amendments to the Delegated Regulation of Regulation (EU) 2019/2088 on disclosure on sustainability (Delegated Regulation). The public consultation will be open until July 4, 2023.

The review of the Delegated Regulation responds to a [mandate of the European Commission](#) (EC) of April 2022 in which it requested (1) a review of the indicators of principal adverse impacts (simplify and further develop the regulatory framework, consider expanding the lists of mandatory indicators as well as opt-in ones, and refine the content of all indicators and their respective definitions, methodologies, metrics, and presentation) and (2) amendments related to the transparency of financial products with regard to disclosures on decarbonization targets as well as the review of product disclosures on investments in activities of the Taxonomy Regulation (EU) 2020/852.

In addition, the ESAs review other issues raised in the consultation paper, including disclosure design options regarding the do not significant harm principle and simplification of the templates.

Modifications to query

1. Extension of the social indicators for principal adverse impacts (PAI)

The EC considers it necessary, on the one hand, to reduce the risk of “false certainty” and possible “safeguards washing” by requiring substantiated evidence that the investments conform to the safeguards and, on the other, that the disclosures based on these indicators are proportionate and feasible for financial market participants (FMPs) and that is what guides these proposed amendments.

To improve and expand the list of social indicators and ensure the availability of information, the first set of drafts of the European Sustainability Reporting Standards (ESRS) have been used as a basis.¹ However, the ESAs also suggest new mandatory and opt-in indicators that are not currently included in the ESRS and seek input from stakeholders.²

Two questions are also pointed out about the PAI indicators related to real estate assets, there is a question about the advisability of including social indicators for these assets, since they currently do not exist, as well as reviewing the definition of the indicator of exposure to energy inefficient real estate assets to adjust it to the criteria of European taxonomy.³

Likewise, the indicators have been revised to adjust them to the ESRS (use the same terminology to refer to the same information) and improve their formulation.

To ensure consistency with other regulations such as the Taxonomy Regulation and Regulation (EU) 2019/2089 on climate benchmarks, it is proposed to change the indicators related to violations (indicator 10) and the Lack of processes and compliance mechanisms to monitor compliance (indicator 11) with the with UN Global Compact principles and OECD Guidelines for Multinational Enterprises. It is proposed to replace the reference to the UN Global Compact principles by the UN 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.

Finally, to improve the practicality of calculating the indicators, comments are requested on whether the definition of “enterprise value” has any impact with respect to the definition of “current value of investment” included in

Annex I of the Delegated Regulation.

2. Technical Review of the PAI Framework

Formulae are included for the calculation of all the indicators (until now they were only provided for some). A series of adjustments are also made to the indicators or their definitions to make them clearer.

Question II.1 of the ESAs' Q&As on the SFDR Delegated Regulation published by the ESAs in November 2022 (ESAs Q&As) noted as good practice to show the proportion of investments for which FMPs rely on direct information from the investee companies, it is now proposed that this be shown in the 'explanation' column relating to PAI indicators.

Comments are requested on the notion of "current value of all investments", which is used as the denominator in the calculation of the PAI indicators. The definition of "all investments", included in point (3) of Annex I of the proposal as stated in Question I.2 of the ESAs Q&As, refers to all investments made by the FMP. This makes it possible to compare the impact per million euros invested for each FMP and makes it easier to carry out the calculations. However, "all investments" could be understood as investments in a type of entity or asset that causes PAI (PAI indicators are divided into three types of investments: 1) in companies, 2) in sovereigns and supranationals and 3) in real estate assets). This category approach would have the advantage that each indicator would focus on the investments for which it is relevant, but it would make comparability more difficult. Illustrative examples of both approaches are provided.

Due to the number of inquiries regarding the consideration or not of the value or supply chains of the investee companies when calculating the PAI, it is proposed to take it into account when investee companies report it in accordance with the ESRS under their own materiality assessment or in other public reporting.⁴

Another issue that has been discussed is the treatment of investments through derivatives for the calculation of PAI indicators. It is proposed to include derivatives with an equivalent long net exposure among the investments that are considered in the numerator of the indicators. The reason is that in those cases the transaction would result in a physical investment in the underlying asset by the counterparty or other intermediary in the transaction, therefore, unless the FMP can demonstrate that this is not the case, it is considered that these investments through derivatives have adverse impacts. The objective is to avoid the circumvention of the disclosure requirements on PAI and its underestimation through the use of derivatives, therefore, as is done to measure the exposure to the underlying assets and their contribution to the risk profile of the investment funds, the derivatives would be converted to equivalent positions in the underlying asset.⁵ In addition, it is clarified that this would not affect the calculation of the denominator since "all investments" include investments through derivatives.

