Categorisation of Products under the SFDR: Proposal of the Platform on Sustainable Finance

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Platform Briefing on product categorisation

EU Platform on Sustainable Finance

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1. Executive Summary

The EU Platform on Sustainable Finance (the Platform) strongly supports establishing a categorisation scheme that benefits retail investors and is usable for all investors. **This proposal outlines the categorisation scheme and considerations that the Platform recommends the European Commission implement as part of the SFDR review process.** The proposal takes due consideration of the need for a smooth transition from the existing disclosure regime. The introduction of categorisation should carefully consider the potential impact on the existing offerings, the SFDR implementation efforts, the sustainability preferences and the basis on which investors have invested in such products.

The Platform recommends categorising products with the following sustainability strategies:

- **Sustainable**: Contributions through Taxonomy-aligned Investments or Sustainable Investments with no significant harmful activities, or assets based on a more concise definition consistent with the EU Taxonomy.
- **Transition**: Investments or portfolios supporting the transition to net zero and a sustainable economy, avoiding carbon lock-ins, in line with the European Commission's recommendations on facilitating finance for the transition to a sustainable economy.
- **ESG collection**: Excluding significantly harmful investments/activities, investing in assets with better environmental and/or social criteria or applying various sustainability features.

All other products should be identified as **unclassified products**.

The proposed scheme is rooted in the overarching sustainability objective of financial products linking it to client perspective. These categories allow for a differentiation between products that can largely be considered sustainable through their solutions or practices in line with EU classification where it exists (sustainable); foster the transition to a net zero and an overall sustainable economy by 2050 and milestones in line with these EU goals (transition); or that select or exclude sectors or companies based on ESG performance (ESG collection).

The proposal puts retail investors and their needs at its core. To be effective, it requires aligning sustainability preferences with the categories. Investors and advisors should easily identify the products that match their sustainability preferences, supported by mandatory disclosures that facilitate the alignment. **The categorisation of products should reflect the sustainability strategy employed in constructing each financial product.**

The Platform recommends evaluating whether the scope of the categorisation should go beyond the current SFDR, considering whether all products and services under sustainability preferences in IDD/MiFID should be categorised. Furthermore, the Platform recommends the European Commission to develop a common understanding on impact investing in the EU sustainable finance framework and how it relates to the EU Taxonomy (Taxonomy) and, subsequently, determine how to integrate it in the categorisation scheme.

This categorisation scheme should be grounded in the sustainability strategy of the financial product and align with an investor's values or impact objectives. Investors' sustainability values should be identified through their preferences, enabling a clear match with available products. Pre-contractual product disclosures will assist in identifying suitable options, while regular reporting should keep investors informed about the sustainability performance of their chosen products. All types of products and services relevant for IDD/MiFID sustainability preferences should be able to be classified within the scheme. Furthermore, investment options that today do not fall under SFDR[1] should be able to demonstrate that they fulfil the category criteria and are then classified accordingly.

[1] See also JC 2023 55 - Final Report SFDR Delegated Regulation amending RTS (europa.eu), p. 19.

The proposed categorisation scheme leverages the positive elements of SFDR and the broader Sustainable Finance Framework. Categories have precise minimum criteria, clearly defined objectives, and measurable KPIs. Products within these categories should measure and disclose their sustainability performance.

The categorisation scheme proposed addresses SFDR disclosure issues such as the challenges related to inappropriate use of SFDR disclosure requirements. It aims at mitigating fragmentation due to varying national labelling regimes and different interpretations by National Competent Authorities (NCAs), auditors, and lawyers. **The scheme should facilitate investment flows and sustainable economic growth by preventing fragmentation, which affects the passporting regime for investment products.**

This proposal remains high-level, but it should serve as a basis from which to build a complete and detailed categorisation scheme. The proposal requires further development to define or refine thresholds based on real-world testing. Achieving market acceptance and trust involves balancing concerns from investors, market participants, regulators, and civil society.

2. Background

In response to the European Commission´s mandate, the Platform has been working on enhancing the effectiveness of the SFDR as well as seeking high levels of consistency with the rest of the Sustainable Finance Framework. During its mandate, the Platform published two briefs on SFDR - Response of the Platform on Sustainable Finance to the Commission's targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR) ("**SFDR Level 1 Brief**") and Platform briefing on Sustainable Finance Disclosure Regulation (SFDR) and summary of the Platform's response to the joint ESAs consultation on SFDR Delegated Regulation ("**SFDR RTS Brief**").

In the SFDR Level 1 Brief, the Platform advocated for the introduction of a common categorisation scheme to address the existing fragmentation and confusion in the EU market. The Platform suggested that it:

- should be structured in such a way to be easily understood by retail investors and used to address sustainability preferences.
- should avoid the impression that one product's objective (e.g. "transition") is ranked better than another's (e.g. "sustainable") or vice versa. This should not hinder applying different transparency requirements depending on the category.
- should only be based on a thorough analysis of the intended use, how to ensure clarity of categorisation, proper evaluation of the impact of such categorisation as well as an analysis whether it should be mandatory or optional. In addition, it should be analysed whether the categorisation should be based on committed elements or actual elements of a product.

Following a consensus for the establishment of a categorisation scheme, the Platform has developed a high-level proposal which represents a first major step forward.

Developing categorisation is a lengthy process requiring market impact assessment, stakeholder feedback, and testing to ensure desired outcomes. The proposal's elements are indicative and need refinement. Any approach needs to be tested for retail and other investor usability. Testing involves understanding consumer perception, addressing sustainability preferences, analysing impact on asset allocation and determining necessary disclosures. It also includes evaluating data availability, potential thresholds for data coverage, impact on existing products, and possibly tightening minimum criteria over time.

This briefing contains ideas and suggestions intended to stimulate discussions and actively contribute to the process of developing a categorisation scheme.

3. Proposal for categorisation

Key messages:

- The proposal outlines mandatory minimum criteria with an underlying selection of binding elements that could meet these criteria, along with potential indicators. Financial Market Participants (FMPs) should identify the binding elements relevant to their products, determine their specific details, and select the indicators they will use for measurement.
- Financial products pursuing a strategy with focus on social aspects are generally able to fit into any of the categories.
- While the EU Sustainable Finance Framework and Sustainable Finance initiatives address human and labour rights as well as governance, they have yet to fully define specific social objectives and activities. Further efforts are needed to identify clear social objectives and indicators. This work should involve analysing social elements within existing frameworks, such as Principal Adverse Impacts (PAIs) indicators and European Sustainability Reporting Standards (ESRS).
- Before setting specific thresholds for the categories, the Platform recommends conducting further analysis on the potential impact of thresholds for all SFDR products. Additional next steps should comprise identification of sources, collection and analysis of data for SFDR products other than liquid funds, in particular insurance and pension products, as well as private market funds, analysis of the different potential thresholds and identification of approaches to address different asset classes, investment strategies, and types of products.

The Platform proposes the establishment of a product categorisation scheme within the Sustainable Finance Regulation (e.g. SFDR) comprising three distinct categories of products, while naming all products not falling into a distinct category "unclassified". Each category should have defined minimum criteria that all categorised products must meet, including that a pre-defined number of investments fulfil the core sustainability objective. Guidance on how to identify these and other thresholds and supporting data is included in Annex A. Financial market participants (FMPs) can select from a pre-defined list one or more binding elements. Performance indicators, pre-contractual, and reporting disclosures complete the proposal.

The Platform stresses that the thresholds are to be determined based on feasibility and ambition. Products within the sustainable category should probably benefit from a much lower percentage in the beginning, subject to review, as they focus on Taxonomy-aligned investments for activities included in the Taxonomy.[2] The suggested criteria and other elements should be thoroughly tested before adopting the categorisation scheme.

Working title[3]	Sustainable[4]	Transition	ESG collection
Minimum Criteria	• X% of the investment[5] weighted assets contribute	• X% of the assets and/or the portfolio are transitioning[10],	• X% of the assets follow one or a combination of one or

[2] See details on the evolution of Sustainable Investments in 4.3.1.

[3] The names of the categories should clearly identify the underlying approach. In particular for ESG collection, it needs to be clear that it comprises be very different strategies with very different ambition levels.

[4] The amount should be lower in the beginning and adjusted over time. Feasibility of threshold needs to be tested. More details are included in section 4.3.1.

[5] This includes Taxonomy alignment based on revenues and CapEx. Additionally, the Platform believes that a voluntary Taxonomy-aligned OpEx metric could be useful for guiding investment decisions in venture capital funds, particularly those investing in early-stage companies that lack revenues or formal CapEx. Such reporting would be voluntary and could build on or leverage the Platform's proposal for *a streamlined approach* for unlisted SMEs to the Taxonomy.

[10] According to the European Commission Recommendation (EU) 2023/1425 of 27 June 2023, transition finance means financing investments that are compatible with and contributing to the transition while avoiding lock-in, including:
(a) investments in portfolios tracking CTB and PABs ('EU climate benchmarks');

Working title[3]	Sustainable[4]	Transition	ESG collection
	positively through Taxonomy-aligned or environmental and/or social Sustainable Investments (amended definition[6]). Any other assets must not undermine the sustainability objective. The FMP has to determine committed Taxonomy alignment / SI for the product. • All non-Taxonomy investments pass the Sustainable Investment (SI) Do No Significant Harm (DNSH) test defined through PAI thresholds[7], except for hedging and liquidity instruments. The FMP has to prioritise PAIs for the DNSH test according to relevance for sustainability features. • Minimum Exclusions[8] building on EU Paris Aligned	measured with credible transition pathways or plans on portfolio and/or investment level. The FMP has to identify relevant criteria through any or a combination of: - Reduction on portfolio level at least in line with regulatory standards (e.g., for decarbonisation according to Benchmark Regulation)[11], - investments in portfolios tracking Climate Transition Benchmarks (CTBs) and Paris-Aligned Benchmarks (PABs) also known as "**EU Climate BMs**"; [12], - Committed Taxonomy-aligned CapEx or transitional activities (revenues or CapEx),	more material sustainability feature. Materiality to be defined through effectively either one criterion or a combination of any of the following with a focus on environmental, social and/or Governance:[20] - X%[21] better than the reference benchmark or investable universe or year-on-year improvement on specified indicators, - Effective reduction of investment universe of at least (e.g. 20%[22]), - Target vehicles that are sustainable, transition or ESG collection, - investments in companies without transition plan, provided credible engagement strategy with

(b) investments in Taxonomy-aligned economic activities, including: (i) transitional economic activities for the climate mitigation objective, and (ii) investments geared to make economic activities becoming Taxonomy-aligned over a period of maximum 5 years (exceptionally 10);
(c) investments in undertakings or economic activities with a credible transition plan at the level of the undertaking or at activity level;
(d) investments in undertakings or economic activities with credible science-based targets, where proportionate, that are supported by information ensuring integrity, transparency and accountability.
At the moment this category focuses on climate. More work needs to be done to define requirements for other environmental objectives than climate. ESRS can serve as a basis. In order to include social in this category, even more work would need to be done. The topic could be tackled within the next Platform mandate.

[6] See section 4.3.1. p. 17 et seq.

[7] See section 4.3.1. p. 17 et seq.

[8] Any exclusion for any of the categories should be defined consistent with CSRD ESRS disclosure to enable FMPs relying on companies' disclosure for exclusions.

[11] Target setting could be set over a longer period of time (e.g. five years) but progress should be reported annually.

[12] Once the ESAs RTS or the guidelines included in the RTS regarding funds with a decarbonisation objective enter into force, financial products with a decarbonization objective should be included. Equally, Investing for Transition Benchmarks and individual environmental objectives benchmarks in line with the Platform´s recommendations.

[20] Any of the following thresholds are subject to testing and could be adjusted over time as appropriate.

[21] Exact number depends on Benchmark and investable universe, i.e. specific percentage might not be determined by the regulation.

[22] This figure is derived from AMF Position - Recommendation DOC-2020-03 Information to be provided by collective investment schemes incorporating non-financial approaches (amf-france.org) requiring a minimum 20% reduction in the investment universe.

Working title[3]	Sustainable[4]	Transition	ESG collection
	Benchmarks ("**PABs**") though adjusted.[9] • FMP may determine additional binding elements, e.g. Engagement.	- Investments with credible transition plan[13] or science-based targets.[14] - Up to X% (e.g., 20) investments in companies without transition plan, provided credible engagement strategy with escalation mechanism and ultimately divestment.[15] - Transitioning real estate and infrastructure based on a credible plan at portfolio level to render the assets environmentally sustainable.[16] - Sovereign debt based on Nationally-Determined Contributions (NDCs), climate mitigation, adaptation, just transition and other environmental	escalation mechanism and ultimately divestment,[23] - All investments eligible for the transition and the sustainable category. • Any other assets must not undermine the ESG characteristics/features. • Minimum Exclusions building on **CTBs** though adjusted.[24] • FMP may determine additional binding elements.

[9] Exclusions to be adjusted in line with the amendments proposed by the Platform recommendations the Benchmark Regulation, as follows: (1) Excluding companies that violate UNGP instead of UNGC, (2) not applying to issuers of use-of-proceeds bonds financing sustainable projects provided issuers have a CapEx plan in line with EU GBS and of (3) excluding companies that (i) derive 1% or more of their revenues from and invest in first-time production, expansion or exploration of fossil fuels, i.e. ≥ 1% CapEx from coal exploration or processing activities, (ii) derive 10% or more of their revenues from and invest ≥ 10% or more of CapEx from oil exploration or processing activities, or (iii) derive 50% or more of their revenues from and invest ≥ 50% or more of CapEx from gas exploration or processing activities except where activity is Taxonomy-aligned.

Corporate CapEx activity disclosures is still lacking, where no CapEx data is available, however forthcoming advice by the Platform on use of estimates would help to fill this gap. If neither data nor estimations are available, the Precautionary Principle suggests that issuers should be excluded if they fail the revenue threshold or if there are investing in new fossil fuel-related infrastructure. When CapEx data is unavailable or cannot be estimated, and revenues are used as a proxy, the revenue threshold could be higher. The key factor is that there should be no indications of investments in new fossil fuel-related infrastructure, and revenues from such activities should decline over time.

