General information about respondent

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<th>Name of the company / organisation</th>
<th>Institutional Investors Group on Climate Change</th>
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For further information on this consultation, please contact Leo Donnachie.

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?

IIGCC supports proposals to align the definition of PAI indicator 22 more closely with relevant DNSH criteria under the EU Taxonomy’s technical screening criteria for climate mitigation and adaptation. Upholding coherency between the various regulations underpinning the EU’s sustainable finance framework makes it easier to compare disclosures, and helps to reduce reporting costs and burdens for firms. We would also emphasise the need to ensure that the higher levels of ambition established in the recast Energy Performance of Building Directive (EPBD) are integrated into the Taxonomy once finalised.

We remain concerned about the extent to which the Taxonomy criteria can, at present, support greater standardisation of disclosures in practice. For example, EPC ratings and average energy efficiency across national building stock can vary drastically between member states, and for non-EU products and assets, these metrics may not be used at all. In addition, this lack of consistency calls into question whether assets that meet these criteria will always be able to make substantial contributions to the EU’s climate goals.
In the absence of harmonised EPC methodologies and ratings, investors urgently need guidance on how to apply the Energy Efficient Buildings PAI across the different methodologies and ratings being used in different Member States. They also need guidance on how to apply this PAI to countries outside the EEA where EPCs may not be used and where NZEB requirements have not been established.

We would note that at present, PAI indicator 22 focuses only on a snapshot of the operational sustainability of the underlying assets, rather than forward-looking assessments of these assets’ transition. This is in arguably a much broader issue with PAIs as currently structured, but it is an issue that should be addressed in the regulations.

The definition for inefficient real estate assets is not particularly workable at present, and we strongly emphasise the need to avoid disincentivising investments that improve the performance of inefficient real estate assets over time. We would suggest having a single methodology for assessing the energy efficiency of all buildings (both pre- and post-31/12/2020), and would support the following re-definition of “energy inefficient” in this context:

- “as-built” or “design” EPC rating of D or below; and / or
- CRREM pathway stranding before 2035 (Version 2); and/or
- bottom 70% of local building stock.

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?

The interaction between the two definitions can create calculation-related challenges for investors. We suggest that both values should be calculated at the same time for the purposes of PAI calculations, to accurately reflect the percentage of ownership of an enterprise by the investor.

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

Overall, the proposed new calculation formulae provide some welcome clarifications and should help to promote more transparency and comparability across PAI calculations. However, introducing this a year or so after implementation is not ideal as investors have already developed systems and solutions using their own methodologies. There will be costs associated with reviewing and amending these and this will also have an impact on comparability.
With regards to PAI indicator 9 (Hazardous waste and radioactive waste ratio), we would note that although both are calculated in tonnes, they differ significantly in magnitude and impact per tonne (with nuclear waste often being negligible). To facilitate effective assessments for nuclear waste, it may be appropriate to calculate these ratios separately and split this indicator into two separate indicators.

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?

The current lack of a clear definition of “all investments” under SFDR has led to inconsistent approaches to PAI calculations between FMPs and undermines scope to compare products. Where PAIs are calculated on the basis of all investments, the regulatory text should clarify whether the denominator should be AUM or NAV for fund–level calculations. We would also highlight the need for clarification on the calculation of PAI indicators, namely for a) eligible assets and/or assets for which data is available; and (b) for assets where data is not available, where guidance is needed as to whether the value of such assets should be reported as 0, or extrapolated based on the portfolio covered value.

With regards to specific PAI indicators:

- For calculation of Scope 3 GHG emissions under PAI 1 (GHG emissions), we note that estimated models can diverge significantly, leading to heterogeneity in calculation approach between FMPs.
- On PAI indicator 7 (Activities negatively affecting biodiversity-sensitive areas), it is not clear what exactly is meant by ‘located in or near’. Some more quantitative prescriptions as to geographical distance (e.g. kilometres) would make this metric more precise and decision-useful.
- On PAI indicator 6 (Energy consumption intensity per high impact climate sector), we would welcome clarification on the primary NACE code of the company to be used where the company operates across multiple sectors, and to understand how the primary NACE code is expected to be defined.
- For PAI indicator 19 (Sovereign GHG intensity), more clarity is needed on the scope of emissions covered, focusing in particular on territorial emissions, treatment of agencies, treatment of imported emissions, treatment of exported emissions.
Lastly, we reiterate that beyond the EU, there will continue to be significant challenges in collecting this data in a standardised way without introducing equivalence mechanisms to account for how this information might be disclosed under wider reporting regimes using different standards and definitions. For example:

- Several definitions such as “Emissions to water” cross reference to EU directives. Investees located in the EU are already familiar with these definitions and collect data and monitor against these, however, there is a disproportionate amount of effort, work and challenge with collecting data from investments located outside of the EEA and in locations that have their own definitions. These companies comply with their local regulations and collecting data in accordance with this. We ask that the definitions be broadened to give scope to local legislation where investees are outside of the EEA. This would significantly aid in streamlining the data collection process and is the approach that has been taken with the definition of adequate wages, as an example.

