

4 July 2023

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By electronic submission

Joint Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures (JC 2023 09) (“Consultation Paper”)

MSCI Inc. (“MSCI”)¹ welcomes the opportunity to comment on the Consultation Paper. We understand the purpose of the Consultation Paper is to inform broader efforts to review the SFDR disclosure framework² and to address some technical issues that have emerged since it was originally agreed. The Consultation Paper provides an opportunity for market participants to highlight challenges in the application of the principal adverse impact (“PAI”) indicators. Below, we set out our main observations on the Consultation Paper and in the attached Annex we offer more detailed comments.

1. Adding social indicators as mandatory / opt-in PAIs is a welcome step and the addition of formulae reduces uncertainty in interpretation.

MSCI supports the incorporation of social indicators from the EU sustainability reporting (ESRS) draft standards,³ which refer to globally recognised and well accepted frameworks such as the UN Guiding Principles on Human and Business Rights and the ILO Declaration on Fundamental Principles and Rights at Work. We encourage the ESAs to closely work with the EU Commission in the finalisation of the ESRS, currently under consultation, to ensure the disclosure framework

¹ MSCI Inc. comprises subsidiaries including MSCI ESG Research (UK) Limited (United Kingdom), MSCI ESG Research LLC (United States), and MSCI Limited (United Kingdom). MSCI indexes are products of MSCI Inc., and MSCI Limited is the benchmark administrator. Products and services in the ESG and Climate segment are provided by MSCI ESG Research (UK) Limited and MSCI ESG Research LLC.

² [COMMISSION DELEGATED REGULATION \(EU\) 2022/1288 of 6 April 2022 supplementing Regulation \(EU\) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’, specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in precontractual documents, on websites and in periodic reports](#) (EU Commission).

³ [EFRAG's First Set of Draft Sustainability Reporting Standards](#) (EFRAG | 2022).

for investee companies closely aligns with the reporting requirements under the SFDR.⁴ An integrated disclosure framework would lead to a common understanding of the PAIs, reduce interpretative uncertainty and enhance data availability. This would facilitate better comparability of investment products for the end investor. The incorporation of all adverse impact indicators, including the proposed extensions, into specific calculation formulae will significantly help with the implementation and further enhance comparability.

2. Aggregation of PAIs for relevant asset classes will ensure a consistent approach.

We support the aggregation of PAIs for the relevant asset class instead of an all-investment approach. Aggregation by asset class would introduce consistency of components in both, numerator and denominator. Whereas an all-investments approach could potentially lead to understating adverse impacts due to the inclusion of non-eligible holdings in the denominator. Additionally, there are no established estimation models for adverse sustainability impacts of certain investment components like cash, derivatives or sovereigns. This could further hinder comparability of PAIs across investment products even for identical portfolios.

3. The suggested approach for derivatives is not workable and will reduce transparency.

As per MSCI ESG research, the most important principle for long-short portfolio ESG reporting is transparency.⁵ For an accurate assessment of ESG risks and opportunities, both regulators and investors need transparent disclosures on the long and the short sides of the portfolio. We therefore recommend that, in addition to any portfolio level aggregation approaches, long-short portfolios report ESG metrics separately for the long and the short legs. This allows the greatest transparency and flexibility for aggregate portfolio reporting under both a double and financial materiality assessment.

4. The Do No Significant Harm (DNSH) approach under EU Taxonomy is not suitable for SFDR purposes.

Applying the EU Taxonomy's DNSH framework to SFDR is not suitable and could be practically challenging. The two frameworks are fundamentally distinct. The Taxonomy DNSH approach comes with specific, detailed, technical, activity-level criteria. Undertakings review those when assessing taxonomy alignment of their activities. It is not suitable for implementation by investors and not easily applicable to global portfolios. We agree with an approach that requires transparency in the way investors take into account PAIs for the purpose of DNSH assessment for sustainable investments and to leave flexibility as to how this is being implemented. As some indicators are not relevant for all sectors, it would be helpful to receive additional guidance on how thresholds could be set to identify significant harm building on the SFDR

⁴ [European sustainability reporting standards – first set](#) (EU Commission | 09 June 2023).