Regarding the consideration of derivatives, in order to avoid greenwashing from a broader perspective, in addition to the need to address the case of calculating PAI indicators where the risk results from excluding them, as previously indicated, we reflect on the treatment for calculating the proportion of investments in accordance with the Taxonomy Regulation or sustainable investments in accordance with article 2.17 of the Disclosure Regulation (SFDR), where the risk results from the inclusion of investments through derivatives in the numerator of the formulas in order to overestimate it.

To address this, it is noted that, according to the Taxonomy Regulation, long net exposures must be netted against net short positions through derivatives to calculate the proportion of investments, but nothing similar has been established for the calculation of the proportion of sustainable investments according to SFDR, so it is asked whether the same criteria should be established. On the other hand, this netting is established only for equity and sovereign exposures but not for other assets such as corporate bonds, so it is questioned whether this issue should be addressed. With respect to net short exposures, the ESAs suggest that, as indicated in Question I.3 of its Q&As that the PAIs of the long and short positions should be netted at the individual counterparty level, but without falling below zero, the same criteria are followed for the proportion of sustainable investments and investments according to taxonomy.

3. Do not significant harm disclosure design options

As established in the disclosure framework, FMPs must describe how they take into account the PAI indicators to demonstrate that the investments respect the do not significant harm (DNSH) principle. There are no common criteria or thresholds to define what results in significant harm and what does not. Therefore, the FMPs are the ones that establish the criteria to assess that the investments do not cause significant harm and this makes it difficult to compare financial products from different FMPs and can also lead to situations of greenwashing. To

increase transparency and improve comparability, more specific reporting requirements on the DNSH based on PAI indicators are being considered.

In addition, the relationship with environmental taxonomy must be taken into account, which does use technical screening criteria to measure the DNSH.⁶ However, it should not be forgotten that this is done at the level of sectors and economic activities, while the sustainable investments of SFDR and the DNSH principle based on PAI refer to the company level (in which different economic activities can be integrated in various sectors). Although these inconsistencies are being discussed, the ESAs consider that they should be addressed by the co-legislators and could send an Opinion to the EC on the matter. The ESAs believe that the taxonomy technical screening criteria should be the basis for the evaluation of DNSH also in the disclosure framework, however, further analysis is needed so it is considered an objective to be achieved in the long term. For all this, the ESAs welcome the “comprehensive assessment” of SFDR announced by the EC in January 2023.

Given the current situation, other improvement alternatives are proposed: 1) Keep the *status quo* while the FMPs become familiar with the information requirements of the Delegated Regulation (applicable from January 2023) and with the use of the taxonomy and the necessary improvements can be analysed. This would avoid further implementation efforts on the industry. 2) Require more detailed information on the websites of the FMPs on the criteria for determining the thresholds that define the DNSH and information in pre-contractual documents and periodic reports on how the PAI indicators are taken into account, as well as referral to the website for more details. This would improve transparency and some comparability, although not completely as each FMP would still set its evaluation criteria and the risk would remain that these would allow investments that could be considered in some way significantly harmful. 3) Safe harbour for optional environmental DNSH. It would be a way of taking advantage of the disclosures provided in accordance with article 3 of the Taxonomy Regulation, so that activities that are considered environmentally sustainable economic activities and have been assessed according to technical screening criteria in relation to the DNSH, can be exempted from the need to evaluate these activities in terms of the DNSH based on environmental PAIs (not the one based on social PAIs). Economic activities that do not comply with Article 3 of the Taxonomy Regulation would continue to be assessed under the PAI-based DNSH. Therefore, for investments in companies with taxonomy compliant and non-compliant activities, this would need to be integrated. Given the complexity of the separate treatment of economic activities within the same investment, this safe harbour is proposed as optional.