- “Emissions to water” is currently defined as “direct emissions of priority substances as defined in Article 2(30) pf Directive 2000/60/EC of the European Parliament and of the Council and direct emissions of nitrates, phosphates, and pesticides. This definition will be used by investees located in the EU however, for those located outside of the EU, it is defined differently. Companies will naturally monitor compliance with their own local laws and regulations. We suggest definitions allow emissions to water to be defined in accordance with local laws as will be done with the definition for adequate wages, as an example.

- “Activities negatively affecting biodiversity-sensitive areas” is also a metric that is jurisdictionally driven and not typically collected and available from investees, especially those outside of the EEA.

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?

IIGCC agrees with this proposal, while noting that it will increase the complexity of the reporting. However, it is worth emphasising that in the absence of widespread and high-quality information reported directly by investees, investors continue to face challenges in sourcing this data without incurring considerable costs. To increase the accuracy and comparability of PAI disclosures, it is essential that the availability and consistency of data reported directly by investees increases (e.g. via the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS) that will underpin it). It will therefore be essential to ensure that the
Commission does not move away from implementing mandatory reporting requirements for indicators relevant to SFDR disclosures. Any failure of the ESRS once implemented into legislation to require corporates to report the information investors need to meet their obligations on PAI reporting risks perpetuating data gaps and reliance on estimations. On this basis, we would note that it would also be helpful to require disclosure of the share of PAI data that is estimated as well.

More broadly, and as highlighted in our responses to Q7 and Q9, while it is helpful the PAIs are derived from the ESRS, there remains a challenge collecting data for firms that invest outside of the EEA and in private markets. These investees may not be subject to requirements to disclose the data points required for the purposes of this disclosure, which creates a barrier to effective data collection. While this is beyond the scope of the consultation, it will be important for definitions to consistently give scope to local legislation where investees are outside of the EEA. This would significantly aid in streamlining the data collection process and promote transparency and the desired outcomes for consumers. It would also help to promote interoperability with wider global reporting regimes.

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?

“All investments” as defined in Annex I point 4) allows for easy comparability between funds because it is only adjusted with the size of the fund. However, this definition could create challenges for funds promoting sustainable characteristics or pursuing sustainable investment objectives. For example, a fund holding a greater proportion of derivatives, cash, holdings for which there is less/no data, or asset classes which are not relevant for calculations, could perform relatively well on most PAIs. In contrast, a fund that invested only in relevant asset classes with the objective of selecting companies that have the capacity to reduce PAIs over time could find itself penalised. In our view, this runs contrary to the spirit of the regulation.

Taking “all investments” as described in Annex I essentially states that non-relevant asset classes, and positions in holdings for which data is not available, have a PAI equal to 0. This might be true for some PAIs (e.g. exposure to controversial weapons) but this will certainly not be the case for others. The formulae for PAIs should therefore be reviewed to address this issue. For instance, and as highlighted above, for PAI indicator 6 (which looks at energy intensity per sector), it does not make sense to use “all investments” as the denominator, which would suggest that all investments that are
not included in those sectors have a PAI of 0. We suggest instead that the denominator should refer to all investments within that specific sector to ensure an accurate weighted intensity.

Furthermore, we would advise to provide clarifications with regards to the approach to be used by FMPs for PAI indicators that have low data coverage. Below a certain level of coverage, disclosing an indicator can create confusion, while not being meaningful and representative (and potentially increase greenwashing risk). The development of additional guidance to assist in-scope firms with setting acceptable performance ranges for each PAI indicators would also be valued. Where the PAIs ask firms to normalise by enterprise value, this could create an incentive to add debt to a company to increase its taxonomy alignment in a portfolio. It is also not helpful to have three different values for equities, so ideally this would be rationalised.

**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?**

The proposals are broadly sensible and should help to enhance the connectivity and coherence between SFDR and the wider EU regulatory framework for sustainable finance, including CSRD (although we reiterate our concern about the move away from mandatory reporting of SFDR-relevant information under the ESRS, as outlined above). However, until this information is reported in a standardised way by a broad scope of companies (e.g. under the European Sustainability Reporting Standards), investors are likely to continue facing challenges in sourcing relevant, decision-useful data directly for the purposes of PAI calculations. We also note that the forthcoming Corporate Sustainability Due Diligence Directive (CSDDD) will require additional reporting by in-scope firms on adverse impacts across their value chain, and it will be important to ensure full consistency between these requirements and those established under SFDR going forward.