⁵ [ESG Reporting in Long-Short Portfolios](#) (MSCI ESG Research | April 2022) (Investors may wish to separate the ESG and climate disclosures for the long and short portions of their portfolios, to be as transparent as possible.).

adverse impact framework. This would help to address the missing data challenge, while helping to develop best practices and a sufficiently robust approach.

MSCI would like to thank the ESAs for its consideration of our submission. Should you have any questions, please do not hesitate to contact me through ryan.mensing@msci.com.

Yours sincerely,

/s

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Annex - ESAs Joint Consultation on Review of SFDR Delegated Regulation

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

MSCI broadly agrees with the proposed indicators. We also highlight the following observations:

- Adding a mandatory indicator for non-cooperative tax jurisdiction may be seen as overlapping with the reference to tax compliance in the good governance requirement in Article 2(17) of the SFDR, so for the purpose of running a DNSH assessment for sustainable investments, this can be seen as redundant. For other use cases, for example entity-level reporting, it may be adding value.
- Exposure to tobacco is also an exclusion criterion for Paris Aligned Benchmarks and leads to closer regulatory alignment. It is also part of the baseline screen for the MSCI SFDR Article 2(17) Sustainable Investment Methodology, which introduces a screening factor "EU Sustainable Investment" that investors can use for assessing sustainable investments.
- For the two other indicators (trade unions, adequate wage), please refer to our response to Question 2.

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

MSCI acknowledges that the mandatory social indicators are in line with the draft ESRS S1. Collaboration between ESAs and the EU Commission would ensure alignment between investee company disclosures and the disclosure requirements outlined in the SFDR, thereby establishing a cohesive and integrated disclosure framework. The following adjustments may be considered to the proposed mandatory social indicators.

a. Interference in the formation of trade unions

- A strong policy or program may not always prevent controversies. An additional indicator and a corresponding policy commitment could further enhance the disclosure framework. The requirements could also include the extent to which the workforce is covered by trade unions or collective agreements and absence of serious allegations of anti-union practices.
- Providing additional guidance on what constitutes "interference," aligned with the International Labour Organization (ILO) guidance and jurisprudence, would be beneficial in enhancing clarity and ensuring alignment within the framework. For example, a company may not interfere in the creation of unions, but it can organise mandatory sessions for employees explaining the downsides of joining a trade union, which may not necessarily be considered "interference".

b. Share of employees earning less than the adequate wage

- Disclosure of how the investee company calculated adequate wage would facilitate comparability of data and reduce the number of different results.
- The PAI refers to employees only. However, some industries heavily rely on the gig economy, temporary workers and zero-hour contractors, which do not qualify as employees. Therefore, wages of such a category of workforce should also be considered in this disclosure for a holistic disclosure.
- Living wage is an indicator that is defined as a sufficient income to meet basic needs. Disclosures of living wage paid and the calculation to derive the living wage would strengthen the indicator and align with the widely recognised human rights standards and reporting frameworks. Therefore, the standard should be to disclose the share of employees earning living wage instead of adequate wage.

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

It would be useful to have more guidance on determining the threshold for what would constitute an “excessive use” (e.g., absolute level or industry-specific approach).

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

Please refer to our responses to Question 02 and Question 03.

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

Yes, MSCI broadly agrees with the changes proposed to the mandatory and opt-in social indicators in Annex I, Table I and III.

Focusing on the OECD Guidelines for Multinational Enterprises and 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 (ILO), offers more consistency with the other pieces of sustainable finance legislation (i.e., Taxonomy Regulation, Low Carbon Benchmarks Regulation). However, the following aspects require further clarification.

- **Scope of policies and guidelines to be covered in the PAIs** e.g., OECD Guidelines include policies on environmental protection, business ethics, etc. but the SFDR PAI metric seems to imply narrower scope of “social and employee matters” only.
- **Application of principal and additional social indicators to companies’ own operations or full value chain (suppliers).** For example, for PAIs 10 and 11 and additional social Indicator 9 and 10.
- **More guidance on the definition of alignment** with the OECD guidelines, UNGPs and ILO will be welcomed, to avoid differences in interpretation.
- **More guidance on defining minimum requirements** is required in relation to mechanisms of compliance. For example, there may be many different initiatives and policies focusing on OECD, ILO and human rights. It is unclear whether having one policy addressing one aspect be considered adequate evidence of mechanisms or whether having a set of policies and initiatives but only at one location be considered adequate evidence of mechanisms.