[13] On climate mitigation, the CSDDD specifies that a transition plan should include (in line with CSRD): (1) Science-based, time-bound GHG emissions reduction targets from 2030, in five-year steps up to 2050, covering emission scopes 1-3, (2) Key decarbonisation levers and actions to achieve these targets, (3) Investments and funding supporting the plan, (4) Governance of the plan.

[14] Companies with a Taxonomy target as part of their transition plan could be included.

[15] Details on "credible engagement strategy" and escalation mechanism to be defined (note that the Platform is working on recommendations in this respect). Part or all of the 20% could also be by the remainder of the product which does not need to be following a transition strategy. While engagement is usually considered being only relevant for equity investments, fixed income investors are not excluded from engaging and could use this element, where they proved for a credible engagement strategy absent voting rights.

[16] Details on "credible plan" to be determined. With respect to decarbonisation, e.g. based on ETC`s guidance.

[23] See Footnote15.

[24] See footnote 9.

Working title[3]	Sustainable[4]	Transition	ESG collection
		objectives and performance,[17] - Social Transition once objectives are developed and recognised[18] - Investments eligible for the sustainable category. • Any other assets must not undermine the transition objective. • Minimum Exclusions building on EU Climate Transition Benchmarks ("**CTBs**") though adjusted.[19] • FMP may determine additional binding elements.	
Indicators to measure	• Taxonomy alignment and SI share. • PAI performance. • Adherence to determined exclusions. • Indicators to measure additional binding elements, where determined by FMP.	• Indicators to measure credible transition pathways or plans on portfolio and/or investment level. Indicators depend on binding elements and could comprise: - Tracking CSRD ESRS transition plan or equivalent for holdings in line with Platform´s recommendations. - Taxonomy share (split CapEx, Revenue). - Measurement against EU Climate BMs. - Science-based targets in line with Platform´s recommendations. - Engagement activities[25] and indicator measuring changes in issuers relating to the engagement topics - For investments eligible for the sustainable category, respective indicators. • Indicators to measure additional binding elements, where determined by FMP.	• Indicators to measure the determined Materiality, i.e., depending on binding elements. Indicators could comprise: - Performance against Benchmark or investable universe on specified indicators, or year on year reduction, - Effective reduction of investment universe, - Identifying target vehicles that are sustainable, transition or ESG collection, - Identifying use-of-proceeds bonds financing sustainable project, - Engagement activities[26] and indicator measuring changes in issuers relating to the engagement topics, - For investments eligible for the sustainable or transition category, respective indicators.

[17] The market e.g. through initiatives has developed methodologies which are used by FMPs to examine the transition for sovereign debt. The Platform considers that an analysis of the used framework and their effectiveness should be done which could serve as a basis for a recommendation to assess sovereign debts for the product categorisation.
[18] Elements could be built on ESRS.
[19] See footnote 9.
[25] Details to be determined.
[26] Details to be determined.

Working title[3]	Sustainable[4]	Transition	ESG collection
			• Indicators to measure additional binding elements, where determined by FMP.
Pre-contractual disclosure	• Minimum criteria including binding elements • Indicators to measure	• Minimum criteria including binding elements. • Indicators to measure.	• Minimum criteria[27] including binding elements. • Indicators to measure
Reporting	Reporting of the following (please note that some information is mandatory and other only when the FMP is or has committed to it). Performance of: • Taxonomy alignment share, revenue / CapEx, • SI share, revenue / CapEx,[28] in case of commitment (including social as developed in accordance with the Platform´s proposal) • Confirmation adherence to PAB exclusion,[29] • All mandatory PAIs and relevant voluntary PAIs, • Additional indicators if FMP considers helpful, • Voting coverage, engagement activities, use of escalation, where relevant.[30]	Reporting of the following (please note that some information is mandatory and other only when the FMP is or has committed to it). Performance of • mandatory and selected environmental and social indicators • Annual GHG emissions reductions against (portfolio or company) science-based targets or on transition plans. • Taxonomy alignment share, revenue / CapEx. • Confirmation adherence to CTB exclusion. • Where product sets decarbonisation objectives, measurement against an EU Climate BM. • All environmental mandatory PAIs for products with environmental features, all social mandatory PAI for products with social features, all mandatory PAI for products covering both	Reporting of the following (please note that some information is mandatory and other only when the FMP is or has committed to it). Performance of • mandatory and selected environmental and social indicators, • Taxonomy alignment share, revenue / CapEx, • All environmental mandatory PAIs for products with environmental features, all social mandatory PAI for products with social features, all mandatory PAI for products covering both environmental and social elements, • Taxonomy alignment (Revenue) PAI GHG emissions (1), carbon footprint (2) and UNGPs[32] (11), • Confirmation adherence to minimum exclusion criteria, • Additional indicators if FMP considers helpful Voting coverage, engagement

[27] To be tested whether this category requires an additional disclaimer in terms of ambition level.
[28] Please note that the Platform recommends the European Commission to eliminate the requirement for FMPs to calculate Taxonomy alignment of their portfolios using OpEx, given that the information will not be readily available and add little value to end-investors (Platform Recommendations on Data and Usability, October 2022). However, the Platform believes that a Taxonomy-aligned OpEx metric could be useful for guiding investment decisions in venture capital funds, particularly those investing in early-stage companies that lack revenues or formal CapEx. Such reporting would be voluntary and could build on or leverage the Platform's proposal for a *streamlined approach* to the Taxonomy for unlisted SMEs.
[29] Exclusions are to be monitored throughout the year (e.g. in a liquid fund as part of the guideline monitoring) and confirmation can be based on such monitoring. The Platform recognises that there might be different interpretation of the exclusion criteria by data providers, however, if the FMP has followed due process in onboarding data provider (e.g. due diligence), it can rely on the data provided.
[30] Relevance depends on whether this is part of the strategy or is compatible with the respective asset class. For instance, it would not be relevant for fixed income investments.
[32] Platform recommends changing this together with the PAIs to UNGP in line with the minimum safeguards of the Taxonomy, CSRD ESRS and the CSDDD.

Working title[3]	Sustainable[4]	Transition	ESG collection
		environmental and social elements. • Additional indicators if FMP considers helpful: Voting coverage, engagement activities, use of escalation, where relevant.[31]	activities, use of escalation, where relevant.[33]

All products that are not categorised by FMPs in any of the aforementioned categories are to be considered "unclassified". This includes products that do not fulfil the categories criteria or have not been categorised (e.g., by choice of the FMP including where requested by the product's investor). For those, neither minimum criteria / binding elements, nor indicators are pre-defined. Where they have sustainability features and the FMP chooses or is required to disclose these, the FMP should describe such features in the pre-contractual disclosure which is clearly distinguishable from the disclosures of the categorised products.

Unclassified products should be required to report on the following:

- Taxonomy alignment (Revenue and CapEx).
- PAI GHG emissions (1), carbon footprint (2), GHG intensity of investee companies (3) and UNGPs or OECD MNEs[34] (10).

FMPs might voluntarily decide to report against any additional indicators they might consider useful in a section clearly separated from the mandatory reporting.

Lastly, multi-option products ("**MOPs**") might remain unclassified due to the variety of underlyings which often can be determined by the client at the point of sale. MOPs therefore can vary significantly depending on the client's selection. With respect for the categories, a client interested in a particular life unit-linked insurance product offered by an insurer could choose underlying fund options that align with specific categories, which makes it more difficult to categorise them as sustainable, transition or ESG collection beforehand. The Platform hence sees merit in allowing FMPs to also categorise a MOP at the point of sale (see section 4.3.4).

4. The categories

Key points in the section:

- The Platform favours a categorisation scheme based on the overall objective of the sustainability features.
- Proposed categories allow for differentiating between products that can largely be considered sustainable through their solutions or practices (sustainable); foster the transition to a net zero and sustainable economy by 2050 (transition); or that select or exclude sectors or companies based on ESG performance (ESG collection).
- The proposed category scheme should be consistent with investors objective of value-alignment and/or impact.
- The Platform sees value in defining impact investing at EU level and in identifying products providing impact investments to address investor's objective to directly link the investment to real-world change.

[31] See Footnote 30.
[33] See Footnote 30.
[34] See Footnote 32

- The categorisation scheme was drafted based on sustainability features or strategies that align most closely with the investor's perspective.[35] The resulting categorisation could be refined with a bottom-up analysis of a set of indicators that could inform the different categories. While the Platform aims at starting to conduct such analysis, it believes that it might be premature and further analysis might be needed, given the expected rapid evolution of data availability as a result of the implementation of various disclosure regulations in and beyond the EU.

4.1. Investor perspective

Investor perspectives on sustainability are the foundation for developing the categorisation system. Broadly, investors may either be uninterested in sustainability or, conversely, seek to align their investments with their values. Some may even aim to drive change through their investments.

More specifically, the distinction can be identified along the following investor's objectives:

- **Invest Sustainable:** Investing in products that direct investments towards assets, activities, or economic actors that are already sustainable. These products do not invest in any significantly harmful asset or activity.
- **Invest in transition:** Investing in products that primarily or exclusively invest in assets, activities, or economic actors becoming more sustainable (invest in **transition**). These products support economic actors transforming or upgrading their activities or assets, such as companies with significant Taxonomy CapEx alignment.
- **Invest in ESG:** These products avoid significantly harmful investments (e.g., through exclusions) and/or invest in assets with better environmental, social, and/or governance (ESG) performance within their sector (e.g., best in class). They may also include or even focus on activities or assets that are already environmentally or socially sustainable, provided they offer sufficient safeguards.

While the latter tends to mitigate risks to financial performance caused by environmental, social or governance factors, depending on the criteria used, the former two aim are relevant for investors who seek to invest environment- or socially friendly or in creating change. For investors that are not interested in sustainability, all categorised products can be offered to these investors, provided they address their general investment and financial objectives and needs.[36] The table below provides a snapshot on how the different categories might respond to investors´ perspectives.

Working title to differentiate	Sustainable	Transition	ESG collection	Unclassified products
High level description	invest in sustainable activities or assets	invest in transition	avoid harmful / invest in and/or manage towards better performing	not categorised or not qualified for any of the other categories
Description of investor's perspective	investing mainly or only sustainable and not harmful	investing in the change towards a more sustainable real economy / and or towards net zero	not investing in industries or assets that are significantly harmful and/or investing in those assets that perform better	
	not interested in sustainability			

Regarding impact investments, it is crucial that investors understand that by simply buying a product which is investing in secondary markets, the contribution or causation to transformation of investees towards a more

[35] See also Annex D.

[36] See also ESMA Guidelines on Suitability, no. 85.

eco-friendly or socially responsible is indirect and might be limited. This limitation may also be relevant when investing in assets that are already sustainable, such as investing in energy companies deriving energy production from renewable energy and therefore already with a high level of revenue Taxonomy alignment. On the other hand, providers of climate solutions can facilitate an effective transition and therefore provide an important contribution. However, by nature, it is more difficult to draw a causal link between an investor's provision of financing (or other activities) and a change in an investee´s behaviour[37] or improvements of an investee´s negative impact through the use of solutions.

There is merit in recognising products that provide for real-world direct change to give clear orientation to investors, but further work on this topic is necessary. The term has no unified EU legal definition yet.[38] In the purest sense, investments in primary markets (i.e., public offerings, or capital increases) in private equity, venture capital e.g., providing for solutions or social enterprises or in case of financing projects, show the highest potential to causally contribute to a transformation.[39] These are very specific types of investments (also referred to as impact-generating[40]) which would be difficult to pursue in products not generally focussing on primary markets such as UCITS. Investing in secondary markets with credible engagement and voting activities is to some extent seen as impact-generating investments if it meets minimum safeguards for intentionality, additionality and measurement. Nevertheless, engagement and voting tend to respond to an entity-level feature (representing all holdings within one FMP in each company) and most impact occurs when engagement is conducted by multiple shareholders and holdings are significant.

Matching investor objectives with their desire for real-world impact involves ensuring that disclosures provide clear information on the following:

- Whether a causal real-world transformation is intended.
- Whether the product achieves measurable improvements.
- Whether the product's measures bring additional benefits for the environment or society.
- Whether none of these elements will be systematically achieved by the product.

The table below describes which categories address investors' values compared to those focused on real-world transformation.

Investors' perspective	Transition	Sustainable	ESG collection	Unclassified products
Value aligned: not investing in industries or assets that are significantly harmful.	Certain types	Certain types	√	X
Value aligned: investing in those assets that perform better from a sustainability point of view.	Certain types	Certain types	√	X
Value aligned: investing mainly or only sustainable and not harmful.	X	√	X	X
Value aligned: investing in measurable positive outcome.	Certain types	Certain types	X	X
Impact generating: causing a measurable positive outcome	Certain types	Certain types	X	X
not **interested** in sustainability.	√	√	√	√

[37] Kölbel et al. (2020) Can Sustainable Investing Save the World?; see also Annex G.
[38] Details and suggestions regarding Impact Investing are included in Annex G.
[39] See for instance 2DII (2023) The Impact Potential Assessment Framework (IPAF) for financial products
[40] Timo Busch et al. (2020) Impact investments: a call for (re)orientation

Investors aiming for real-world impact should look for products that clearly disclose their intent and ability to achieve measurable improvements and additionality.

It is important to note that while some value-aligned investors may be motivated by avoiding financial material impact, those focused on generating impact primarily address non-financial needs, though such products can also meet financial needs. All categories require products to comply with minimum criteria, with many already addressing investors' perspectives. However, investors seeking further measurable positive outcomes or impact generation will need products that meet additional requirements to fully address these needs. Details of these requirements are outlined in Annex G. Although separate recognition of such products is not part of this proposal, the Platform sees merit in analysing how impact investing products could be considered in the categorisation. The Platform also recommends the European Commission to identify how impact investing fits into the existing framework. Depending on the definition, impact investing might overlap with the Taxonomy given that the latter requires as one of the core elements a contribution to an environmental objective which is similar to the expectation of the contribution to a positive impact. It would be essential to clarify the relationship between both.