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

IIGCC broadly agrees with the intention and rationale for the inclusion of long net exposures in the PAI indicators, where they are used to gain exposures to assets contributing to adverse impacts, rather than for hedging purposes. Long exposures held for risk management purposes should be reported separately from other long exposures, but still incorporated into the overall assessment of PAIs (such as emissions accounting).
However, netting these exposures can be seen as equivalent to treating short exposures as offsetting long exposures. While netting exposures makes sense from a financial risk perspective, when it comes to assessing real-world materiality, some IIGCC members are concerned that including shorts in the PAI indicators could leave investors exposed to greenwashing accusations. There is a degree of scepticism in the market as to the impact of shorts on reducing current emissions.

While excluding shorts leads to the double counting of emissions, IIGCC’s initial conclusions on this topic (set out in a discussion paper published in May 2022) proposed that investors should exclude shorts, due to the perceived lack of impact on real world emissions reductions. Netting exposures could mean that a portfolio with an emissions reduction target based on the net of longs and shorts could be considered as ‘net zero’ without actually contributing to real world emissions reductions in the real economy.

Equally, we have concerns around the proposals to net exposures along the investment value chain. This implies that investors would have sufficient knowledge and understanding of the positions of their counterparties, which in practice is very unlikely. Related to the points made above, such an approach could also reduce the scope for achieving real world emissions reductions.

Overall, we are not convinced that the proposed treatment of derivatives in the PAI indicators would help to avoid the circumvention of PAI reporting by FMPs who employ derivatives to artificially reduce their PAIs. We propose that only gross long exposures are considered. Our discussion paper also sets out a range of alternative metrics that could be used to demonstrate how a financial market participant’s long and short book exposure can contribute to addressing PAIs, such as emissions (see page 26 of the discussion paper attached as an annex to our submission).

**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?**

IIGCC is less supportive of the proposed treatment of derivatives as they apply to the assessment of Taxonomy-aligned and sustainable investments. Where derivatives are used to gain long exposure to assets, they should be treated consistently under SFDR, whether they cause adverse impacts or contribute positively to environmental or social objectives. The proposals as they stand suggest that derivatives can contribute to negative sustainability impacts, but not positive ones.
Irrespective of the concerns around greenwashing raised in the consultation, this would create an unhelpful contradiction within the requirements that should be avoided.

**Do you agree with the ESAs’ assessment of the DNSH framework under SFDR?**

IIGCC recognises that having two distinct frameworks for assessing DNSH can cause confusion and reduce comparability between investment strategies and products. However, we urge the ESAs to consider the potential unintended consequences that could arise if more prescriptive requirements for setting DNSH thresholds are introduced. This is particularly important in the context of supporting investment in transitioning assets which can make substantial contributions to the EU’s climate goals and real-world emissions reductions. In addition, if information relevant to assessing DNSH is not reported on a mandatory basis under the ESRS, procuring relevant, granular data from investees could become even more challenging.

Many of IIGCC’s members seek to invest in transitioning assets with credible plans and approved science-based targets to align with net zero over time. In our view, investment in such companies is essential to facilitate the transition to a low-carbon economy, and will generate the greatest real-world impact on emission reductions. It is therefore critical that these investments are appropriately recognised under SFDR as having the potential to support the EU’s climate goals, provided they develop credible plans to align with net zero, and disclose against these plans on an ongoing basis. Investors should also ensure they hold these companies to account for progress against their transition plans through their stewardship and engagement activities.

It follows that many of these transitioning assets that will have the greatest impact on emissions reductions will operate in sectors which are presently carbon-intensive, and may currently be responsible for high levels of GHG emissions. While it is essential for these emissions to come down over time (including in response to investor stewardship), it could be reasonable to assess such investments as presently causing significant harm. As long as investors are able to exercise full discretion as to the methodologies they use to assess DNSH, they can consider harm currently caused by transitioning assets as within risk tolerance (provided comprehensive plans to reduce emissions are in place) and therefore sustainable for the purposes of SFDR. This appears to have been confirmed in the Commission’s responses to the ESA’s questions on SFDR published in April 2023, which clarifies that transitioning assets could qualify as sustainable provided they are deemed to meet the DNSH test today (rather than in the future).