4. Modifications related to greenhouse gas (GHG) emission reduction targets

It is important that financial products that have an emissions reduction target provide the necessary information so that investors can understand what those targets are, track their achievement and compare between products. The EC mandate refers to decarbonization *targets*, however, products with emission reduction as their investment *objective*, such as the products of article 9(3) SFDR, must also provide the disclosures proposed. Although, those products that passively replicate a climate transition benchmark or aligned with the Paris agreement, may simply offer a link to the description of the benchmark methodology. It is proposed to provide: (i) in the pre-contractual documents, simplified disclosures a) on the type of outcome the product is committing to achieve, b) on the level of ambition of the target(s), in particular, for the products disclosing under article 9 the alignment of the target with the goal of limiting global warming to 1.5 degrees Celsius, c) on the part of the investments covered by the target and d) it will also explain how the investment strategy will help to meet the targets; (ii) in periodic reports, simplified disclosures on progress to date and explain how the investment strategy contributed to such progress and also identify possible delays in achieving the target(s) and possible adjustments needed; and (iii) the most detailed information on the website, including references to it in pre-contractual documents and periodic disclosures.

The pre-contractual disclosures would also indicate whether the commitment is to reduce emissions through divestment in companies with certain levels of emissions to invest in others with lower levels and/or through investment in companies that are going to reduce their emissions through solid transition plans or as a result of the commitment that the company acquires with its shareholders, among which are the FMPs that would actively engage to pursue this objective.

Although a specific methodology is not required for the establishment of the targets, to achieve a better comparability, understanding and follow-up of those, the ESAs propose that they be converted and disclosed using as a metric the financed GHG emissions expressed in tonnes of CO₂-equivalent per millions of euros of investments and that the same metric is used to express the baseline value, the target and to measure progress. This metric has been chosen since the Delegated Regulation that will complement the CSRD is expected to establish said standards as mandatory for use by financial institutions, as established in the ESRS.

Also, in this line of coherence with the CSRD, it is requested that the targets related to gross GHG emissions, GHG removals, and the use of carbon credits, if any, be reported separately. Plans to purchase carbon credits and their use over time must be disclosed separately. Given the greenwashing concerns surrounding these carbon credits, sufficient information about them and their quality is critical.

It should be noted that, even if the decarbonization target does not cover all the investments of the product and it is indicated which part it covers, the target must be calculated on the basis of all investments, per million euros invested by the product. This makes it easier to compare products.

5. Simplification of templates

Changes to language, design, and structure to reduce length and complexity are proposed and will be tested among consumers. The intention is to simplify the language to improve understanding by retail investors.⁷

For this reason, a dashboard has been created with key information to include at the beginning of the pre-contractual and periodic disclosure templates to draw the reader's attention to the most vital information and alleviate information overload, while providing more detailed information for more sophisticated investors later in template. This dashboard identifies whether the product has a sustainable investment objective or promotes environmental/social characteristics and the "minimum commitments" for (1) investments used to meet environmental/social characteristics or sustainable investment objectives; (2) sustainable investments and (3) taxonomy-compliant investments, presented as a bar chart. Neutral colours are used except for the green colour that is only used for the investments made by the products, in line with the colours used in the rest of the templates.

The other elements that are collected in the dashboard are information on (i) consideration of PAI and (ii) reduction of GHG emissions (simplified information on decarbonization targets that are described in more detail in another section). The icons that identify this information in the rest of the sections of the template are also used in the dashboard using a green and grey colour code for certain indicators (green icon in case the product makes sustainable investments, investments adjusted with the taxonomy or when it considers PAI and grey otherwise).

6. Other technical adjustments

a) Use of colours: to ensure consistency and avoid confusion with the use of certain sensitive colours (shades of green, use of the grey/green code in the icons of the dashboard) it is not allowed to change the colours of the templates.

b) Sending pre-contractual and periodic disclosures electronically: the ESAs propose to allow communications to be displayed as extendable on click, depending on the questions that open each section (those accompanied by an icon). The ESAs will test this proposal with consumers.