4.2. Framework for the categories

The categorisation should be built on the Sustainable Finance Framework, using tools such as the EU Taxonomy, EU Climate Benchmarks, EU Green Bond Standards, Principal Adverse Impact indicators, and the EU Commission´s recommendation on facilitating finance for the transition to a sustainable economy[41] (“**Recommendation**”). SFDR should form the basis for constructing the categories.[42] Ambition can be determined by (i) how categories are defined, and (ii) calibrating thresholds / pre-conditions, both of which need to be disclosed. For each product, the FMP should clearly articulate the sustainability objective and/or ESG strategy. Available data can assist in identifying relevant thresholds. The Platform has included potentially useful data in Annex A and outlined its limitations in providing a complete overview for categorising existing products.

The Platform suggests applying minimum criteria as a pre-condition for financial products to be included in a certain category. These criteria aim to protect against significant environmental and social harm, aligning with international standards. Given ongoing changes, industry specifics, and improving data availability, fixed mandatory thresholds as minimum criteria should be limited. Minimum criteria should not apply to hedging and liquidity instruments, which serve specific purposes for investor interests. A cornerstone of the minimum criteria is the requirement for a specified proportion of assets to fulfil the overall sustainability features.[43] What is more, the Platform has built on the exclusions within the Benchmark Regulation (similarly to ESMA’s fund naming guidelines) by considering the exclusions foreseen for PAB and CTBs with certain adjustments. Those adjustments comprise: (1) Excluding companies that violate UNGP instead of UNGC, (2) not applying exclusions to issuers of use-of-proceeds bonds financing sustainable projects provided issuers have a CapEx plan in line with EU GBS and (3) excluding companies that (i) derive 1% or more of their revenues from and invest in first-time production, expansion or exploration of fossil fuels, i.e., ≥ 1% CapEx from coal exploration or processing activities, (ii) derive 10% or more of their revenues from and invest ≥ 10% or more of CapEx from oil exploration or processing activities, or (iii) derive 50% or more of their revenues from and invest ≥ 50% or more of CapEx from gas exploration or processing activities except where the activity is Taxonomy-aligned. These adjustments

[41] EU Commission`s recommendations on facilitating finance for the transition to a sustainable economy, EUR-Lex - 32023H1425 - EN - EUR-Lex (europa.eu)

[42] See also Annex F.

[43] For labelling / categorisation and naming rules, regulators often identify a certain minimum coverage of the assets to which binding elements apply. The Platform notes differences in the approaches and sees a merit in identifying the minimum coverage to ensure that products mainly follow the essence of the category (see Annex K).

are in line with the overall goals of the Sustainable Finance Agenda. The Platform also recommends for the Commission to consider whether the PAB and CTB exclusions should be amended accordingly and clarify that the exclusions for CTBs identify always significantly harmful activities for which no technological possibility of improving their environmental performance.

Generally, exclusion requirements should only be put in place where data is publicly available or can be derived or estimated from publicly available data. Detailed requirements should be consistent with CSRD reporting. Corporate CapEx activity disclosures are still lacking, where no CapEx data is available, however, forthcoming advice by the Platform on the use of estimates would help to fill this gap. If neither data nor estimations are available, the Precautionary Principle suggests that issuers should be excluded if they fail the revenue threshold. When CapEx data is unavailable or cannot be estimated, and revenues are used as a proxy, the revenue threshold could be higher. The key factor is that there should be no indications of investments in new fossil fuel-related infrastructure, and revenues from such activities should decline over time.
The minimum criteria to be fulfilled require a specified proportion of assets to fulfil the overall sustainability features. This is to be determined through a list of binding elements provided per each category from which the FMP can choose. This provides a common framework, allowing FMPs to tailor sustainability features to their overall financial product strategy. Indicators should be used to measure adherence to the binding elements, as currently already foreseen by the SFDR. Disclosure should first pre-contractually define the binding elements, indicators for measuring adherence, and minimum criteria. Second, it should include performance reporting on these elements and potentially other indicators not used for adherence measurement. The categorisation criteria need to balance flexibility to address different asset classes with sufficient clarity on the minimum criteria.

These considerations lead to the following structure.

Working title	Sustainable	Transition	ESG collection
Minimum Criteria to be fulfilled by every product falling in that category	• Minimum exclusion criteria • Minimum of investments positively contributing in line with sustainable strategy described by a list of binding elements to be determined in detail by FMP	• Minimum exclusion criteria • Minimum of investments in line with transition strategy described by a list of binding elements to be determined in detail by FMP	• Minimum exclusion criteria • Minimum of investments in line with identified ESG-criteria described by a list of binding elements to be determined in detail by FMP
Indicators to measure	Depending on the binding elements, pre-defined or to be determined. E.g., commitment to certain Taxonomy alignment commitment needs to be measured against the resulting reported Taxonomy alignment of the product (based on revenues or CapEx).		
Pre-contractual disclosure	Defined (minimum criteria / binding elements, indicators to measure)		
Reporting	Defined (pre-defined indicators, minimum criteria, and additional indicators).		

For the minimum criteria / binding elements, and indicators, the lifetime of a product should also be considered. This is particularly important in private markets, where products undergo ramp-up and wind-down phases.

During these, adherence to the minimum criteria / binding elements, as well as measurement with indicators, might not always be possible. A similar approach to the ELTIF Regulation should be considered, allowing:

- Application by the date specified in the product's rules or instruments of incorporation.
- Cessation of application once the product begins to sell assets to redeem investors' units or shares after the product's life ends.
- Temporary suspension of rules when the product raises additional capital or reduces its existing capital, provided such suspension lasts no longer than 12 months.

The Platform also sees merit in assessing the potential for rule suspension in cases of force majeure (such as market turbulence during the initial COVID-19 crisis).

4.3. The individual categories

As outlined above, the Platform recommends establishing three categories Transition, Sustainable, and ESG collection and refer to the products not falling in any of the categories as "unclassified products". Considerations on the need for additional categories or sub-categories are outlined in Annex H.

4.3.1. Sustainable

Investments that are recognised as sustainable, i.e., positively contributing, are a core element of the EU Sustainable Finance Framework. The EU Taxonomy is a transparency tool, allowing investors to more easily identify investments which are in line with long-term environmental goals. Besides this, the framework also recognises SI as defined in Art. 2 (17) SFDR as sustainable. Both types of investments are relevant for the sustainable category. Which means that the **minimum criteria** for such products are a minimum percentage of capital weighted (revenue, CapEx) and aggregated Taxonomy-aligned and/or SI determined based on FMP methodology ("**FMP SI**"), e.g., such product could invest 1/3 in Taxonomy-aligned and 2/3 in FMP SI revenues without pre-defining a minimum allocation between Taxonomy alignment and FMP SI. The percentage should be lower in the beginning given that the relevant measurement is capital weighted. As of the end of 2023 and Companies have reported a total of 249 billion Euro Taxonomy alignment.[44] As of August 2024, based on reported data by approximately 1000 companies, Taxonomy alignment amounting to an average of overall percentage on aligned revenues of about 13% and of CapEx of about 18%.[45] In general, reported Taxonomy alignment in revenues and CapEx saw almost 30% increase over the last years.

The minimum percentage needs to be tested and could increase over time with more Taxonomy-aligned investments becoming available. In addition, with the PAB exclusions, the EU legislator has determined exclusions relevant for sustainable portfolios which should apply to those products,[46] though adjusted (see 4.2). Exclusions should apply to all investments in this category except for cash and derivatives used for hedging. Lastly, any other investment in the transition category should not undermine the overall sustainability objective of the category, i.e. any investment of the remainder should not comprise activities that are significantly harmful. This principle ensures that the remaining investments should not negatively impact the primary goal of contributing positively to sustainability.

To further determine the minimum criteria, FMPs should identify as **binding elements** of such products the commitment to a minimum of positive contribution identified by Taxonomy alignment and/or FMP SI. They could also allow for investments in use of proceeds bonds financing sustainable projects. In practice such products could invest in companies that have a share of Taxonomy-aligned revenues/CapEx and EU Green

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[44] The EU Taxonomy's uptake on the ground - European Commission (europa.eu).
[45] Source: Morningstar, data as of August 2024.
[46] See Art. 12 Commission Delegated Regulation (EU) 2020/1818. This view is shared by ESMA (see ESMA34-472-440 Final Report on the Guidelines on funds names (europa.eu)).

Bonds. Such products could also invest in assets that qualify as SI which could include green bonds not following the EU Green Bond rules but which have a minimum Taxonomy alignment and/or sustainability (green and social together) or social bonds.

Further binding elements should cover the requirement of remaining investments not negatively impacting the main goal. This can primarily be achieved by requiring all investments which are not Taxonomy-aligned including those that are not sustainable to pass a “Do no significant harm” (“DNSH”) test. Such test should build on the requirements laid out in connection with Art. 2 (17) SFDR. Hedging and liquidity instruments should be excluded from such requirement since they serve a specific purpose for the financial instrument. The FMP would need to put in place and disclose a methodology (e.g., escalation mechanism) in line with the overall strategy of the product, prioritising those PAIs, that are of particular relevance for the investment strategy (e.g., environmental PAIs for an environmentally focused product), identifying measures to improve PAIs and thresholds for exclusions taking into account sector, asset class and region specifics. The Platform recommends using in particular the activity-based PAI indicators and due diligence PAIs. PAIs that identify always significant harmful activities should always be considered if not already covered by the PAB exclusions such as controversial weapons and tobacco. The pre-contractual disclosure should explain the methodology and highlight what type of potentially impairing investments might still be allowed. Within the periodic reporting, FMPs should explain deficient or poor PAI indicator performance and how this is in line with the principle that the remainder should not undermine the sustainability objective.

To achieve the goals of the EU Sustainable Finance Framework, the Platform recommends strengthening the concept of both the definition of SI as well as the DNSH test according to Art. 2 (17) SFDR and align it with the Taxonomy concept. Unlike the EU Taxonomy with clear screening criteria and metrics, FMP SI is based on a legal definition which is open to different applications. While the Taxonomy requires substantial contribution to an environmental objective defined in EU regulation, the legal definition of SI in Art. 2 (17) SFDR recognises any contribution defined by FMPs. As such, the Taxonomy is a subset of SI that obeys to strict and reliable criteria. The Platform is aware of the current shortcomings of FMP SI. The Platform recommends that only the Taxonomy dictates activity-based environmentally sustainable investments for all those activities that are eligible[47] or for always significantly harmful activities, where a lower-carbon or more environmentally sustainable replacement exists in the Taxonomy. Only for those activities not yet included should FMPs be allowed to identify substantial contribution to the Taxonomy objectives and DNSH.

DNSH thresholds should be evidence and science based.[48] While changes on entity level (such as reduction of GHG emissions or improvement of gender diversity) are important, they should not fall under the FMP SI definition but should be recognised as eligible investment in the transition category, if pre-conditions such as transition plan are fulfilled.

This means that the more the EU Taxonomy is developed, the less need there will be for the use of FMP SI, ultimately leading to the full replacement of FMP SI by the Taxonomy. Or put it another way: anything that is already captured by the EU Taxonomy cannot be considered FMP SI unless it meets the technical criteria of the Taxonomy. Having multiple definitions of whether and how an economic activity can be deemed sustainable, creates confusion, inefficiencies and ultimately undermines the overarching goal of the Sustainable Finance package to channel capital towards genuinely sustainable economic activities. Strengthening the legal SI definition should not, however, create a second type of Taxonomy to avoid jeopardising the overall goal of completing the EU Taxonomy.

[47] Whenever eligibility may be in doubt (e.g. third-party vendors may offer diverging numbers or issuers may have diverged from reporting guidance), Capex to Valuation ratios or Revenue to Valuation ratios, respectively, may be used as guidance with higher values indicating a stronger need to have only the Taxonomy dictate activity-based environmentally sustainable investments.

[48] Further details can be found in the SFDR RTS Brief.

In turn, socially sustainable activities are not yet classified and, therefore, should be defined by FMPs. While the Platform reiterates its support for the development of a social taxonomy that could serve a similar role to the environmental Taxonomy, it also believes that some guidance could be provided regarding EU social objectives. The Platform recommends using the previous Platform report on a Social Taxonomy, the social PAI indicators, Corporate Sustainability Due Diligence Directive (CSDDD) and the social indicators embedded in the ESRS as a foundation. These should be leveraged as much as possible to build upon the common ground established by the Sustainable Finance Framework.

The Platform envisions the following evolvement of SI in the future.

	Environmental	**Social**
Positive Contribution - Objectives	As defined by the EU Taxonomy.	To be identified (eventually a Social Taxonomy).
Positive Contribution - Measured	Contribution to SI objective determined by FMP can only be measured at **activity level (including project bonds)**. In detail this means: - Where activities are covered by the EU Taxonomy (eligible), exclusively those technical screening criteria apply. No other criteria for such activity can be considered FMP SI. - Activities covered by the EU Taxonomy but not meeting the substantial contribution criteria, yet improving to move out of significantly harmful and/or towards Taxonomy alignment, could be classified under the transition category.[49] - FMPs can identify other activities in a similar manner, analogous to the EU Taxonomy, based on their alignment with science-based targets or their provision of solutions for achieving science-based targets.[50] The improvement of positive impact or reduction of negative impact based on entity-level metrics should not be considered FMP SI. This is sufficiently captured in the transition category.[51]	Contribution to SI objective can only be measured at **activity level. Socially sustainable activities** to be defined by FMPs. Not every investment in a social sector investee should be considered sustainable.
DNSH	Use of environmental PAI indicators. Thresholds should be sector, asset class and region specific, and should also be science based. Thresholds should be used as follows: - Excluding the worst performers unless a positive outlook combined with a credible engagement strategy and/or an escalation	Use of social PAI indicators based on similar concept as DNSH for environmental contribution.

[49] Such investments could be part of the remainder of the product provided the investment pass the DNSH test.
[50] Market practices such as identifying SI through ESG ratings will likely not be sufficient under the new definition.
[51] This is deviating from the previous recommendation of the Platform due to further evolvement of the understanding regarding transition financing.

	Environmental	Social
	mechanism eventually leading to exclusion if the threshold is not reached. - Monitoring and/or engaging if PAI indictors decrease / the likelihood of no longer passing the DNSH test in future increases.	
Minimum Safeguards	Follow safeguards according to Article 18 of the EU Taxonomy Regulation, also note that those companies that comply with the CSDDD will automatically meet the minimum safeguards of the Taxonomy (as explained in a previous report by the Platform on minimum safeguards).	For social contribution, the safeguards need to cover environmental and governance aspects. Activity-based environmental PAI indicators could be used to identify safeguards.