IIGCC is concerned that a more prescriptive approach with regards to DNSH tests could create a risk that transitioning assets can no longer be held in Article 8 and 9 funds, which in turn could limit
the reorientation of capital flows towards the transition. We appreciate that more fundamental changes to SFDR would be required to introduce amendments to DNSH tests, and that the ESAs have recommended that this is addressed as part of the Commission's forthcoming review of the Level 1 requirements.

Requirements to disclose more granular information as part of the DNSH test could help to improve transparency and comparability between products. And it is incumbent on investors holding transitioning assets that are currently carbon-intensive to clearly explain why these assets are being held in their funds, and to set out the methodologies used to assess the credibility of their transition plans. But to increase the scale and pace of transition finance flows under SFDR, we urge the ESAs to exercise caution around proposing the introduction of narrower/more prescriptive approaches for assessing DNSH compliance.

We also recommend that the forthcoming review of SFDR sets out proposals for how the framework can better evolve to capture transitioning assets, including via greater emphasis on forward-looking metrics such as investee companies’ transition plans and decarbonisation targets.

Lastly, and in relation to interoperability and global competitiveness, if the DNSH regime becomes too onerous to comply with, there is a risk that firms will downgrade funds from Article 8/9 to avoid excessive reporting burdens. It will be important to avoid this outcome, which could also lead to a reorientation of capital to other jurisdictions where it is less costly to comply with the requirements, leaving the EU at a competitive disadvantage to other parts of the world.

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

We consider that this approach may be unhelpful, given that to date investors have had a degree of flexibility to determine whether PAIs are within risk tolerance with reference to both qualitative and quantitative assessments. As noted above, some investments that are essential for the transition (e.g. in carbon intensive sectors) may presently be causing harm but have credible plans in place to reduce this harm and generate real world emissions reductions over time. Our view is that this flexibility to make such investments (provided robust criteria are adhered to) should be retained, otherwise SFDR risks undermining the scope to accelerate transition finance flows. The subset of Taxonomy-related DNSH criteria already provides sufficient, consistent and relevant quantitative thresholds for the assessment of investments that are already aligned to climate and
environmental objectives. The introduction of additional disclosures on quantitative thresholds risks overcomplicating the framework further, and creating potentially duplicative burdens for investors.

We would also note that simply making PAI thresholds more ‘quantitative’ in nature does not necessarily always equate to improving them. Investors should retain a degree of flexibility to make their own assessments of PAI indicators, and in some instances (e.g. for specific indicators products, or asset classes), qualitative tests could be more appropriate. For example, it would be difficult to develop quantitative thresholds for PAI indicators 10 and 11, covering violations of the OECD Guidelines for Multinational Enterprises.

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

We agree that an optional “safe harbour” for Taxonomy-aligned activities makes sense, given that they are investments that are presently aligned with EU climate goals (otherwise known as ‘climate solutions’) and which have already been assessed against DNSH tests with stricter, quantitative thresholds. This would also align with the Commission’s recent clarifications on what constitutes a sustainable investment under SFDR. However, our view is that this issue would be better addressed through amendments to the Level 1 text, rather than the Regulatory Technical Standards. We also note that the use of an optional safe harbour could reduce comparability between products, where some FMPs opt to use it and others continue to rely on the entity-level DNSH approach under SFDR.

**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.**

We note and recognise the need for greater coherency between the concept of sustainable investment (and the tests underpinning it) as defined in the Taxonomy and SFDR respectively. However, for the reasons outlined above in our responses to Q17 and Q19, we believe that the two parallel concepts of sustainability should be retained broadly as they are at this point in time. Basing concepts of sustainability solely on the Taxonomy could hinder investors’ capacity to invest in transitioning assets, given that there are still a wide range of sectors and economic activities that are not captured in the existing framework. To scale and accelerate transition finance, the EU’s regulatory framework for sustainable finance needs to facilitate investment in both transitioning assets with credible plans in place to align with net zero, and climate solutions that are presently sustainable/aligned with the EU’s climate goals (e.g. Taxonomy-aligned activities).
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.

IIGCC supports the introduction of additional narrative explanations as to how GHG emissions reduction targets will be achieved under the proposed disclosures. These disclosures will provide end-investors with more granular, decision-useful information on the nature of the fund’s emissions reduction commitment. The proposed disclosures could also help to improve clarity on the objectives targeted by the product, the methodology used, and progressed achieved, which will help to support comparability of the products.