c) Definition of equivalent information: Article 17(2)(b) of the Delegated Regulation indicates that when there is no public information available regarding how investments in a company align with the Taxonomy Regulation, equivalent information obtained by the FMP directly from the investee companies or from third-party providers may be used. In an EC Q&A document from May 2022, reference is made to the use of estimates under recital 21 of the Taxonomy Regulation and the ESAs propose to use the word "estimates" instead of "equivalent information" to ensure consistency. Although it is possible that the EC develop some guidelines on the use of estimates in the different pieces of legislation on sustainable finance, the ESAs consider it appropriate to consult on the approach proposed by the Platform of Sustainable Finance (PFS) in its [Platform Usability Report](#) and summarize possible criteria that could be used to make these estimates as the PFS outlines.

d) Calculation of the proportion of sustainable investments of the products: although article 17 of the Delegated Regulation establishes how to calculate the proportion of investments aligned with the taxonomy, there is no provision regarding sustainable investments. It is asked if rules for the calculation that would be based on the aforementioned article 17 of the Delegated Regulation are considered necessary and on what was previously proposed regarding the consideration of derivatives.

e) Financial products with investment options: in the case of products with a large number of underlying investment options, so that investors can easily access information on these options and avoid information overload, the Delegated Regulation provides for the possibility of providing pre-contractual documentation through references to the documents of those products. In the case of periodic information, it was considered that, since the number of options finally chosen was smaller, the documents could be provided instead of referring to them, but requests have been received to adopt the same approach as the number could also be high. In addition, when a

link is provided, it should open the document and not refer to a website for the investor to search for. It is also proposed to include in the Delegated Regulation the clarifications on the content of the information on the website related to these products, which had already been provided through an [ESAs clarification document](#). Finally, there may be investment options that are not stand-alone financial products, such as profit participation funds. In order to avoid greenwashing, it is proposed that templates be provided with information on these investment options, with the exception of financial instruments such as equity and bonds as it would vastly expand the disclosures obligation.

f) Machine readability: In the context of the future Regulation on the Single European Access Point (ESAP) it may be necessary to develop which information should be provided in a machine-readable format and which format should be used and feedback is sought on this.

¹ The [ESRS drafts](#) were published by the European Financial Reporting Advisory Group (EFRAG) in November 2022 as mandated by the Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464 or CSRD).

² Mandatory: 1) Amount of accumulated earnings in non-cooperative tax jurisdictions. It is not required in the ESRS but it is reported by the parent companies where the total consolidated revenue on their balance sheet date for each of the last two consecutive financial years exceeds total of EUR 750M. 2) Exposure to companies involved in the cultivation and production of tobacco. ESRS 2 SBM-1 and in line with the exclusions of the Delegated Regulation on climate benchmarks. 3) Interference in the formation of unions or the election of worker representatives. In the ESRS S1 this is mentioned as an example of a policy that can be disclosed so it is not an obligation. 4) Proportion of employees earning less than the adequate wage. ESRS S1-10. Opt-in (table 3), regarding investee companies: 1) Excessive use of non-guaranteed-hour employees. ESRS S1-6. 2) Excessive use of temporary contract employees. ESRS S1-6. 3) Excessive use of non-employee workers. ESRS S1-6. 4) Insufficient employment of persons with disabilities within the workforce. ESRS S1-12. 5) Lack of grievance/complaints handling mechanism for communities affected by its operations. ESRS S3. 6) Lack of grievance/complaints handling mechanism for communities for its consumers/end users. ESRS S4.

³ Section 7.7 (“Acquisition and ownership of building”) of Annex II of the Commission Delegated Regulation (EU) 2021/2139.

⁴ As an exception, there would be indicators 1-3, 15 and 18 of Table 1 of the current Delegated Regulation, since they require scope 3 greenhouse gas emissions (that is, emissions from the value chain).

⁵ Article 51 of the UCITS Directive and Article 42(2) and 43(5) of Commission Directive 2010/43/EU and Article 8 and Annex II of the Commission Delegated Regulation (EU) No 231/2013.

⁶ This issue is limited to the environmental sphere, since, at this moment there is no social taxonomy, it cannot be extended to the DNSH based on social PAI indicators.

⁷ An attempt has been made to keep the language as simple as possible as the explanations in the boxes to the left of the template only partially address the problem arising from the technical language used in the templates.

Link of interest: [Public consultation on the review of SFDR Delegated Regulation](#)