Lastly, the ESAs may consider making opt-in indicators related to lack of a human rights policy and due diligence mandatory (Table III- 9 and -10).

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

The PAIs apply both at entity level (Article 4 of SFDR) and at product level (Article 7 of SFDR), and it is relevant for the entity (e.g., at the asset manager level) to disclose social indicators. But for the real estate products that the asset manager offers to investors (e.g., the Real Estate fund of the asset manager) the social indicators are not directly relevant, nor can they be identified. One would have to look at the operational management of the real assets with each fund, and within that activity to see if all social aspects are respected. This approach is not only challenging but is unlikely to be directly relevant to a real estate investor.

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

The existing EPC threshold utilised in the current SFDR PAI is sufficiently robust and provides a reasonable level of consistency, as both approaches employ EPCs as an assessment measure.

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

The aggregation of certain PAIs requires adjusting the current value of investments for each quarter-end with the fiscal year-end EVIC. This process is aimed at limiting a spill-over of share price volatility into the adverse impact measurement but is cumbersome to implement from a market perspective.

Adjusting the current value of investments at each quarter end with fiscal-year end EVIC requires multiple data inputs.

- Share price as of portfolio date
- Fiscal year-end of the investee
- Share price as of fiscal year-end of investee

Also, these data points are not necessarily available for all investee companies and all securities. An additional limitation is that the definition of current value of investment precludes the possibility of measuring and monitoring entity level impact, in real-time, during a reference period year. i.e. It's not possible to measure impact until the reference period fiscal year end has passed for all investee companies.

This requirement was introduced in the clarification by the ESAs provided in November 2022 but referred to as a 'recommendation' by ESMA in the public hearing on the consultation. We would recommend further clarification taking into account the above challenges.

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

The inclusion of formulae will contribute significantly to the advancement of measuring adverse impact. The lack of uniformity in calculating individual PAIs and their aggregation within the market necessitates detailed guidance to foster a shared approach in measuring adverse impact.

Definitions

- **Definition (5) for 'companies active in the fossil fuel sector'** - Definition (5) for PAI 4 now excludes companies from the scope of this indicator if they derive revenue from environmentally sustainable economic activities.⁶ It would be helpful to clarify if that exclusion from PAI 4 is specifically written for the purpose of green bond issuances, where the use of proceeds can be ring-fenced to specific activities. Or if it was meant broader, i.e. to allow for financing companies with (any) fossil fuel ties that also have (any) taxonomy aligned activities.

Also, PAI 4 is now split into two elements, with the addition asking for share of investments in companies active in the coal sector. However, "coal sector" has not been defined, so it remains vague what activities should be included in "coal sector". For

⁶ '[C]ompanies active in the fossil fuel sector' means companies that derive any revenues from exploration, mining, extraction, production, processing, storage, refining or distribution, including transportation, storage and trade, of fossil fuels as defined in Article 2, point (62), of Regulation (EU) 2018/1999 of the European Parliament and of the Council, except for environmentally sustainable economic activities referred to in Section 4.29 to 4.31 of Annexes I and II to Delegated Regulation (EU) 2021/2139.

example, an important element to clarify is if coal sector activities should e.g., include power generation.

- **Definition (15) for 'pay'**: Referencing the EU legal definition when trying to capture PAI 9 (pay gap) from non-European companies could be challenging. ESAs may note that the gender pay gap could be calculated with a different methodology in various markets and as a result the investors may calculate the pay gap at the portfolio level with a limitation of non-availability and inconsistency of data.
- **Definition (23) on 'unadjusted gender pay gap'** - The removal of current definition (23) on '*unadjusted gender pay gap*',⁷ could be challenging because the definition under the Pay Transparency Directive does not explain at what level (e.g., hourly, gross) the average pay gap should be captured, nor does the proposed formula. MSCI therefore proposes to retain the current PAI.
- **Definition (17) for 'adequate wage'** – Please refer to our response to Question 01.