That said, we believe the framing of the various approaches to achieving emissions reduction targets outlined in paragraph 66 impose unhelpful binary or ‘either/or’ distinctions between portfolio alignment strategies. In IIGCC’s view, a comprehensive investment strategy for achieving emissions reductions could encompass elements of each of the approaches outlined. But to maximise real world impact, we would emphasise the importance of investing in companies that are expected to deliver emissions reductions over time (e.g. via a credible transition plan) plus investor engagement with investee companies (e.g. both strategies outlined in paragraph 66 b). This approach is broadly consistent with that established by the Net Zero Investment Framework (NZIF), which encourages investors to maintain investments in companies that need to transition, and which have a credible plan in place to do so. Investors can then use stewardship and engagement to encourage their investees to progress against these plans, with divestment used only as a last resort (in the case it can be used at all) where escalation has been exhausted or change is otherwise seen as infeasible. In contrast, excluding relatively high-emitting assets from the portfolio could achieve a reduction in financed emissions, but not necessarily lead to a parallel reduction in emissions in the real economy. In our view, this approach is much less desirable from a systemic perspective.

As noted in the consultation, it is essential that disclosures against 2050 targets are complemented by intermediary targets, including robust short- and medium-term targets.

A need for greater nuance in the proposed approaches is also relevant in the context of paragraph 66 a) (e.g. divestment-focused strategies). For example, divestment from whole regions (such as emerging markets), or whole sectors (e.g. oil & gas), is a different approach to tilting within sectors or industries to better performers. Within the current proposals, both of those approaches are
aggregated into one under the umbrella of “divestment” and “reallocation”, but in our view these should be treated separately as they are not generally considered equal in the industry.

IIGCC supports proposals to require investors to use PCAF’s standard when measuring emissions and setting targets. We also welcome the emphasis on maintaining consistency between the proposed disclosures and wider reporting requirements, including under CSRD. We are generally supportive of emissions intensity reporting for the purposes of comparison, but given the sensitivity of these metrics to market and revenue-related fluctuations unrelated to changes in emissions profile, IIGCC encourages disclosure of multiple emissions metrics such as financed emissions (absolute), EEI (financed emissions intensity per EUR invested), and WACI. We believe it is important for investors to tell a narrative around changes in emissions data, and draw attention to the PCAF standard’s data hierarchy and recommendations relating to attribution.

To further improve the proposed disclosures, we emphasise the need for more transparency on the ‘additionality’ generated through investment strategies that pursue emissions reductions as an objective. The current GHG reporting standards fail to incentivise the development of additional renewable energy capacity, which will be essential for reaching net zero. Fostering the energy transition requires investors to develop new renewable energy projects rather than just ‘passing the parcel’ and investing in existing ones. The proposed disclosures should also measure investors’ contribution to the development of additional renewable energy capacity and the deployment of capital in economic activities that support the transition to a low-carbon economy. Just as investors must show they actively generate returns (alpha), we believe there should be questions about ESG value-add as a result of a manager’s investment or ownership of the asset.

In addition, we received the following comments from members on how the proposals could be further improved:

- whilst clarity and transparency are necessary on methodologies used to achieve the objective of emissions reductions, sufficient flexibility should be allowed as strategies with such objectives may differ in terms of asset classes, investment approach and therefore achieve the decarbonisation objective using the available levers in different ways (e.g. engagement vs portfolio allocation).

- Funds which target reduction in GHG emissions, so as to support real-world decarbonisation, should be able to keep a diversified exposure in terms of sectors, rather than having to be allocated only to certain sectors. FMPs may struggle to respond in a satisfactory manner to the specific paragraph dedicated to 1.5°C in the pre-contractual template specific to Article 9 products.
• For Article 9.3 products which track a PAB or CTB, it may be helpful to have pre-contractual disclosure requirements align more closely with those for active Paris-aligned strategies which also have an objective of emissions reductions. Such products being categorised as a sub-category of Article 9, whilst benefiting from an enhanced flexibility in terms of the expectation to invest not only in sustainable investments, will require sufficiently detailed disclosures on the methodology used by the benchmark provider. Providing such details in the pre-contractual disclosures would also help ensure that sufficient controls have been established by the investor when selecting the benchmark to ensure robustness of the benchmark methodology in relation to DNSH and good governance requirements.

• In the pre-contractual annex, it may be worth adding a column in the table in relation with the use of engagement and voting as a way to steer companies in portfolio in their transition journey. To facilitate comparability, this could include questions such as “Use of engagement and / or voting to achieve GHG emissions reduction with dedicated policy in place: Yes / No” with a hyperlink to the corresponding policy. That could also help enhance market practices on such policies.

• In the periodic reporting template, members suggested that a column could be added in the table in relation to shareholder engagement on climate issues conducted during the period under review, and associated outcomes/follow-up actions, given that this is a critical tool that investors can leverage for such strategies.