The Platform recognises challenges when it comes to data requirements for non-CSRD entities. Data availability on non-CSRD entities should be considered when setting up the categories and revising the SI definition. While these include SMEs, EFRAG´s VSME ESRS and the simplified approaches the Platform is working on should improve considerably sustainability data from European SMEs.[52] This should be considered also for financial products which finance SMEs.

Indicator of the sustainable category would be the adherence to a share of EU Taxonomy alignment and/or SI commitment, as well as the adherence to the exclusion criteria. The Platform recommends for the reporting to require disclosure of the actual share of EU Taxonomy alignment as well as the SI share besides the confirmation that exclusion criteria have been adhered to.

4.3.2. Transition

Financing the transition to a climate-neutral and sustainable economy is the cornerstone of the EU Sustainable Finance Agenda. This category captures products with a focus on the transition. Which means that the **minimum criteria** for such products are a minimum of X% of investments are transitioning measured with credible transition pathways or plan. A credible transition strategy can also be set on portfolio level. In addition, with the CTB exclusions, the EU legislator has determined exclusions relevant for transitioning portfolios which should apply to those products[53] though adjusted (see 4.2). Exclusions should apply to all investments in this category except for cash and derivatives used for hedging. Lastly, any other investments in the transition category should not undermine the transitional objective meaning that the FMP should not invest the remainder in assets contradicting the overall transition strategy which could e.g. be measured against relevant PAI indicators.

The **binding elements** of this category should be based on the Recommendation. There, the Commission has highlighted the need to finance the transition from current climate and environmental performance levels towards a climate neutral, climate-resilient and environmentally sustainable economy in a timeframe that allows reaching the EU's climate and environmental goals. It specifies that transition finance means financing investments compatible with and contributing to the transition (while avoiding lock-ins) including:

a) investments in portfolios tracking EU Climate Benchmarks,
b) investments in Taxonomy-aligned economic activities, including: transitional economic activities for the climate mitigation objective, and investments geared to make economic activities becoming Taxonomy-aligned over a period of maximum 5 (exceptionally 10),

[52] Link to SME statement.
[53] See Art. 10 Commission Delegated Regulation (EU) 2020/1818. This view is shared by ESMA (see ESMA34-472-440 Final Report on the Guidelines on funds names (europa.eu)).

c) investments in undertakings or economic activities with a credible transition plan at the level of the undertaking or at activity level,
d) investments in undertakings or economic activities with credible science-based targets, where proportionate, that are supported by information ensuring integrity, transparency and accountability.

Intermediate (i.e., they meet DNSH thresholds, but not substantial contribution) and significantly harmful activities could be eligible for this category, as long as there is a credible transition plan to transform them. Harmful activities which cannot be transformed should be excluded (i.e., always significantly harmful (ASH) activities). In the absence of an ASH activities Taxonomy, the adjusted CTB exclusions should be used as proxy. Credible transition plans for climate change mitigation are described by the Corporate Sustainable Due Diligence Directive (CSDDD).[54] Further guidance for credible transition plans may evolve over time (at the time of publication the Platform is in the process of finalising a report on the core elements for assessing corporate transition plans). The same holds true for investments in undertakings or activities with science-based target. As science on other environmental Taxonomy objectives (or on social objectives) evolves, investment opportunities for transition products might increase. Generally, improvements (e.g. decarbonising or adaptation) can be done at project, investment and portfolio level. The latter could provide indirect pressure on the real economy to transition, e.g. if exclusions are the last measure of an escalation mechanism in engagement. Investors, in particular those who have pledged to achieve net-zero targets, usually do not differentiate between these improvements. For instance, on portfolio/product level the commitment could be made to increase the share of investments in b), c) and/or d) over time. A product which has decarbonisation among its objectives should also report its decarbonisation performance against an EU Climate BM.

Further, the category could also include an additional optional binding element focused on stewardship (engagement and proxy voting) strategy aimed at encouraging undertakings which are not yet sufficiently transitioning or whose actions or plans are considered insufficient or not credible. Stewardship is increasingly emphasised by investors as a key lever through which they aim to play a role in supporting sustainable long-term performance of companies in which they are invested, but it should be robust and effective. Therefore, it needs to be accompanied by a set of rules including an outline of the engagement strategy with the following elements:

- transparency on overall engagement goals, ideally measurable,
- transparency on voting policy and implementation (equity only) – such policy would need to demonstrate alignment with Paris Agreement goals,
- transparency on engagement policy and proportion of portfolio covered by engagement activity, including in particular assets which do not fulfil yet requirements,
- transparency on progress of engagement and use of escalation without disclosing confidential engagement interactions,
- transparency on credible escalation mechanism including description for what cases and within what time frame measure of last resort (divestment) will be applied,
- transparency on changed investee behaviour (depending on data availability).

Where engagement and voting activities have the potential to achieve transformation, these products might address investors with preferences to invest in a positive measurable outcome. FMPs should be allowed to refer to the credible engagement plan in place on entity level, however, should disclose in period product reporting only those activities and outcomes relevant for the product.

Moreover, real assets such as real estate or infrastructure are urgently in need of transitioning. Hence, for instance the following should be recognised as a possible binding element for the category: acquiring property with the intention of renovating it with the goal to achieve an A-rated Energy Performance Certificate, targeting

[54] Art. 22 (1).

emission reductions over time in accordance with science-based targets or specific greening objectives. Further work could be done to assess the elements for real estate and infrastructure transitioning and their usability within the categorisation scheme.

The following provides examples of **indicators** to measure the proposed potential binding elements and reporting.

Binding element	Indicator	Reporting
Investments in assets fulfilling criteria of the Recommendation	Adherence to investment commitment	Statement of adherence to only invest in transition investments
	Where a minimum percentage of such investments is committed to, adherence to such commitment	Statement of adherence to minimum percentage of transition investments or reporting of actual percentage of transition investments
Commitment to increase share of transition investments mentioned in the Recommendation over time in line with science-based targets	Adherence to increase of share of transition investments over time	Statement of adherence to increase of transition investments or reporting of actual percentage of transition investments
Stewardship / Engagement strategy identifying overall goal (e.g. decrease of emissions by investees or increase of number of transition plans on investee level)	Adherence to identified goal of e.g. emission reduction by investees.	Statement of adherence or reporting of actual number of reductions
Commitment to reduce emissions in real assets over time in line with science-based targets	Adherence to reduction of emissions in line with target over time	Statement of adherence to emission reduction in line with target or reporting of actual percentage of emission reduction

The understanding of transition with respect to climate is the most advanced. Nevertheless, the transition category should not be limited to climate mitigation and adaptation only. The Platform recommends assessing how criteria could be used beyond climate, e.g., on biodiversity appreciating that data availability needs to be increased and that metrics are less developed compared to climate ones. Though not specifically mentioned by the Commission in its recommendations, the Platform also recommends that in developing the categories, analysing further how social elements (especially the Just Transition) could be in scope of a transition category.

Apart from climate transition there could be more environmental or social objectives that classify for a transition category in the future. Benchmarks could guide the development of products that invest in transitioning towards a more sustainable economy from the perspectives of biodiversity or water, for example. With respect to biodiversity, the nature protecting benchmark concept is expected reduce nature related significant harm to protected areas while incentivising corporations to mitigate any material nature harm their operations maybe causing.

With respect to water, the benchmarks under development separately address water pollution and water stress. While acknowledging that water stress can be a result of both excessive withdrawals and alteration in water quality, two different benchmarks were created to address feasibility considerations including data availability. The water stress benchmarks aim to progressively reduce and neutralise excessive withdrawals from areas of water stress, while the water pollution benchmarks aim to minimise water pollution on a downward trajectory comparable to climate transition benchmarks.

A transition category specifically needs to balance pre-contractual commitments and disclosures. To avoid misuse of the transition category, there is a need for some commitments to be reached over time. In this respect, the transition category is the most exposed one to potential changes in the market, science and technology, as well as in the political environment, which means the FMP needs to calibrate forward-looking commitments

diligently. The challenge lies in effectively balancing forward-looking information (intention) with commitments and investor protection. The need for suspension of the rules in case of force majeure might be important for this category. Lastly, when transition is achieved, FMPs should have flexibility in not being required to sell investments which have become sustainable, since this would trigger a mandatory turnover which might contradict the financial strategy. Over time, the share of Taxonomy-aligned and SI investments of a transition product could increase. There might be concerns that FMPs could misuse the transition category to put in place a strategy that could fit in the sustainable category but be a weakened version. However, (i) the product would still need to be in line with the overall transition objective, (ii) auditors, investors and supervisors would be able to identify the transitional progress in the periodic report, and (iii) if a transition product invests in Taxonomy-aligned investments or SI, this would still benefit the overall Sustainable Finance Agenda.

4.3.3. ESG collection

This category serves to cover all other products with substantial sustainability features that provide for a credible degree of sustainability materiality, thereby aligning to certain values of investors. The category could comprise products with any of the following features:

- Traditional sustainability features where issuers are selected based on a scoring method, e.g., by selecting the better performing issuers within a sector overall or focused on one or more issues/indicators (e.g., gender or corporate governance) or dropping the worst or simply excluding certain investments (e.g., through negative screenings). Negative and positive screening are a comparable way of approaching investments insofar as one cuts of coming from the bottom (exclusions / negative screening) or investing in the better performing or higher scoring thereby cutting of coming from the top (e.g., best in class or norm-based screening). While the latter might not primarily look at avoiding certain investments, it results in avoiding investments in the worst performing issuers. In all cases, the outcome is that the investment universe is shrunk through selecting, either positively from the top, or negatively from the bottom.
- Management towards the improvement of a sustainability indicator either by comparison to a benchmark or by a year-on-year improvement.
- Investments in target vehicles or where sub-portfolios are managed in a different way, i.e., by combining different categories and/or different binding elements within a category. Those strategies form a significant part of the market. They include multi-option products (“MOPs”), fund of funds (“FoFs”), and standardised portfolios (together “Mixed Products”). Mixed Products can also be classified in the sustainable or the transition category, if they fulfil the respective criteria. However, in practice this might be more challenging due to these products’ diverse underlying investments. They include products where the client identifies the underlying investments (from up to 1,000 options and might even switch during the lifetime), and those where they are chosen by the FMP who might or might not have the possibility to steer the underlying investments with respect to their sustainability elements.

Minimum criteria for such products are at least X% of the investments following one or more material sustainability approach. Similarly to the transition category, the CTB exclusions should apply, though adjusted (see 4.2).[55] Exclusions should apply to all investments in this category, except for cash and derivatives used for hedging. Lastly, any other investment should not undermine the ESG characteristics. This could be done, e.g., by prioritising improvement of PAIs that reflect the ESG characteristics promoted.

Besides the exclusion criteria, the **binding elements** of this category should be chosen from a list which at the relevant point in time is considered as sustainably material. While exact thresholds and requirements should be tested both in terms of sustainability performance but even more so whether it aligns with investors preferences

[55] The Platform also recommends for the EU Commission considering whether the CTB exclusions should be amended accordingly.

if they are looking for value-aligned products, the FMP should be able to choose from the following binding elements in order to comply with the minimum of X% investments following one or more approaches:

- Certain percentage better than the reference benchmark or investable universe, or year-on-year reduction on specified indicators. The exact percentage depends on the indicator and the benchmark. Reduction should be sufficiently significant. This requirement could be used e.g., for best in class or positive screening approaches.
- Effective reduction of investment universe of at least e.g., 20%.[56] This requirement could be used e.g., for exclusion or best in class approaches.
- Target vehicles or sub-portfolios that are sustainable, transition or ESG collection. This would reflect ESG-multi-asset strategies, FoFs and would also be highly relevant for MOPs.
- All investments that are eligible for the sustainable or the transition category.

Eligible investments in the ESG collection category should also comprise those investments that are eligible for the transition and the sustainable category. This reflects the need of Mixed Products, but it should not be limited to such products. It should generally be encouraged for all ESG collection to e.g., invest in Taxonomy-aligned investments or facilitate transition for products which cannot be or are not yet classified as sustainable or transition where it is in line with the disclosed objective. This serves the overall Sustainable Finance Agenda and provides the flexibility necessary to achieve financial goals. However, to avoid circumvention and facilitate investor protection, FMPs should not be allowed to present very similar characteristics to “sustainable” or “transition” products, but without respecting their respective safeguards (e.g., no positive contribution to Taxonomy objectives without regarding the DNSH requirements unless transition requirements are achieved). Further, the product would still need to be in line with the overall objective of its defined ESG goal which would be visible to auditors, investors and supervisors in periodic reporting showing performance against the ESG goal.

The Platform notes that the category might be more difficult to explain to end investors, given the products might be very diverse in practice and a range of them might vary over the lifetime. It is therefore important that the category name and description clearly states that it covers a very diverse range of products some of which might invest in a diverse range of ESG approaches. Description of the category and disclosure of the products’ objective must therefore not convey any confusing messages that facilitate misconception, instead, they need to enable investors to clearly identify the differences between products in this category and the other categories.

The following provides examples of **indicators** to measure these binding elements and reporting.

Binding element	Indicator	Reporting
X % better than Benchmark or investable universe over a defined timeline or year on year reduction on specified indicators	Adherence to performance or reduction commitment	Statement of adherence to performance or reduction commitment or reporting of actual percentage of performance or reduction
Effective reduction of investment universe of at least 20%	Adherence to reduction commitment	Statement of adherence reduction commitment or reporting of actual percentage of reduction
Target vehicles or sub-portfolios that are sustainable, transition or ESG collection	Adherence to investment commitment	Reporting of actual percentage of allocation to each of the underlying categories

In addition, **reporting** on PAI indicators should be used as an assessment for the overall portfolio, as well as to demonstrate that investments do not undermine the ESG goal. This means that the performance of those PAI

[56] Details to be determined, in particular the calculation of the 20%.

indicators which reflect the ESG goals should be disclosed: If environmental, then the family of environmental PAIs indicator performance should be disclosed, if a combination of environmental and social PAIs, then all PAI indicator performance should be disclosed. Reporting would then show how the PAI indicators perform for this specific portfolio. For certain products, receiving and aggregating PAI data is difficult (e.g. MOPs or FoF investing outside the EU), which hinders reporting. This could be solved by using estimates in line with the forthcoming Platform recommendations, or by disclosing coverage ratio, or by allowing reporting on PAI-Indicators at the level of the underlying investment option, following already existing rules for MOPs.