Formulae

- **Formula (6) share of non-renewable energy consumption and production.** Division by consumption of energy or production of energy, is appropriate. However, the PAI 5 description may then need to be corrected to read '*...as share of total energy intensity.*' and not '*over renewable energy*'. For both the production and consumption -specific indicators. Please also refer to our response to Q10.
- **Formula (11)** may potentially capture a large number of companies as 'violation' is not defined by any of the guidelines / principles and the formula's reference to 'at least one violation' could lead to very different applications depending on whether or not 'severity of harm' is being considered.⁸ More guidance with respect to what constitutes a violation as well as for how long a violation should be considered would be helpful.
- **Formula (12) on 'lack of processes to monitor compliance...'** is helpful though the reference to 'at least one' may be misunderstood and should be deleted entirely. As an alternative, we propose the following:
'current value of investments in investee companies with no policies to monitor compliance with or no available grievance and complaints handling mechanisms to address violations of at least one international guideline or principle.'
- **Formula (48) 'Number of days lost to work-related injuries...'** it appears that the structure may be mis-represented. We suspect there is a formatting issue, but the

⁷ '[U]nadjusted gender pay gap' means the difference between average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees.

⁸ Violations of Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises or the UN Guiding Principles, including the principles and rights set out in the eight fundamental conventions identified in the ILO Declaration.

placement of the parenthesis and the factors do not appear to be consistent with the expectation.

- **Inconsistencies in formulae:** Inconsistencies in some of the formulae require to be revisited and addressed. For example, (62) does not include the word 'significant' but only refers 'at risk'. Certain descriptions refer to 'excessive' or 'insufficient' but do not qualify those, hence the formulae only capture the situation of forced or compulsory labour, leaving it to the investor to judge on these terms. In addition, (55) 'excessive temporary contract employees' just captures the share of temporary contract employees in the total workforce of the investee company. A similar scenario can be seen in (54), (56) or (58). In contrast, formula (67) asking for 'cases of insufficient action to address breaches of standards of anti-corruption and anti-bribery' directly picks up this definition in the calculation. This can lead to confusion in the interpretation of adverse impact indicators when disclosed.

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

Please refer to our response to Question 09. In addition, clarifications or technical changes on the below indicators are required:

- **PAI 5 (Share of non-renewable energy consumption and production):** This PAI is commonly understood to identify the share of consumption/production of renewable energy as compared to the total energy consumption/production, which is well captured in the formulae. However, the same is not reflective in the description of PAI 5 in Table I. To align the description of the PAI and the formulae, the following changes are proposed in the description of PAI 5:
 - a) *Share of non-renewable energy consumption of investee companies from non-renewable energy sources compared to total energy consumed ~~renewable energy sources~~*
 - b) *Share of non-renewable energy production of investee companies from non-renewable energy sources compared to total energy produced ~~renewable energy sources~~*

Additionally, weighted average does not appear to be a meaningful approach for this indicator. For example, assume two firms, same size, same capital structure but different levels of energy consumptions. Company A vs. B, with A's energy consumption at 100xB. Assume both have the following PAI 5 ratio – Company A 90%, Company B 10%. The same investment in each firm would lead to average ratio of 50%, however from a footprint perspective it would be 89%.

- Weighted Average Footprint for Non-Renewable Energy Consumption: $0.5 \times (90 + 0.1) = 90.1 \times 0.5$
- Weighted Average Footprint for Total Energy Consumption: $0.5 \times (100 + 1) = 101 \times 0.5$