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.

IIGCC agrees with the proposal to provide hyperlinks to benchmark disclosures for products tracking a PAB or CTB per Article 9(3). In line with the Commission’s April 2023 response to the ESA’s questions on SFDR, where actively-managed funds have a carbon reduction objective under Article 9(3), and do not strictly track a benchmark, they should provide additional disclosures as to how their investment strategy supports emission reduction targets. We would welcome more clarity on the types of disclosure required for different active and passive strategies targeting emissions
reductions under Article 9.3, and more specifically, how disclosure for products with active management can ensure comparability (or equivalency) with the PAB/CTB criteria.

We do not believe that the introduction of additional disclosures for products with GHG emissions reduction targets will create confusion. Under the Level 1 SFDR regulation, it is clear that products with emissions reduction objectives form a discrete sub-category of Article 9 products. It follows that this specific sub-category of products should be required to set out additional information on how these objectives will be met. Article 9 and Article 8 products cover a much wider range of sustainability objectives and characteristics, and more granular reporting for Article 9(3) products specifically should help, not hinder, the distinctions between them.

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.

As noted in our response to Q22, IIGCC is strongly supportive of investment approaches that seek to reduce financed emissions by maintaining investment in assets with credible transition plans in place. This is also the best way to maximise real world impact on emissions reductions. Strategies that rely excessively on divestment may reduce the investor’s exposure to climate-related risks (‘paper decarbonisation’), but they will not reduce the systemic risks posed by climate change unless emissions are actually reduced.

We would also note that a comprehensive investment strategy for decarbonising a portfolio, such as that established by the NZIF, combines investment in companies with robust targets and transition plans and engagement with these companies to encourage emissions (e.g. the final two bullets of recital 66b.). For example, investors using NZIF will seek to invest in companies operating in material/carbon-intensive sectors and assess where they sit on an alignment maturity scale (e.g. the extent to which they have developed a credible transition plan). Investors can then use stewardship and engagement to encourage their portfolio holdings to transition and reduce emissions over a period of time, with a view to increasing the proportion that are aligned to a net zero pathway and ultimately achieving net zero. Selective divestment can be deployed where portfolio companies fail to make progress or have not responded to escalation following
engagement (e.g. where all other options have been exhausted). As noted in our response to Q22, divestment approaches can also differ. Divestment may also occur in the form of tilting towards higher performers from a climate perspective *within* industries or sectors. This could help to send signals to companies that access to capital is contingent, to an extent, on their transition. However, divestment can also occur through exclusion policies, such as excluding whole industries, sectors, or regions (such as emerging markets where emissions are generally likely to remain high or grow in the coming years). These two approaches are different and are likely to yield different outcomes with different levels of impact on real economy emissions and therefore, should not be grouped together under one “divestment and reallocation” categorisation which we currently see in 66b. We would therefore emphasise that product-level commitments to decarbonise may not necessarily fall neatly into prescriptive or binary buckets, and that a blended approach can often be most impactful in supporting decarbonisation targets. We would encourage the ESAs to avoid being too prescriptive in suggesting an ‘either/or’ approach and instead encourage investors to deploy a range of actions and tools to achieve emissions reductions targets.

Furthermore, we request that the ESAs provide more guidance and specificity as to how investors can assess the credibility of transition plans under SFDR, in collaboration with the European Commission. Guidance and recommendations should align with the Commission’s recent communication on transition finance, and how existing tools and policies can support transition plan assessments. We would also encourage the ESAs to consider how existing initiatives that have wide uptake in the market can be incorporated into assessments (including NZIF and the CA100+ Benchmark, TPI, etc).

**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.**

We agree that it is useful, to a degree, for investors to disclose on the extent to which their sustainable investment objectives and/or targets set for their Article 9 funds are Paris-aligned. However, without an accompanying definition and detailed methodology, this will not increase comparability or create a level playing field across products and institutions, and could create confusion as well as potentially incentivising adoption of the the least robust methodologies.
'Paris-alignment' can be interpreted in a variety of ways by different market participants. For example, it could encompass strict adherence to a Paris-aligned Benchmark or Climate Transition Benchmark, or a less ‘aggressive’ initial reduction in emissions relative to an investable universe, where carbon-intensive companies with credible plans to transition continue to be held in the portfolio. Approaches to Paris-alignment could opt to focus solely on quantitative data on emissions and targets, or adopt an approach that incorporates qualitative as well as quantitative indicators and information to determine current and future Paris-alignment. It would be helpful if the ESAs can provide more details on the proposed scenario and methodologies that a product would use, rather than the current phrasing of the questions. It will also be essential to ensure that emissions reductions in the real economy are prioritised, rather than reductions in financed emissions or portfolio emissions achieved through divestment and/or reallocation of capital to low-carbon sectors.