4.3.4. Considerations for Multi-Option Products, Funds of Funds and similar products

Mixed Products serve a large range of investors, ranging from retail investors seeking a way to combine insurance and investment elements to institutional investors using e.g., FoFs to bundle their different investment needs. Those Mixed Products need to fit into the categorisation scheme and should not be discriminated by nature. It is therefore important to test whether the suggested categories allow for these products to be categorised appropriately. The Platform specifically suggest looking into the following:

- **Use of ESG collection category for Mixed Products**: It is challenging to set up specific, quantitative, ex-ante KPIs where there target investments follow diverging thresholds, methods, etc. Mixed products often do not have full control over target fund managers investment decisions including which companies end up in its portfolio. A Mixed Product could hence determine a certain percentage to be invested in products that fall into any of the categories (except for the unclassified products category). For the remainder the relevant minimum criteria for this category would apply. Should the ESG collection category be stricter in some elements than the transition or the sustainable category, for instance, with respect to exclusions, Mixed Products should be allowed for their underlying investments to apply the rules of the categories respectively relevant to them. For example, if a Mixed Product invests 30% in products falling in the transition category, those investments will need to follow the rules for the transition category but only those. On the Mixed Product level, a percentage of allocation of investments in defined categories would be required with no sub-limit with respect to the different categories. To facilitate transparency to investors, in the reporting the respective level of allocation within the reporting period should be disclosed.
- **Use of other categories**: Given the variety of target investments in a Mixed Product, it might be challenging for Mixed Products to fulfil the conditions of the transition or the sustainable category though this is generally desirable. Feasibility might improve over time with more relevant target vehicles or portfolios becoming available.
- **Offer of unclassified products**: The unclassified products can comprise products that have sustainable elements but are simply not classified in any of the three specific categories. At the point of sale, investors could be interested in having a categorised option of an underlying product. In particular, MOPs often have an alternative underlying product that would fall into any of the defined categories. For those MOPs it would be helpful to be able to show to the client that a categorised option is available which could be done when choosing the underlying. FMPs would have to provide the corresponding disclosure (pre-contractual and periodic) if the customer chooses a variation of a generally non-classified product that fulfils all the requirements of one of the other three categories. This should be accompanied with a disclaimer for the customer that if it changes the underlying funds, the classification might change.

For Mixed Products, the annual report should follow the existing rules while providing transparency on the allocation of the different categories included in the Mixed Product for the reporting period. For some products, e.g., MOPs, it is difficult to aggregate the information on a wrapper level, those could follow existing rules.[57] For other Mixed Products an aggregation on Mixed Product level is also challenging, in particular, where the methodologies of underlying asset managers diverge. The Platform recommends analysing in more detail how such reporting but also the pre-contractual disclosure could be achieved in a meaningful way, while at the same time ensuring sufficient comparability between different Mixed Products.

4.3.5. Unclassified products

Products that are not falling in any of the aforementioned categories will inevitably be named by the market (see the use of Art. 6 SFDR to identify products not disclosing sustainability features). All products not falling into any of the previous categories will be considered and named unclassified. Unclassified products should report on Taxonomy alignment, GHG emissions and human rights due diligence.[58] These can comprise products:

- that do not have sustainability features.
- that have some sustainability features but would not fulfil the ambition of the categories.
- that fulfil the ambition of the categories but where the FMPs chooses to not categorise them, e.g. due to the investor scope.

The scheme should maintain flexibility for FMPs to decide on whether to categorise products. When the categories are tied to the sustainability preferences, FMPs have an incentive to categorise products. Despite this incentive, there might be a range of reasons why FMPs choose not to categorise, e.g., for institutional products the investors might not be interested, or a categorisation could not be in line with the overall financial strategy. The category could also be relevant for allowing innovation for new ESG strategies, FMPs can use this category to place their most novel approaches whose category might not be obvious and while still finetuning them.

Products in this category will be required to minimum disclosures but will not be required to fulfil minimum criteria as sustainability features. Further, as enshrined in SFDR and sectorial legislation FMPs should consider sustainability risks and, where relevant PAIs. Should the FMP (e.g., on request of the institutional investor) commit to ESG characteristics or sustainable or transition features, this would need to be reflected in the product's legal documentation. However, to clearly distinguish unclassified products from those categorised, the Platform recommends prohibiting unclassified products to include description of ESG characteristics or sustainable or transition features in the marketing material. Further, a disclaimer should state that (i) the product is unclassified, (ii) it does not fulfil the standards required for a categorised product and (iii) any ESG characteristics or sustainable or transition features must only be described in the legal documentation.

All unclassified products should be required to report at least on the following:

- Taxonomy alignment (Revenues and CapEx),
- PAIs: GHG emissions (1), carbon footprint (2), GHG intensity of investee companies (3) and UNGPs[59] (10).

[57] e.g. Art. 20 para 2 b) SFDR Level 2.

[58] This is in line with the Platform`s previous recommendations see e.g. SFDR L1 Brief.

[59] Platform recommends changing the current standing UNGC together with the PAIs to UNGP in line with the minimum safeguards of the Taxonomy, the CSRD ESRS and the CSDDD.

5. Indicators to be used

Key messages:
- Indicators should be measurable and existing indicators already recognised by the Sustainable Finance Regulation should be used, where feasible.
- Usability of indicators depend on their readiness. This should be considered when deciding which indicators should be used for the reporting. Some of the indicators are well developed and data is increasingly available. For other indicators, reporting is only starting.
- Regulation needs to distinguish between the requirement to adhere to binding elements and minimum criteria as a commitment and the duty to report on performance of certain indicators. The latter can also be relevant for products without any commitment/binding element connected to the reported indicator.

In its SFDR L1 Brief, the Platform recommended for the categorisation to use of measurable indicators available provided they are sufficiently objective. Indicators should be used as follows (see also Annex J):

- To **measure adherence** to **binding elements** and **minimum criteria**. Those indicators should be identified in accordance with the sustainability features the FMP defines. To avoid innovation restrictions, FMPs should generally identify the indicators which best measure any binding element including the level of commitment, where necessary. Guidance should be given on criteria for indicators to fulfil (e.g., science-based). For certain products in certain categories, the FMPs discretion to choose indicators is reduced. For instance, a climate transition product would be expected to commit to a certain level of Taxonomy Capex alignment where the transition investment is Taxonomy CapEx eligible. The Platform stands ready to provide detailed advice to the Commission which indicators could typically be used for specific types of sustainability features.
- To **report** on the **sustainability performance of the product**. Reporting requirements should be defined on (i) the commitments including safeguard adherence as well as (ii) additional performance of typical indicators (e.g., environmental PAIs for products with environmental characteristics) also to ensure that sufficient transparency is provided for that part of the product for which the binding elements do not apply. The correct reporting audience should also be determined, by distinguishing between products where information should be publicly disclosed and those where they should be reported to the investor only and if there is a need for a reporting to the regulators.

Indicators that have been developed or are used under the EU Sustainable Finance Framework have to be analysed with respect to their usability for a categorisation. In addition, the Platform sees a merit in analysing how specific indicators interact and what impact such interaction has for a categorisation. Given that in the next few years European companies are going to disclose against the ESRS, and that data from non-EU companies will also evolve, a thorough analysis on how indicators interact, and which indicators work for what type of category should be done at a later stage.[60] Further, Taxonomy reporting by investees is also due to expand, while estimates for non-EU are being refined. The Platform notes that a change of any thresholds over time needs to address the impact on existing products.

The table below shows which indicators could be used for the different categories. A more detailed analysis of the readiness and how to use the indicators is included in Annex I.

	Sustainable	Transition	ESG collection	unclassified
Taxonomy alignment, revenue	CMLCO, RM	CO, RM	CO, RM	RM
Taxonomy alignment, CapEx	CO, RM	CMLCO, RM	CO, RM	RM
Taxonomy always significantly harmful	CM, RM	CM, RM	CM, RM	(RM)

[60] Further guidance for the indicators is included in Annex I.

	Sustainable	Transition	ESG collection	unclassified
CTB Exclusions	-	CM, RM	CM, RM	-
PAB exclusions	CM, RM	-	-	-
PAI (mandatory)	CMLCO: Relevant PAIs (e.g. env.) E.g. PAI 4	CMLCO: Relevant PAIs (e.g. env.) Engagement PAI 4	CMLCO: Relevant PAIs (e.g. env.)	RM e.g. PAI 1
SI share, Revenue for not-yet-Taxonomy eligible activities	CMLCO, RM	CO, RO	CO, RO	-
SI share, CapEx for non-yet-Taxonomy eligible activities	CO, RO	CMLCO, RM	CO, RO	-
Transition Plans and/or Targets KPIs	CMLCO, RM	CMLCO, RM	CO, RO	-
ESG Ratings (potentially)	CO, RO	CO, RO	CO, RO	-
Voting / Engagement	CO, RM	CO, RM	CO, RM	-

CM = pre-contractual commitment mandatory
CMLCO = pre-contractual commitment mandatory, level in FMPs discretion
CO = pre-contractual commitment optional
RM = reporting mandatory
RO = reporting optional, where indicator is chosen as commitment, RO becomes RM

Sovereign debt and non-listed investments are particularly challenging. Though improving, thanks to mandatory reporting becoming more common in other jurisdictions and to the use of ever more accurate estimates, investments outside of the EU continue to also pose a challenge. All three are of significant importance for investors:[61]

General sovereign debt. The sovereign bond market is of considerable size. In addition, in order to meet long-term liability and other regulatory requirements, many asset owners are required to allocate a large proportion of their investments to sovereign bonds. The EU legislator has provided a framework for Green Bonds including sovereign Green Bonds[62] which serves as a labelling scheme, including external assurance. Further, FMPs might include other sustainability use-of proceeds sovereign instruments such as social bonds within their sustainability features. Soft standards have developed by the industry to assess ESG performance from sovereigns, including with regards countries advancement and management of the transition to a net zero and resilient economy based, among other variables, in an assessment of countries national defined contributions (NDCs), or with regards to social issues including human rights as an example. This could for instance be reflected as element in the transitional category. Further work could be done to assess the soft standards and their usability within the categorisation scheme.

Private markets. Indicators such as PAIs are often not tailored for private market investments like infrastructure debt and equity, private equity and debt, venture capital, real assets, indirect investments. For investors, guidance on how these investments could be assessed would be welcomed. This could e.g., be done by providing examples of indicators usable as a proxy for indicators commonly used for listed asset classes.

[61] For specific types of asset classes, the usability of some indicators beyond the Taxonomy would need to be improved. Building on the usability report of the previous Platform, the Platform will issue another usability report which will include recommendations regarding further evolution of the Taxonomy and the wider Sustainable Finance Framework. Within this report, the Platform could provide more detailed analysis regarding selected indicators.

[62] L_202302631EN.000101.fmx.xml (europa.eu)

6. Sustainability preferences and clients' needs

Key messages:

- Sustainability preferences should be adjusted in line with the categorisation scheme. Only clients without sustainability preferences should be offered unclassified products.
- Sustainability preferences should move away from questioning investors about specific indicators (as the preferences are currently set up. They should, however, facilitate the process of matching products to investors' preferences.
- The level of detail in the client's sustainability exploration will depend on the client preferences.

The existing system of sustainability preferences provides some challenges for the advisors as well as the investors. The use of indicator thresholds might not be the best way of identifying client's needs and of matching products to such needs. Consumers struggle to understand the definition of sustainability preferences. While some consumers express general an interest in sustainability, data on how high the interest is in expressing specific minimum proportions on the indicators and the extent to which preferences need to be adapted is rare. Given the feedback received on the consumer testing regarding the new SFDR templates as well as on the difficulties to understand the difference between Taxonomy alignment and Sustainable Investment, it is very likely that similar levels of confusion occur at the point of sale. The following considerations are relevant:

- **Sustainability preferences should remain part of the suitability test, but the process needs to be streamlined.** Sustainability preferences are one specific element of clients' objectives and needs and should therefore remain part of the suitability test. The test in its current form though poses some challenges for investors and advisors. In particular, the process and the need for the client to adapt preferences to match the market reality leads to a longer process than needed thereby risking that the client (or the advisor) loses the focus on the topic. Products which are not categorised should not be considered as addressing sustainability preferences.

- **Different levels of questions can address investors' different needs**. Establishing a categorisation scheme that facilitates the process will make it easier for the investor to understand what the product can deliver. It should also facilitate the suitability test. Some investors are only generally interested in investing sustainably without no further specific preference whether they would like to align their investments to their values or invest in real world change. It is important for them to avoid misconceptions. When an investor expresses interest in something "sustainable," their perception of what this entails can vary significantly. This may include investing in already sustainable assets, avoiding harmful investments, or seeking to create a real-world impact. Identifying the investors' preferences along those understandings should be the first step when assessing sustainability preferences. Tailoring questions to the different levels or aspects of investor interest would allow to reflect the diversity of views among investors. For investors that do not express clear preferences, very simple few questions should suffice.

- **Institutional investors should have full flexibility to use or not use a categorisation scheme.** Institutional investors value flexibility allowing for different outcomes and even novel or innovative economic activities to be considered under sustainability. FMPs should be able to reflect this in the client sustainability exploration. Despite any duties applicable to the FMP (e.g., managing sustainable risks), whether professional clients want to categorise or not, the categorisation and underlying criteria might also help identifying institutional investors' sustainability preferences.

The Platform strongly supports the adjustment of the sustainability preferences in line with a categorisation scheme moving away from questioning investors about specific indicators (as the preferences are currently set up). Sustainability preferences should be explored based on several levels of questions but allowing the investor at any point in time to be or not to be more specific. This could be done along the following lines:

Sustainability preferences mean a client's or potential client's choice as to whether his or her investment should be

- aligned with his or her sustainability value by
  - not investing in activities or assets that are significantly harmful,
  - investing in assets that perform better than others within the same sector with respect to environmental, social and governance criteria,
  - investing mainly in activities or assets that can already be considered sustainable and/or avoid significantly harmful investments, or
  - Investing in measurable positive outcome (where investee companies exhibit performance improvements)

or

- contribute to transformation of the economy by
  - Causing a measurable positive outcome.