- Ratio Non-Renewable / Total Energy Consumption and production = 90.1 / 101 ≈ 89%
- **PAI 6 (Energy consumption intensity per high impact climate sector):** The June 2022 ESAs clarification explained that the calculation is restricted to the energy consumption of the entities for their high impact climate sectors only, not the general entity-level energy consumption intensity of that company.⁹ Such a calculation requires energy consumption per each NACE Class, which is not reported at such granular level. Disclosure constraints aside, this approach would also not be meaningful and representative of companies' footprint. Most energy intensive activities are usually not associated with significant revenue or with any revenue at all. For example, a company that generates all of its revenues from sale of aluminum die-cut details (medium energy intensity NACE Class activity) may not reflect the energy intensity of the actual aluminum production (high energy intensity NACE Class activity) as it is not associated with any revenue. In this case, **reflecting the entire scope of energy use for such a company, and use its NACE Sector classification** is more meaningful and reflective of actual energy intensity relative to peers within the same sector.
- **PAI 7 (Activities negatively affecting biodiversity-sensitive areas):** Identification of biodiversity-sensitive areas e.g., Key Biodiversity Areas is not widely available and is currently available from only one provider.
- **PAI 8 (Emissions to water), 9 (Hazardous waste) and 12 (Gender pay gap):** As per MSCI ESG research, very few companies report this data. Only 1% of companies in MSCI All Country World Index Investible Market Index (ACWI IMI Index), which comprises large-, mid- and small-cap securities in developed and emerging markets, containing nearly 10,000 companies, report this information. The proportion of companies that report this information are: 1% report emissions to water, 18% report hazardous waste and 6% report gender pay gap.
- **PAI 10 (Violations of OECD Guidelines for Multinational Enterprises or the UN Guiding Principles including the principles and rights set out in the eight fundamental conventions identified in the ILO Declaration and the International Bill of Human Rights):** More clarity is required on what constitutes violations of global norms, since it is not defined by the OECD/UNGP.
- **PAI 15 (Exposure to controversial weapons):** Military weapons producers often also sell them to their buyers. There is very limited information reported on distribution or transport of controversial weapons.

⁹ To clarify indicator 6 in Table 1 of Annex I (Energy consumption intensity per high impact climate sector), the ESAs consider that the calculation is restricted to the energy consumption of the entities for their high impact climate sectors only, not the general entity-level energy consumption intensity of that company. (Clarification on the ESA's draft RTS under SFDR | 2 June 2022).

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

No comment.

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

SFDR defines PAI indicators for three types of asset classes: corporates, sovereigns and real estate causing the adverse impact. Calculating indicators based on relevant asset classes and ensuring that the denominator and numerator refer to the same type of assets is helpful for a consistent approach. Additionally, incorporating a coverage ratio would offer valuable insights into the share of this asset class within the overall portfolio. An “all investments” approach leads to understatement of adverse impacts due to inclusion of non-eligible holdings in the denominator. For example, if you have a large cash position, this will lower the PAI %. In addition, there are no established estimation models for adverse sustainability impacts of certain investment components like cash, derivatives or sovereigns.

Lastly, paragraph 27 of the Consultation Paper regarding comparability between FMPs relies not only on a comparable asset basis but also on the approaches taken for factors such as estimating missing data (with best efforts and reasonable assumptions) or aggregating across all indicators for the entity-level PAI statement. In practice, these factors can lead to significant variations in results for portfolios consisting of identical constituents.

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

The supply chain information can be a meaningful addition to disclosures as for instance in the case of biodiversity, the largest impacts often occur through the supply chain and not through direct operations. However, certain clarifications on which adverse impact indicators (PAIs and optional indicators) should include supply chain data will be helpful, as not all lend themselves to this extension. The proposed approach appears difficult to implement in practice, as it could lead to a lack of comparability among companies in the same sector. Also, it is unclear how thresholds should be set for DNSH for biodiversity or human rights where typically the most adverse impact arises in the supply chain. For instance, under PAI 11 (lack of processes and compliance mechanisms to monitor compliance), it is unclear whether the company should be treated as failing PAI 11 when due diligence processes / policies do not cover the supply chain. Similarly, for PAI 7 (activities negatively affecting biodiversity sensitive areas), it is unclear whether “sites/operations” includes supply chain.

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

If the aggregation method for PAIs was consistently applied only to assets in scope, greenwashing concerns could be mitigated. If the scope for reporting on PAIs for corporate issuers was extended to include derivatives, it would not be possible to exclude derivatives from the numerator and include them in the denominator.

The approach proposed for netting the short and long exposures lowers transparency for reasons outlined below. Without netting, the risk of negative exposures either on taxonomy aligned investments, sustainable investments or PAIs would not arise. Derivatives may be less intuitively relevant for certain PAIs (e.g., gender pay gap), while indicators like carbon emissions may be seen as indirectly financed and linked to associated negative impact through a short or long position.