With regards to methodologies, there is little consensus around metrics to assess Paris-aligned decarbonisation pathways (climate value at risk, carbon budget, Implied Temperature Rise (ITR) metrics, etc). Indeed, we would not recommend the use of some of these metrics (such as ITRs) in their present form, given the ongoing challenges of robustly assessing forward looking alignment using such methodologies. Due to this lack of standardisation, we instead would argue that the focus should be on striking a balance between sufficiently detailed disclosures (i.e. commitment over time, intermediary targets, etc.) that allow for comparability without being overly prescriptive.

For example, and in line with the approach established under NZIF, it could be more helpful to ask:

- How the fund contributes to emissions reductions in the real economy through investment in assets with credible transition plans, and how engagement is used to drive progress;
- How the fund plans to increase investments in climate solutions (e.g. Taxonomy-aligned activities) over time.

**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.**

We agree that calculating the target for all investments of the product is important to promote comparability and ensure a level playing field, as well as addressing potential greenwashing risk. Calculating targets for specific asset classes has some benefits, such as allowing investors to distinguish between asset classes with more mature methodologies and better data (corporate instruments; real estate etc) vs those that don't (derivatives, sovereigns etc). Nevertheless, it is important to avoid ‘cherry picking’ approaches, and promoting efforts to increase the usability of
methodologies and availability of data across all asset classes, and the proposed approach should help to encourage that. It may also be more constructive to account for portfolio emissions coverage in relation to target setting, rather than applying these targets to all investments. For example, a target which covers 80% of portfolio emissions, but only 30% of investments by value, may be more impactful than a target covering 60% of investments by value and only 40% emissions. If target based on value of all investments is used, emission coverage should also be disclosed for comparative purposes.

We would also reiterate that if ESRS disclosures on Scope 1, 2 and 3 GHG emissions are subject to a materiality assessment, investors may find it challenging to source sufficient data to set emissions reductions targets across all their investments. In addition, investments that aren’t in scope of CSRD or equivalent disclosure regimes may not be producing data on GHG emissions. It may therefore be necessary to require disclosure on the share of investments for which emissions data has been estimated.

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.

We agree with the proposed approach, which will help to ensure that the information required by investors in scope of SFDR is consistent with the data that companies are reporting under CSRD. As highlighted in previous responses, it will be essential for GHG emissions reporting under CSRD to operate on a mandatory basis, rather than subject to materiality assessments.

We also support proposals to mandate the use of the PCAF Standard, which is the recommended methodology for measuring financed emissions under the NZIF. The calculation methodologies established by PCAF are well defined, and relevant across a range of asset classes.

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.
IIGCC strongly agrees with the approach proposed by the ESAs on this topic. Consistency across the files underpinning the EU’s sustainable finance framework is essential, so alignment between the approaches taken in SFDR and ESRS respectively is to be welcomed.

Consistent with the latest science and as established by SBTi’s mitigation hierarchy, IIGCC firmly believes that companies should focus on emissions reduction primarily as a means of achieving portfolio decarbonisation targets, with carbon credits used for residual emissions only. For this reason, decarbonisation and avoided emissions disclosures should generally be treated separately as noted in the consultation, as also stated in the PCAF standard.

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.

While an increasing number of investors are setting entity-level net zero commitments and developing transition plans, it is not always easy to ensure consistency between these entity-level targets/commitments and fund-level targets. For example, there will be variations in targets set across different asset classes, and different products will pursue different levels of ambition (even if over time the intention is to increase the total percentage of assets under management that are aligned with the goals of the Paris Agreement). Whilst we could see some benefits to this approach (e.g. as a communication tool for asset manager selection by asset owners), we would exercise caution in requiring prescriptive links between entity- and fund-level targets, which wouldn’t capture the many nuances to a comprehensive net zero strategy at entity- and fund-level. Nevertheless, from an asset owner perspective, greater clarity on whether the products they are invested in are in scope of their asset managers’ climate targets is helpful. This information, and related info such as around stewardship activities, is increasingly being demanded by clients at the fund / mandate level.

As indicated in previous responses, the lack of a clear conception of transition plans and transition finance within the current regulatory architecture will also make such an approach challenging. Greater alignment between entity-level transition plans and targets (under CSRD) and transition-focused strategies under SFDR would be helpful in this regard.

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?

We would support the inclusion of a summary/dashboard at the top relevant disclosures to the extent that it can streamline and simplify key information.