FMPs could also collect information on whether clients' sustainability preferences have a focus on either environmental or social factors or a combination of them.

As a result of the legislative initiative of the retail investment strategy, the suitability test may be adjusted, with the addition of a best interest test. When contemplating sustainability preferences and potential adaptations to existing rules, it is crucial to ensure that all elements of the suitability test function harmoniously in practice for both the investor and the advisor.

The above would only comprise the high-level legal text, in practice advisors could consider different level of questions depending on the interest and need of the investor. This could comprise:

- Clients will be asked their preferences along the distinction as shown above. Advisors would explain based on the disclosure what the product commits to.
- In a second level, advisors can explain within the categories, the investor is interested in, different types of sustainability features including different types of themes (where available) and/or how the product currently performs.
- QR codes linking to more detailed information about the sustainability features of financial products can be provided.

This process needs to strike the right balance between clear communication regarding sustainability features to prevent misunderstandings and to avoid overwhelming clients with excessive information.

Amending the sustainability preferences requires a legislative process. The existing legal text identifies sustainability preferences based on the performance of specific indicators, i.e., the minimum share of Taxonomy alignment, the minimum share of SI and the consideration of PAIs. There is only limited potential to fit the proposed categorisation to the existing definition of sustainability preferences. The main connection would be the indicators that are used for certain types of categories. The only viable connection is that an interest in PAI suggests that the investor is more looking at avoiding harmful investments whereas an interest in a certain level of Taxonomy alignment or SI suggests that the client is interested in investing in already green assets. However, transitional elements including a real-world change is not reflected.

7. Disclosure and naming

Key messages:

- A simplified approach for disclosure should be applied, where possible. The disclosure should clearly align with the sustainability preferences. It should distinguish between binding commitments in precontractual disclosure and actual performance in periodic reporting.

- Category names should only be used by products actually qualifying for the categories. Further, terms clearly related to one specific category should only be allowed to be used for products qualifying for this category. Unclassified products should not be allowed to use sustainability-related terms in their name.

Disclosure is crucial in understanding the products sustainability performance. It includes pre-contractual disclosure, website disclosure (to provide more details where required) as well as reporting. Pre-contractual disclosure should generally only contain the most important and decisive elements whereas the reporting can be more detailed. The former should also be understandable for retail investors and could potentially be more detailed upon request (e.g. through QR code). Rules should also consider already existing sustainability-related reporting requirements where possible (such as those currently included in the SFDR) to limit the implementation changes needed. Wherever possible, a simplified approach should be implemented to enhance retail investors' understanding of financial products. Disclosure can provide important information to the investor if it is (i) easy to understand, (ii) quick to read and (iii) consistent throughout the process.[63]

The table below suggests what the transparency of a product should comprise. Pre-contractual disclosure should only contain information on non-committed (e.g., actual) values within the product (compared to binding elements/commitments) if these are relevant for categorisation and serve to protect investors. Such disclosure should be based on the most recent available audited figures and clearly separated from the committed elements to ensure investors understand the difference. Transparency covers reporting on specific indicators, product performance, and should include the coverage ratio. This allows investors to evaluate the transparency of the product. It should not be voluntary whether to include data in the coverage or what data to include. Where reliable data is available, products using a category should be fully transparent for the relevant identified indicators. If data is not available, estimates or proxies should be used. Yet, it should be clear which percentage of the reporting is based on estimates or proxies as opposed to data provided by issuers. Only if no sensible estimation can be made or proxies are unavailable, the coverage ratio can be used to inform investors about the scale of the product's unknown positive and negative impacts.

<table>
<tr><th>Working title</th><th>Sustainable</th><th>Transition</th><th>ESG collection</th><th>Unclassified products</th></tr>
<tr><td>Mandatory pre-contractual disclosure</td><td colspan="3">Description and level of all mandatory and selected commitments and description on indicators used to measure</td><td>No requirement to avoid confusion. Disclosure can only be included in legal documentations and a disclaimer should clarify that the product is unclassified</td></tr>
<tr><td>Mandatory periodic reporting (all reported indicators should include coverage ratio)</td><td>• Performance of mandatory and selected indicators including all mandatory PAIs.
• actual Taxonomy alignment share, revenue / CapEx</td><td colspan="2">• Performance of mandatory and selected indicators including e.g., all environmental mandatory PAIs for products with environmental features, all social mandatory PAI for products with social features, all mandatory PAI for products covering both environmental and social elements
• actual Taxonomy alignment share, revenue / CapEx</td><td>• Performance of committed indicators.
• actual Taxonomy alignment share, revenue / CapEx
• PAI GHG emissions (1), carbon footprint (2) and UNGPs (11)</td></tr>
</table>

[63] Detailed considerations can be found in Annex L

For MOPs, pre-contractually, a dashboard for should be required, as proposed by the ESAs[64], that would summarise how many options offered in the MOP are in each category, and how many are not classified.

Furthermore, product names serve as a marketing tool that significantly impacts investors' interest and decisions. The naming of categories is likely to have a similar effect, especially if adopted by the market. Naming the categories should help investors and advisors identify products that match investors' sustainability preferences. Therefore, it is crucial to name the categories wisely and test their effect with consumers to minimize the risk of misinterpretation. Category names should only be used by products actually qualifying for the categories. Further, terms clearly related to one specific category should only be allowed to be used for products qualifying for this category. Unclassified products should not be allowed to use sustainability-related terms in their name.

The Platform recommends testing the names in particular if the scope of the categorisation will include all financial instruments not covered by SFDR but relevant for the sustainability preferences under MiFID (see Annex C), or if it is likely that the categories will be used by the market for these financial instruments. Any experience gathered with the implementation of ESMA Fund naming guidelines when identifying specific names for the categories should also be considered.

It is also important to note the imperative that the naming of the categories is consistent with the Green Claims Directive[65] as well as the Empowering Consumers for the Green Transition Directive.[66] Given that categories will and should be named, the substantiation must follow the fact that the FMP needs to substantiate that the product is allocated to the right category. In this respect, the Platform also welcomes EIOPA's general guidance on greenwashing which includes in principle 3 that sustainability claims should be substantiated with clear reasoning and facts. The indicators to be identified for each category will help substantiating a claim.

8. Process of Categorisation

Key messages

- Introducing the categorisation scheme should carefully consider potential impact on the existing offering and basis on which investors have invested in such products.
- Changes to the regulatory framework should be considered carefully, since they might confuse investors and it might trigger additional implementation costs, time, and resources along the value chain.
- Assurance on categorisation could follow sector specific rules which are, however, diverse. The Platform does not recommend mandatory additional assurance. FMPs may seek third party assurance on a voluntary basis.

8.1. Introduction of categorisation scheme

To facilitate the transition from the current SFDR regime to a new categorisation scheme, the need for an interim solution should be carefully considered to facilitate acceptance of a new regime considering potential disruption of implementation. FMPs including professional/institutional investors have often invested considerable time and resources in understanding, operationalising and building reporting systems in line with the existing concepts used in Article 8 and 9 SFDR. It should be clear how products disclosing under Art. 6, but also 8 and 9 SFDR fit in it. While changes will not be avoidable if and when the new system is implemented, the need to adapt

[64] See also JC 2023 55 - Final Report SFDR Delegated Regulation amending RTS (europa.eu), p. 18.
[65] Directive on substantiation and communication of explicit environmental claims
[66] Directive (EU) 2024/825 of the European Parliament and of the Council of 28 February 2024 amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and through better information

set-ups, data bases, systems etc. currently in place, leading to additional costs and resources should be kept to a minimum. Timing should be aligned throughout all affected rules (e.g. SFDR, MiFID, IDD).

Implementing the change should evaluate the need for grandfathering and/or transition rules based on the following aspects:

- **How existing products disclosing under Article 8 and 9[67] SFDR will achieve the minimum criteria and binding elements of the categories and the consequences**: There might be products currently disclosing under Article 8 or 9 which will not be classified or products that will be categorised in a category that seems likely or a category that seems rather unlikely. Through market testing, it could be estimated how many products that are disclosing under Article 8 today would be unclassified products tomorrow. Also, FMPs might consider changing a product´s sustainability feature in light of the new rules. While the latter should follow general rules of disclosure if a product´s sustainability features change, there could be merit in providing non-binding guidance about interim disclosure to help the market understand on a product level the impact of the introduction of the scheme.
- **How products within the existing regime have been sold to the end investors matching the current understanding of sustainability preferences**: Consequences of changing the definition of sustainability preferences or changing from the disclosure regime to a categorisation scheme should not trigger additional information requirements other than those already applying, e.g. in case of an ongoing investment advice, advisors might address the introduction of the categorisation within the normal cycle.
- **Effect of changes to underlying definitions**: If, for instance, the SI definition is strengthened, products that have been sold based on the existing rules might not be able to adhere to their pre-contractual commitments. This is problematic for products where a change to the investment strategy or a change of investments is more complex or not feasible. This is, for instance, the case for long-term illiquid investments but also for MOPs or FoFs where the FMP has limited influence on the target fund portfolio.

Generally, the Platform considers that products (without changing their sustainability features) could be allocated to the categories as follows:

WORKING TITLE TO DIFFERENTIATE	Sustainable	Transition	ESG collection	Unclassified
So-called Article 6	X	X	X	√
Article 8	√	√	√	√
Article 9	√	(√)	X	X
Article 9 tracking Climate Benchmark	(√)	√	X	X

There may be a need to adjust categories or the pertinent indicators and minimum criteria over time in light of scientific advancements. The Platform holds the view that the need to modify the categories themselves should be minimal. However, careful consideration must be given to situations where mandatory requirements e.g., minimum criteria undergo changes, and the aforementioned considerations would apply.

8.2. Responsibilities and assurance

There is a difference between a labelling and a categorisation scheme. While labelling often requires third party verification, a categorisation scheme follows specific rules. The diverse sectorial rules applicable to each of the products require the NCA approval in some cases but not in others and what exactly is approved or reviewed varies between jurisdictions. Same applies for any auditor review. Some reviews comprise checking processes and/or making sample checks other assess all periodic disclosure in scope.

[67] Considerations on how to specifically treat Art. 9 products are included in Annex M.

	NCA approval	Auditor review
IBIPs	Only on national level	Only on national level
Pension Products	Only on national level	Only on national level
PEPP	Yes	
Managed Portfolio	No	Yes
AIF	Not in all cases	Yes
UCITS	Yes	Yes

The Platform notes that this diverse picture is not specific to sustainable finance products, but relevant for any product set up and reporting process. The Platform believes that a well-crafted categorisation scheme based on the Sustainable Finance Framework and its tools should not necessitate additional assurance requirements which could higher costs.

Products disclosing today under Article 8 and 9 SFDR must also follow the sectorial requirements. In addition, supervisors appreciate minimising greenwashing risks and use their existing supervisory tools to address these.

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Annex A. Guidance on setting thresholds and supporting data

The following includes information on (i) the current landscape of SFDR products as well as (ii) certain sustainability information relevant for the Platform`s proposal**. The information available does not allow to fully assess how the thresholds could be determined. Nevertheless, it provides guidance on steps which are useful to determine the thresholds.**

When determining thresholds for the single categories, the following aspects need to be considered:

(1) how existing products should fit into the scheme from the start taking into account different types of products and investment styles
(2) how ambitiously the market shall be incentivised to move towards sustainability while ensuring the categories work on the ground
(3) how rules impact the structure and the management of a portfolio. This includes
    - which activities are and should (not) be invested in, in a certain type of product,
    - what data is (so far and in future likely) available for what activity, region, company sizes and what the consequences including potential data inconsistencies are, e.g. based on coverage universe and different models applied by data providers,
    - what the potential is of a given activity and region to move towards transition or Taxonomy alignment,
    - what are other (regulatory) constraints certain products have, for instance with respect to asset allocation beyond equity funds, particularly with a high share of illiquid assets,
    - the fact that "actuals" of Taxonomy and SI must always be higher than any commitment. Commitments must be set at a lower level with sufficient buffer to be able to manage the portfolio on a day-to-day basis (market movements, in-/outflows, etc.),
    - by failing one DNSH criteria through changes in the EU Taxonomy or through circumstantial changes, a Taxonomy-aligned activity immediately becomes non-Taxonomy-aligned which can have the effect that one of the main holdings contributing to Taxonomy alignment no longer counts for reaching a threshold,
    - how much flexibility would be needed to manage a portfolio considering investors` return objectives and
    - what the (maximum) number of indicators is against which an FMP can realistically manage a portfolio.

Below data is looking at indications on how the current market would perform within the Platform`s proposal. The data has inter alia the following limitations:

- public data is only available for some of the products covered by SFDR, namely funds investing in public markets, and consequently in particular not available for insurance products, pension products or funds investing in private markets;
- depending on the indicators, data will only give rough indications due to different market applications and criteria that are strengthened. This is in particular relevant for SI, transition elements and the criteria for ESG Collection; and
- general limitations on data that are highlighted by the previous Platform in its usability report but also in the forthcoming usability report of this Platform.

Section 1 gives a general overview of the market. Sections 2 and subsequent sections look closer at the potential of the products to fall under a category/ or at least look at how further data work could allow identify potential of these products to be able to fulfil criteria of a category.

Key messages:

Before setting specific thresholds for the categories, the Platform recommends conducting further analyses on the potential impact of thresholds for all SFDR products including liquid funds, but in particular, insurance and pension products as well as private market funds.

The preliminary data analysis shows the following reported data for the contribution:

- Around 17.1 % of liquid Article 9 funds would reach a minimum threshold of 40% Taxonomy alignment (reported).
- For SI at a first glance, the numbers seem higher, but those are based on FMPs diverse methodologies and do not yet take into account the impact of the streamlined definition of SI.
- An exemplary analysis of an insurance general account shows that a high share of investments is allocated to sovereigns and / or predate the Sustainable Finance Regulation. The option to redirect such investments in order to reach thresholds is limited.

A commitment to a certain threshold needs to be considerably lower than reported figures for a sufficient buffer to manage a portfolio on a day-to-day basis and take into account the impact it might have on reallocating to a certain regions and company activity.