MSCI conducted a consultation with owners and managers of long-short portfolios to recommend best practices for fund-level ESG and climate reporting.¹⁰ The results of that consultation suggested:

- Reporting net ESG and climate metrics for long-short portfolios potentially conflates, and may obscure, investors' intent, impact, ownership and risk management.
- For maximum transparency, it is best to keep the ESG and climate disclosures separate for the long and short portions of their portfolios.
- Reporting for ESG transparency is different from reporting for ESG risk exposure. SFDR adverse impact indicators capture 'real world' impacts. This type of risk exposure does not lend itself to netting, as the exposure remains in the portfolio even where netting may reduce the reported position to zero.
- In theory, it is possible to create ESG risk-neutral strategies, but the involvement, impact and emission attributes of such strategies would not be considered as neutral in the real-world sense.
- As an example, while the risk/return of carbon emissions, and their market pricing through carbon taxes or explicit carbon prices, may be susceptible to expression in purely financial terms, this is not the case for real-world physical units of carbon emissions.

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

Please refer to our response to Question 14. MSCI does not support the netting provision of Article 17(1)(g) being applied to sustainable investment calculation.

¹⁰ [ESG Reporting in Long-Short Portfolios](#) (MSCI ESG Research | April 2022) (Investors may wish to separate the ESG and climate disclosures for the long and short portions of their portfolios, to be as transparent as possible.).

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

Please refer to our response to Question 14. There is no clear 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.

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

The responses by the EU Commission to questions raised by the ESAs confirmed that under the current legislative framework FMPs have discretion on the qualification of positive contribution, do no significant harm, or good governance, while also being required to disclose the methodology used for this assessment, e.g., explaining how adverse impacts are taken into account.¹¹

The discretion provided to investors for taking into account PAIs may undermine objectives regarding comparability, transparency and sustainability. Not all PAIs lend themselves to quantitative thresholds, however transparency on the DNSH approach may need to encompass all indicators to avoid a pick-and-choose approach. Requiring absolute thresholds, at this point in time, may either be too high or too low and would need to be regularly adjusted to remain sufficiently stringent over time.

Identifying specific thresholds is reasonable for indicators widely considered as harm and especially those backed by better-established data, such as involvement in controversial weapons or violation of international standards (e.g., OECD). However, going beyond these could become too prescriptive. For example, a gender diversity fund taking into account the mandatory PAI on carbon footprint (PAI 2) and where harm is pre-determined¹² could mean that there may no longer exist Article 9 funds in the EU focused solely on gender diversity, as all such funds will be intertwined with a 30% or 50% carbon reduction (alongside other PAIs). While not in itself negative, depending on how rules are calibrated, such rules could become too prescriptive. This may result in funds that are less representative of the theme in question, less competitive, especially when compared with gender diversity funds domiciled outside the EU, or are subject to secondary debates in terms of the secondary theme achievement (e.g., whether 30% is enough).

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

¹¹ [Question1 of the "Answers to questions on the interpretation of Regulation \(EU\) 2019/2088, submitted by the European Supervisory Authorities on 9 September 2022"](#) (EU Commission | 14 April 2023).

¹² For illustration purposes, these pre-determined criteria are assumed as the highest carbon emitters and further defined, for illustrative purposes, as contributing to hypothetically 30% or 50% of carbon emissions of the portfolio.

It would be prudent to require disclosure of applied principles for considering PAIs by FMPs in the absence of regulatory guidance on DNSH thresholds. The proposal to only disclose quantitative thresholds may have drawbacks insofar as involvement indicators do not lend themselves to such thresholds, yet may be implemented in different ways (e.g., fossil fuel activity exposure). To allow for comparability, we support transparency on the approach taken for each PAI to assess SFDR DNSH.

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

Yes, MSCI supports the introduction of an optional “safe harbour” for environmental DNSH for taxonomy-aligned activities. The EU Taxonomy DNSH tests are more prescriptive as based on technical screening criteria/thresholds and they cover all objectives targeted by the SFDR environmental indicators. Applying additional (entity-level) DNSH on activities that by design adhere to the highest environmental standards is not necessary. However, EU Taxonomy DNSH applies at activity level and the investee company undertaking taxonomy aligned activities may also have activities in the fossil fuel sector, which under SFDR DNSH would require screening out. This could complicate the implementation of a ‘safe harbour’ approach except for its application to use of proceeds instruments, which demonstrates why this should be an optional consideration.