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

Given that full SFDR disclosures have only commenced from January 2023, our members are concerned that further proposals to modify the templates will incur additional costs, complexities and operational burdens for investors. It would be preferable to allow some time for the existing requirements to ‘bed in’ before additional modifications are introduced.

Nevertheless, members have indicated that the dashboard is an improvement on the current SFDR templates. The content is easier to understand, with fewer aggregated metrics and simpler sentence/formulations. Our members have highlighted the following points to us:

- The many pictograms are confusing and will be difficult to implement from an operational standpoint. We suggest avoiding changes to the pictograms.
- On disclosures relating to E/S characteristics promoted or the sustainable investment objective of the financial product: in principle, one member has indicated they are comfortable with the proposals, but they do not agree with limiting disclosures to 250 characters. This would be too restrictive to make a comprehensive statement.
- With regards to the new introductory table in precontractual disclosures, which replaces the asset allocation plan table: this suggestion is welcome as the previous asset allocation table created confusion as to how it should be populated.
- It could be useful to have an additional overview table summarising the exclusion policies, stewardship policies, sustainable investment approach applied, any commitment to reduce investment universe, ESG coverage and any indicators relevant for the fund. This would allow investors to understand the sustainability /ESG profile of the fund before delving into the more detailed SFDR disclosure.
- Other remarks on the templates:
  - The table presenting the GHG emission target reduction is too complex to be understood by retail investors and it includes carbon credits, which remain controversial in terms of their ability to generate positive impact.
  - Avoid the mandatory definition of thresholds for assessing DNSH.
  - Avoid disclosure of two separate pie charts for Taxonomy-aligned investments, as this could create confusion and the reliability of the information is questionable as the
treatment of sovereigns could vary over time and by nature active funds have dynamic allocations.
- On disclosures relating to targets with the aim of limiting global warming to 1.5°C: clearer criteria is needed on how to undertake the assessment of alignment with this goal in the RTS.

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

IIGCC is broadly supportive of the potential criteria for estimates, although more specificity should be provided as to what should constitute viable ‘environmental metrics’ beyond those prescribed by the Taxonomy Regulation. IIGCC has been exploring the feasibility of a number of metrics for measuring climate solutions, which have the potential to complement existing Taxonomy-aligned revenue and capex reporting.

This exploration has focussed on metrics emissions intensive sectors, on a sector-by-sector basis, that could be tested against outputs from climate models for alignment. Production capacity or production metrics could provide investors with useful information on the extent to which investees’ spending on climate solutions (i.e. capex) are making substantial contributions to climate goals. For example, investment (capex €) in renewables technology can be measured in both installed production capacity (in GW) and energy production output (in GWh). Both metrics are outputs of climate scenarios produced by the IEA, and absolute values at a given moment in time or growth in either production or production capacity can be compared their climate scenarios.

These metrics, unlike Taxonomy-aligned revenue, are also insulated from price fluctuations which artificially increase or lower values without any bearing on actual emissions reductions. Work is needed to develop consistent, climate aligned outputs in all sectors, but both metrics should be relatively straightforward to implement, given that companies typically report on their production already. IIGCC would be happy to discuss this metric in more detail with the ESAs, and how it could best be incorporated into SFDR, if helpful.

The strength of any environmental metric depends on the strength of the underlying data, which needs to improve significantly in the short term to allow for more accurate tracking of climate solutions. As highlighted elsewhere in our response, until a broader scope of companies are reporting standardised and comparable data on the impacts of climate and sustainability-related factors on their business (and vice versa), it will continue to be costly and time-consuming to source this information directly. Given the challenges investors are already facing in collecting data
on taxonomy-alignment, we anticipate similar difficulties will arise in procuring information on alternative environmental metrics.

Lastly, we are somewhat sceptical about reporting environmental metrics at the investee company (rather than activity) level. Activity-level metrics provides more granularity and transparency regarding an investor’s contribution to financing environmentally sustainable assets and projects, and help to mitigate greenwashing risk.

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?

Yes – see our response to Q36 for more information. We would also be happy to discuss with the ESAs the work we are doing with investors to develop a broader range of credible climate solutions metrics beyond Taxonomy-aligned revenue, capex and opex.

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

Yes, although in line with responses to previous questions, we would caution against a binary approach to the assessment of sustainable investments that hinders investors’ capacity to invest in transitioning assets with credible plans in place to align with net zero over time. FMPs should be able to set their own approach and disclose their approach.

In addition, more clarity is needed on how to report on cash and cash equivalents, and whether these need to be excluded from the calculation of the proportion of sustainable investments of financial products.

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?