The preliminary data analysis shows the following reported data for the safeguards:

- On DNSH test: A test with a mock-up portfolio of Art. 9 holdings shows that when applying a DNSH test by cutting of the worst companies according to their PAI performance the contribution varies considerably (cut by roughly 50%).
- On exclusions: Funds` portfolio holdings in companies exposed to PAB exclusions (except for UNGC violations) based on a sample of around 10,000 funds shows that the average Assets under Management (AuM) that will have to be excluded are around 4 % for the PAB exclusions and between 6 and 7% for the CTB exclusions. For the latter the main driver of exclusions is the UNGC violations.

The Platform suggests further next steps as follows:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.
- Data analysis on the different potential thresholds design choices including a comparison of relative and absolute contribution thresholds in the context of various exclusion and filtering rules.
- Identifying approaches to address different asset classes, investment strategies and types of products.

1. General data overview

The general data overview provides information on the current market situation for liquid funds and their evolvement as well as two examples of an insurers` general account. Indications for a general allocation to the categories would be as follows:

- Liquid funds disclosing under Article 8 and Article 9 and their evolution since application of SFDR could give an indication on the potential market for the categories. **Article 8 funds have environmental and/or social characteristics and should therefore be generally better positioned to be able to fulfil – potentially with adjustments of the investment guidelines – the criteria for a categorisation, in particular those for the ESG**

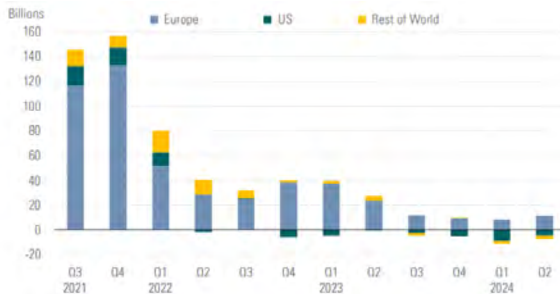
Collection. Article 9 SFDR Funds usually have a high share of SI based on FMPs methodology. In general, FMPs would probably aim at categorising them into the sustainable or the transition category.

- **Terms used in fund names could also help identifying fund objectives**. While there is no indication that those funds will be able to fulfil the categories` requirements in all instances, fund managers will likely assess whether it is feasible to categorise the products. **It is also worth noting that the ESMA Guidelines on Fund naming, once implemented, will give another set of indications on what type of funds would be well positioned to fall into the categories.**
- Examples of the general account show how asset classes are split. This is in particular relevant for the data availability of underlying assets.

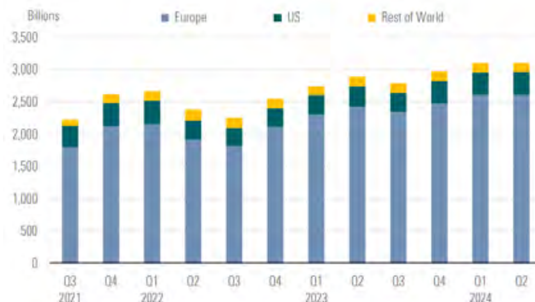
1.1 Liquid funds classified as Article 8 and 9 SFDR

Below graphs show the market development of funds that make claims in the prospectus or other regulatory filings to be sustainable based on flows and AuM for the period between March 2021 and June 2024.[68] **The graphs show that Europe is by far the largest market for such funds, taking up 84% of global sustainable fund assets.**

Quarterly Global Sustainable* Fund Flows (USD Bn)



Quarterly Global Sustainable* Fund Assets (USD Bn)

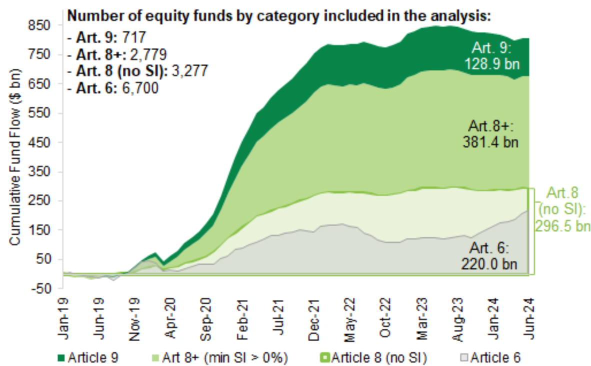


Source: Morningstar Direct, Data as of June 2024
** claim made by the funds according to documentation*

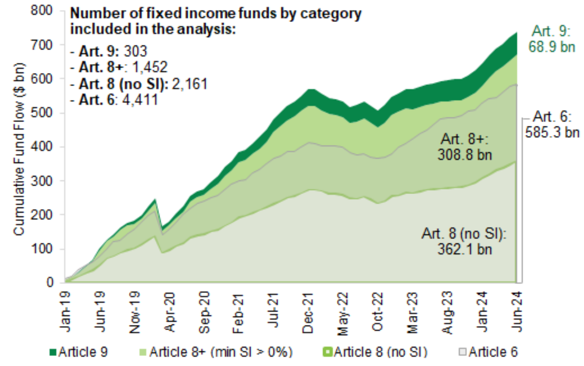
This is likely to be triggered by SFDR and other Sustainable Finance Regulation within the EU. Since SFDR was launched three years ago, flows into Article 8 and 9 funds have outpaced so-called Article 6 (or 'not stated') as shown by below graphs.

[68] According to Morningstar, a fund will be considered as sustainable if in the prospectus or other regulatory filings it is described as focusing on sustainability, impact investing, or environmental, social or governance factors. Funds must claim to have a sustainability objective, and/or use binding ESG criteria for their investment selection. Funds that employ only limited exclusions or only consider ESG factors in a non-binding way are not considered to be a sustainable investment product. Thus, this universe includes all Article 9 funds and those Article 8 funds that satisfy the criteria. Morningstar classifies only 35% of all Article 8 funds as sustainable. It identifies products as Art. 8+ where they commit to a minimum sustainable investment.

Cumulative fund flow of Article 8 and 9 Equity



Cumulative fund flow of Article 8 and 9 Fixed Income

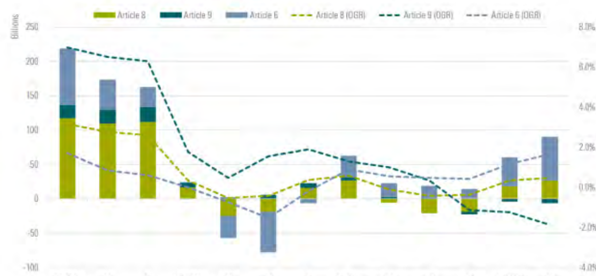


Source: Morningstar, Goldman Sachs Global Investment Research

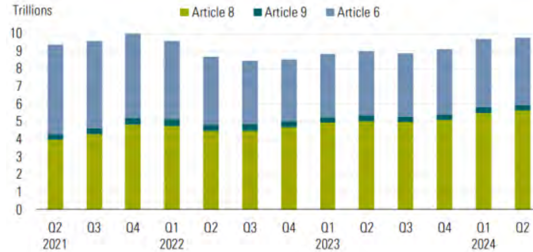
According to Goldman Sachs Global Investment Research, cumulative flows into ESG equity funds have been 2.7 times higher compared to non-ESG counterparts since 2019 to 2023, and ESG fixed income funds have also outgrown non-ESG counterparts. However, since 2023, more inflows have gone into non-ESG (Article 6) funds compared to ESG funds (Article 8 and 9) across both equity and fixed income.

Below graph shows the market development of funds disclosing according to Article 8 and Article 9 based on flows and assets for the period between March 2021 and June 2024.

Quarterly Flows into Article 8 and Article 9 Funds versus so-called Article 6 Funds (EUR Billion) and Organic Growth Rates (%)



Quarterly Asset Breakdown by SFDR Classification (EUR Trillion)

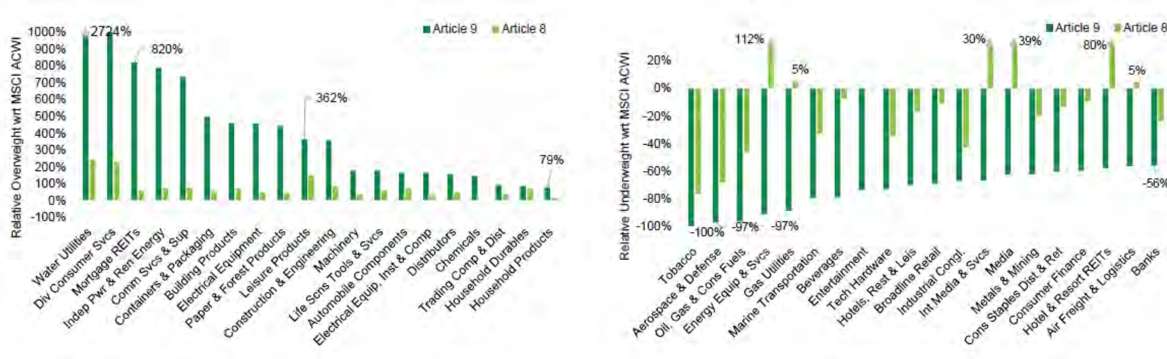


Source: Morningstar Direct. Data as of March 2024. Based on SFDR data collected from prospectuses on 98% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder

According to Morningstar, Article 8 funds increased their market share to 57.6% as of June 2024, Article 9 products remained steady at 3.4%. The figures give an insight of the market share of Article 8 & 9 funds, however, the in- or decrease of their market share is subject to general market developments per asset class.

Below chart shows the allocation of Art. 9 and 8 funds` investments between different industries.

Sub-industry overweight and underweight based on the Global Industry Classification Standard, percentage points relative to MSCI All Country World-Index



Source: Refinitiv Eikon, Morningstar, Goldman Sachs Global Investment Research

According to Goldman Sachs, Article 9 funds overweigh Water Utilities, Diversified Consumer Services and Mortgage REITS, generally Article 8 and 9 funds underweigh Tobacco, Aerospace & Defence as well as Oil, Gas & Consumable Fuels. **The allocation should be taken into consideration when determining thresholds. For instance, activities in certain of the industries underlined above might not be relevant for Taxonomy alignment or SI. Continuing to add new economic activities and enhance the coverage of the EU Taxonomy will support usability of the proposed threshold but it should also be recognised that while investments in certain activities might not be relevant for the overall Sustainable Finance agenda, they might, however, be needed to diversify portfolios provided certain minimum criteria are adhered to (also see the allocation of Taxonomy eligibility within certain industries in section 2.2).**

1.2 Terms and fund names

While disclosure according to Article 8 SFDR does not specify specific product restrictions, terms used in the fund name must reflect the fund´s objective and must not be misleading. Funds disclosing under Article 9 SFDR are required to only invest in SI except for hedging and liquidity instruments. Consequently, **terms used by funds can therefore give a broad indication of the funds´ sustainability objective without showing a substantial direction on how these funds would perform against any of the proposed criteria**.

Further, existing funds will have to apply the ESMA guidelines on fund naming by 21 May 2025 at the latest and new funds as of 21 November 2024. These will limit the use of certain fund names by applying specific product restrictions (e.g. PAB or CTB exclusions). This should provide more insights on the application of the PAB and CTB exclusions. Further, funds using transition-related terms will have to be on a clear and measurable path to social or environmental transition.

Below chart shows the distribution of most used Sustainability-related terms.

Most commonly used sustainability and ESG-related terms and number of occurrence[69]

Environmental-related terms	# funds using single term	# funds with combined terms	Total # funds
ESG	1140	27	**1167**
SRI	372	31	**403**
Responsible	194	35	**229**
Climate	155	41	**196**
Green	126	29	**155**
Ethical	63	2	**65**
Environmental	35	8	**43**
Low Carbon	20	16	**36**
Clean	7	15	**22**
Circular	19	3	**22**
Biodiversity	13	5	**18**
Planet	5	6	**11**
Renewable	0	10	**10**
Earth	3	1	**4**
Ecology	2	1	**3**

Sustainability-related terms	# funds using single term	# funds with combined terms	Total # funds
Sustainability / Sustainable	1253	40	**1293**
SDG	30	19	**49**

Impact-related terms	# funds using single term	# funds with combined terms	Total # funds
Impact	132	81	**213**
Better World	5	1	**6**

Paris-Aligned Benchmark (PAB) exclusions will apply to these funds

Social-related terms	# funds using single term	# funds with combined terms	Total # funds
Social	47	1	**48**
Solidarity	38	0	**38**
Microfinance	16	2	**18**
Diversity	7	1	**8**
Inclusion	6	1	**7**
Equality	0	4	**4**
Women	1	0	**1**

Governance-related terms	# funds using single term	# funds with combined terms	Total # funds
Governance	5	0	**5**

Transition-related terms	# funds using single term	# funds with combined terms	Total # funds
Transition	67	72	**139**
Net Zero	35	11	**46**
Improvers	1	21	**22**
Evolution	0	10	**10**
Transformation	0	4	**4**
Smart Energy	3	1	**4**

Climate Transition Benchmark (CTB) exclusions will apply to these funds

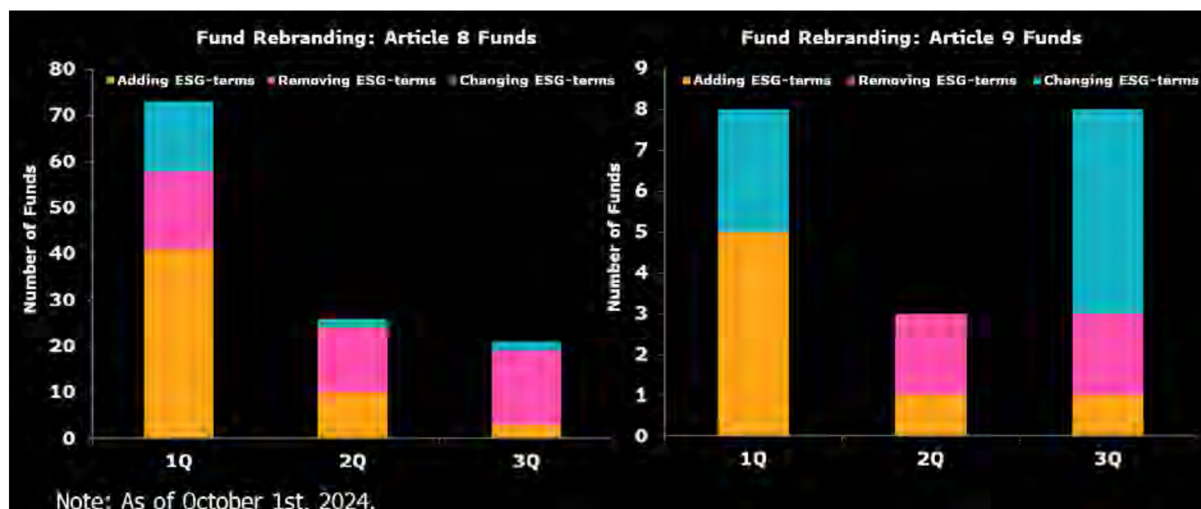
Source: Morningstar Sustainalytics Research. Morningstar Direct. Money market, funds of funds, and feeder funds are included. Numbers include ESG or sustainability-related terms in English and non-English languages. This list is not comprehensive. Additional terms were included in our search and our analysis but do not appear here.