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

The two approaches (DNSH for taxonomy aligned activities and DNSH for SFDR) are fundamentally distinct. While DNSH for SFDR needs to be performed across all PAIs for each sustainable investment, DNSH for taxonomy purposes is required at activity level and with reference to all environmental objectives in scope subject to a multitude of technical screening criteria.¹³ Over 40% of the taxonomy delegated act on Climate DNSH data points to EU legislation, which restricts the use thereof to global portfolios.

In addition, activity-level screens are complex to handle for equity or general-purpose bond portfolios. The DNSH screen for climate change mitigation and adaptation alone contains 800 single data points. Therefore, this may not be a feasible option for portfolio managers to consider.

¹³ COMMISSION DELEGATED REGULATION (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives (4 June 2021).

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

Further clarifications or guidance on the interpretation of some PAIs and treatment of missing data would help reduce the risk of greenwashing.

- **Missing Data:** Clarification is required on how to approach missing data without disincentivizing reporting by companies while pursuing 'reasonable assumptions' according to Article 7.2 of the SFDR RTS. The draft ESRS only requires disclosure on three PAIs (PAI 4 - fossil fuel activity, PAI 13 - board diversity and PAI 15 – controversial weapons), while all others are subject to a materiality assessment. To address the resulting discrepancy in data availability, the ESAs could consider moving mandatory PAIs with very low reported data to the list of optional indicators.¹⁴ Some of the indicators with very low data availability are sector-specific, and are material only for a few sectors, e.g., non-renewable energy consumption or production (PAI 5), emissions to water (PAI 8) and hazardous and radioactive waste (PAI 9). Alternatively, it would help to identify/narrow-down sectors which are particularly impactful for specific PAIs (e.g., PAI 5, 8 and 9 and PAI 7 (Activities negatively impacting biodiversity sensitive areas)).
- **Gender pay gap:** While arguably a material topic for all sectors, it is also facing significant data availability challenges and is not a minimum disclosure under the proposed ESRS. Moreover, the question on what thresholds to apply for assessing DNSH on this indicator is not well researched and therefore subject to individual judgment.
- **Simplification/clarification of aggregation rules:** Formulae will help but market approaches differ due to lack of clarity on how to handle missing data, account for cash or derivatives and netting rules for involvement indicators.
- **Narrowing down of compound indicators,** including PAI 7 (Activities negatively impacting biodiversity sensitive areas), will allow for more comparable approaches across data providers.
- **Specification of certain triggers for significant harm:** More guidance on the triggers for considering "significant harm" will be welcomed. For example, what are harmful levels when considering pay gaps; how to assess violation of global norms; longevity of a violation are some of the aspects which need further clarification to identify "significant harm".

Q22. Do you agree that the proposed disclosures strike the right balance between the need for clear, reliable, decision-useful information for investors and the need to keep requirements feasible and proportional for FMPs? Please explain your answers.

No comment.

¹⁴ [EFRAG's First Set of Draft Sustainability Reporting Standards](#) (EFRAG | 2022).

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

Yes, providing a hyperlink to the benchmark disclosures for products, especially for funds that passively replicate their respective benchmarks would be a prudent approach. This is also consistent with the response to Question 5 of the Q&A published by the ESAs, where EU Low Carbon Benchmarks are vetted as in line with the long-term global warming objectives of the Paris Agreement.¹⁵ However, the disclosures on benchmarks are governed by benchmark regulations that may or may not be in line with the disclosure requirements for financial products as per SFDR standards. In addition, FMPs may opt to disclose specific metrics that provide other or more meaningful evidence of their funds' objectives.

The introduction of GHG emissions reduction target disclosures, as proposed currently, may be more appropriate for funds that are geared towards complying with a specific subset of rules for consideration of Article 9(3), such as metrics in line with the requirements for EU Low Carbon Benchmarks. Even so, the calculation requiring the denominator to be in EUR could indicate unnecessary 'misalignment' given currency discrepancies.

We agree that these disclosures may create confusion, where an Article 8 product with a carbon reduction strategy is expected to disclose the same requirements as an Article 9(3) product, but they may not be aiming to align with the long-term objectives of Paris Agreement and hence appear negatively from one lens. Moreover, using the exact metrics calculation may detract from the fund's actual objective and conflate with the fund's own metric for calculating carbon reduction. Even within the Article 9(3) product classification, the prescription of metrics may complicate the objective of such funds that use a different calculation but have in theory proven to be in line with the Paris Agreement. Unless technical specifications of Article 9(3) characteristics are established, beyond those by the EU Low Carbon Benchmarks Regulation, it may be preferable for disclosure to be less prescriptive in the reporting requirements (especially with regard to metrics calculation).

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

Based on the proposal to provide a narrative description, the distinction would be useful for investors as they speak to the nuances in approach in terms of low carbon transition – whether

¹⁵ [Answers to questions on the interpretation of Regulation \(EU\) 2019/2088, submitted by the European Supervisory Authorities on 9 September 2022](#) (EU Commission | 14 April 2023)

through fund strategy (methodology rules) or through engagement. A descriptive approach would allow for recognition of both approaches as being integral in their respective ways, where an FMP may create in-house policies on a certain portion of investments to engage with, while relying on rules to govern the inclusion/exclusion and/or re-weighting of investments.

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

While ideal to have a metric that determines the degree of alignment to the Paris Agreement, the practical application is challenging, in terms of accuracy and completeness of disclosure at issuer level, in addition to a globally agreed upon framework to measure alignment. In this case, it may be more appropriate to disclose relevant metrics and provide information on the underlying framework/methodology used by an FMP to calculate the associated metric without imposing on specific methodologies at this point in time.

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

No. Please refer to our response to Question 12.

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

Yes, MSCI agrees with the proposed approach to use PCAF as the only standard to ensure comparability and facilitate reporting. PCAF is the leading standard for calculating financed emissions, and while it has its weaknesses, there is no other comparable standard covering asset classes as comprehensively.

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

Yes, MSCI agrees with the suggested approach. Disclosures should be reported separately to provide a maximum of transparency. Removals or use of carbon credits should not be counted as part of a transition plan's GHG reduction target. This is also in line with guidance from the Glasgow Financial Alliance on Net Zero (GFANZ).¹⁶

¹⁶ [Expectations for Real-economy Transition Plans](#) (GFANZ).

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

No, this exercise would be too complex. The product and the entity's targets may be based on different metrics, which could be difficult to achieve full consistency and also to interpret (e.g., implied temperature rise measuring degrees of misalignment with the Paris Agreement's objectives will be at the product level and portfolio-based carbon intensity reduction targets for the entity).

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

As it relates to a potential specific set of rules to govern the calculation of the proportion of sustainable investments, this would be dependent on the use case of such calculation. In the case of the requirement for each underlying asset for qualification of Article 9(1) based on economic activities (here defined as revenues for illustration), calculations such as a weighted average approach would make it impossible for any fund to reach 100% unless an FMP guarantees investment only in companies that derive 100% in revenue, which is very limited.

As an example, if MSCI ESG Research’s Clean Tech data set is used, which measures the revenue of a covered business activity of an entity that is in line with activities that are considered environmentally sustainable economic activities of an entity, only a small number of MSCI ACWI Index constituents would be eligible at varying thresholds.

Table I: Constituents of MSCI ACWI Index meeting the Clean Tech Revenue threshold

Clean Tech Revenue threshold	MSCI ACWI Index ¹⁷				
	Count of Companies	% of ACWI	% of ACWI Lost	Index Weight	Index Weight Lost
> 0%	980	34.00%	66.00%	36.89%	63.11%
≥ 5%	521	18.08%	81.92%	20.00%	80.00%
≥ 25%	181	6.28%	93.72%	4.41%	95.59%
≥ 50%	93	3.23%	96.77%	1.59%	98.41%
= 100%	11	0.38%	99.62%	0.21%	99.79%

In contrast, measuring on the basis of the fund allocation (weights) or number of constituents could help determine the qualification of each asset, based on defined thresholds, and is more practicable, with either one presenting benefit depending on the fund strategy.

MSCI does not agree with the proposed treatment of derivatives and would recommend requiring separate disclosure of the long and net sustainability exposures, rather than netting them. See response to Question 14. Such an approach should apply both to the numerator and the denominator when calculating alignment or share of sustainable investments.

¹⁷ As of the January 2023 snapshot for MSCI ACWI (2,882 constituents), which comprises large- and mid-cap securities in developed and emerging markets.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.