While **4,170 funds are using environmental-related terms, 124 social and 5 governance-related terms, they would not necessarily comply with the criteria for either category proposed by the Platform**. **Nevertheless, the fund names might indicate for what funds managers would have the ambition to leverage any potential of them being categorised without pre-empting any categorisation**. Those funds would need to be assessed against the new criteria for each category including funds using a sustainability related term against the requirements of the sustainability category bearing in mind the streamlined approach towards SI. Consequently, whether any of the funds would be able to fulfil the criteria would need to be assessed on a case-by-case basis.

[69] Morningstar has identified close to 4,300 mutual funds and exchange-traded funds available for sale in the EU that use some ESG or sustainability-related terms in their names and may fall in scope of the new guidelines.

Below chart shows that already a considerable number of funds is removing ESG-related terms from their name. This is likely in anticipation of the ESMA guidelines.

European Sustainable Fund Name Changes



Source: Bloomberg Intelligence, BI SFDR Barometer 2H 2024 Outlook, as of October 1 ,2024.

According to Bloomberg, since beginning of the year, 16 funds disclosing according to Article 8 SFDR and 8 funds disclosing under Article 9 SFDR which had sustainability or ESG-related terms in their names have removed these terms since beginning of 2024. Further funds will likely remove or modify their sustainability or ESG-related terms in their names within the next months. Consequently, information on the distribution of most used Sustainability-related terms will likely be subject to considerable changes.

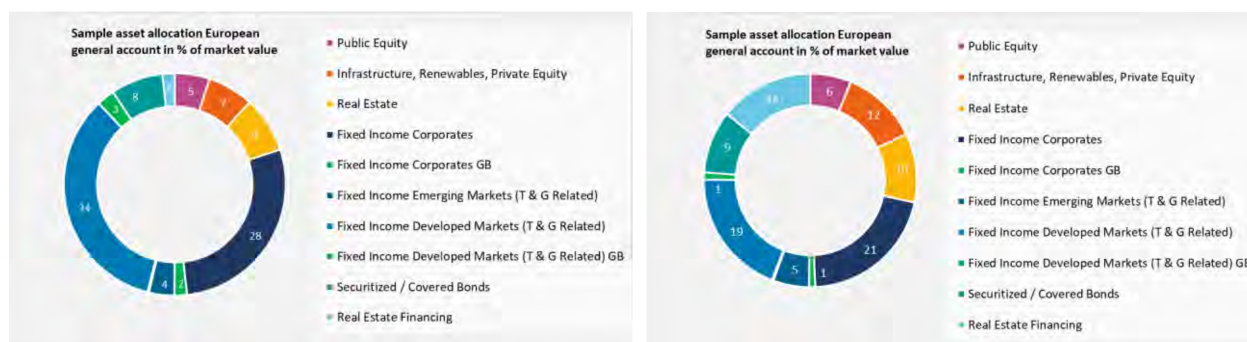
The portion of market that is making ESG claims could have sustainability objectives linked to a proposed category. **Although the ESMA Fund Naming guidelines may introduce further homogenisation when effectively fully implemented, the use of terms, however, does not give us an indication of their ESG performance and its capacity to reach the necessary ambition which the Platform proposal would set. It could also have the reverse effect, i.e. a product with an environmental term in its name, where FMP identifies that it will not meet the criteria for any category would ultimately be impacted insofar as the ESG claims the FMP will be allowed to make for the product might be limited.**

1.3 Asset class splits for a general account

A general account or profit participation fund is a key component of a life insurance company's financial structure. When policyholders pay premiums for their life insurance policies, these funds are pooled together on behalf of the policy holders in the insurer's general account. By pooling funds from many policyholders, the insurer can achieve economies of scale, allowing for more efficient and diversified investment strategies.

General accounts typically have a very diversified asset allocation as can be seen in the chart below, and particularly have a higher share of sovereign debt exposure. This is partly due to the need to match long term liabilities and fulfilment of guarantees in life insurance products. These objectives are also triggered by regulation which provides for constraints addressing these. The long-term investment horizon and the need to diversify portfolios for a competitive risk-return profile also results in a higher share of illiquid assets as well as material exposures to Sovereign bonds than other products. This is – inter alia – due to regulatory constraints. Data especially for illiquid assets is not readily publicly available e.g., if held through funds where fund managers are not obliged to report on sustainability factors. To illustratively show how general accounts could be affected, below are two examples of an asset allocation in a general account of a large insurer.

Two real life examples of allocations in a general account



Legend: GB = Green Bonds

Legend: T & G Related = Treasuries and Government Related

The long-term investment horizon of general accounts makes them uniquely positioned to fund changes of the real economy, such as renewable energy and infrastructure projects. However, transitioning general account towards net-zero necessarily means a transition with differing speed across asset classes. Collaboration among asset owners and industry is key to a) achieve transparency about footprint of existing assets b) set targets for new investments and c) develop approaches to transition existing assets and/or engage with Asset Managers.

Unlike investments in Public Equity and Fixed Income Corporates which can generally be redirected towards more sustainable or transitional options, due to Asset-Liability Management and other considerations as well as constraints, insurers may not be able to freely change allocations of these assets. Fixed income investments are often held for extended periods to manage duration, and there may be restrictions on accounting impacts from realisation of unrealised reserves or losses in case of investment disposals due to the collective nature of life insurance. Additionally, investments in sovereign bonds, such as those in Fixed Income Emerging and Developed Markets, would require criteria to be defined to allow classification into the transitional category or, in the case of restricted use of proceeds, into the sustainable category.

Insurers strategically diversify their asset allocation with alternative investments that align with their long-term investment horizon. These alternative investments, whether direct or in funds, typically have long holding periods. For instance, private market funds holding periods often stretch to more than 10 years. Equity investments in real estate or infrastructure have significantly longer investment horizons and face higher constraints in the speed of transitioning or selling non-transitional or sustainable assets as these are typically bought within a buy & hold strategy (e.g. for real estate investments, renovations are planned long-term). Where there is a market to dispose of these assets, insurer might only sell with a discount. As a result, there is typically a high share of investments in insurance general accounts that predate the Sustainable Finance Regulation. These arrangements did not foresee reporting on certain KPIs on the investee side, limiting insurers' ability to assess sustainability or transition potential for indirect investments specifically. Lastly, re-investments require availability of sustainable investment opportunities fitting in the insurers strategy which is also not necessarily a given.

It is worth noting that at the end of 2023 OECD government bond debt was projected to increase to USD 56 trillion in 2024[70]. At the end of 2023, global corporate bond debt reached USD 34 trillion. As such, being able to address investments in government bonds in the categorization framework, possibly with a focus on transition, would be highly relevant.

For a complete understanding of the existing market, the Platform suggests the following next steps:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.

[70] Global Debt Report 2024 | OECD

- Analyse and understand the impact of the ESMA fund naming guidelines on the investment universe and whether it has any knock-on effects.
- Analyse the regional and industry allocation of Art. 8 and 9 products compared to other products and aim at identifying the reason, where possible.

2. Sustainable category – contribution

The Platform suggests categorising products according to the following elements: Contributions through Taxonomy-aligned Investments or SI with no significant harmful activities or assets based on a more concise definition consistent with the Taxonomy.

The data analysis therefore looks at indications on:

- SI performance and
- Taxonomy alignment and eligibility.

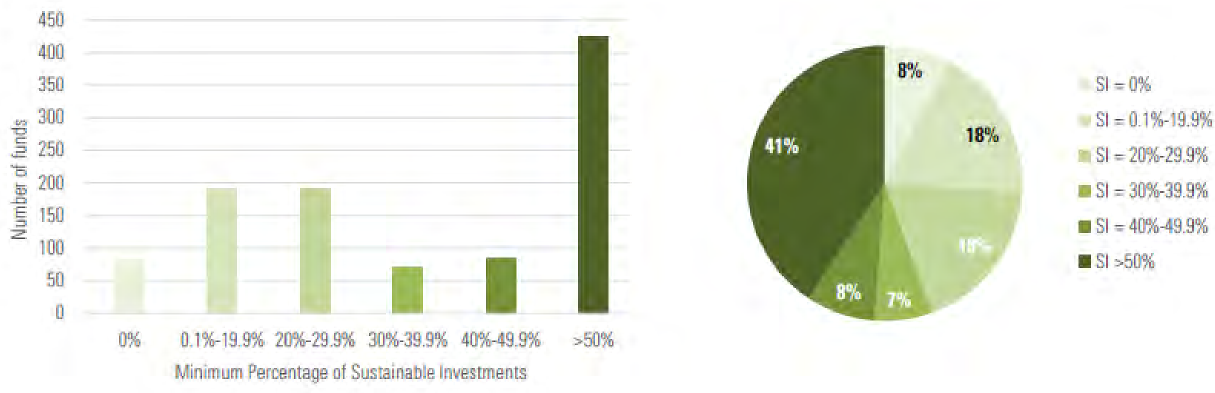
to identify how such data could be used and what further steps would be needed to determine requirements for the contribution in the sustainable category in detail.

2.1 SI performance

For setting a threshold for the sustainable category, data indicating the level that currently could be relevant for the positive contribution to SI should be considered. While SI is an indicator already used today by FMPs, the method to measure SI is determined by the FMP and hence diverse. Also, the Platform`s proposal includes enhancement of SI. As a consequence, today's numbers on the distribution of minimum SI commitment for funds which use the term sustainable, or similar in their names as shown in the next chart, do not provide a strong indication of which funds would be able to commit significantly to invest in SI.

Below chart rather shows the current distribution of proportion of SI for funds using the term "sustainable" in their name.

Number of Funds with "Sustainable" in their names and distribution of minimum SI

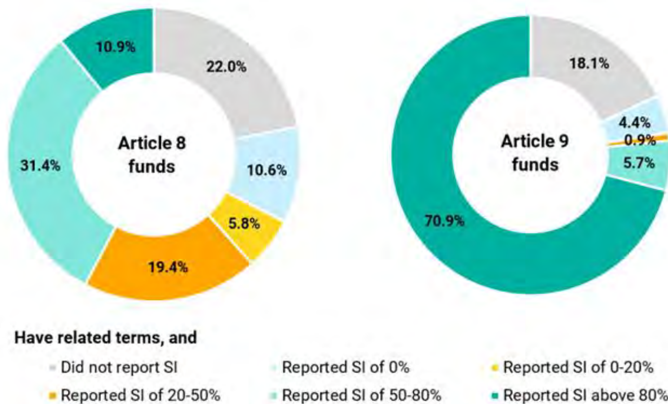


Source: Morningstar Direct. Based on 1,043 funds with "sustainability" or "sustainable" in their names and the "EU SFDR Minimum or Planned Investments Sustainable Investments" data point populated.

The count and proportion of reported SI per number of funds and in percentage based on the current methodologies might give an indication on which funds could potentially aiming at falling into the sustainable category. Below chart shows the distribution of reported SI from 900 Article 8 and 9 SFDR funds with sustainability-related terms in their names from the disclosure in the EET (April 2024). Reported SI per is based

on the current methodologies as applied by the FMPs which assess sustainability at entity rather than activity-level in many cases for now. Applying the suggested enhancement of the SI definition, should lead to lower SI figures.

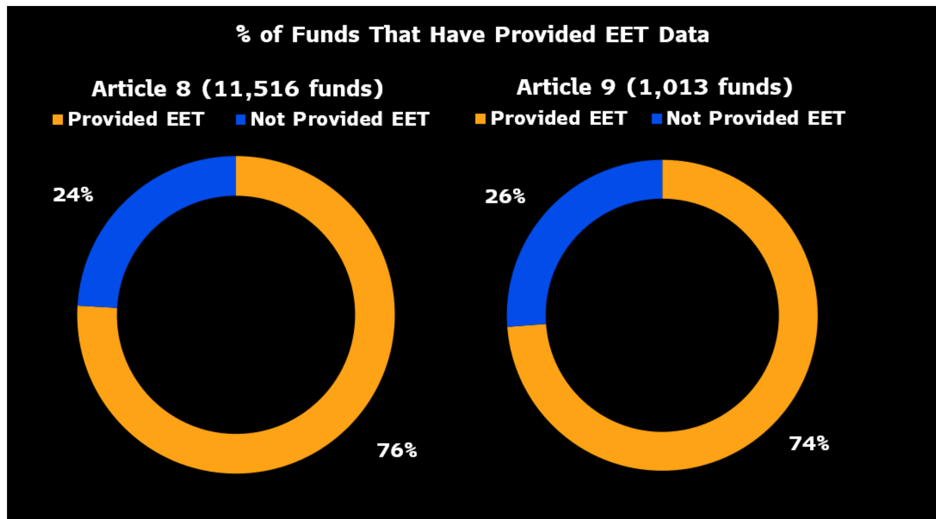
Reported SI for funds with sustainable-related terms in their names



Source: MSCI ESG Research, Funds and the European Sustainable Finance Landscape 2024, October 2024.

The chart shows that Article 9 funds with sustainability-related terms in the name reported a higher allocation to SI.

The data is not complete which is indicated in below chart showing the percentage of the funds providing data (including potential commitments to SI) via the European ESG Template ("**EET**"), a market developed standardised template provided by FinDatEx[71] for FMPs to exchange specific ESG data.



Source: Bloomberg Intelligence, BI SFDR Barometer 2H 2024 Outlook, as of October 1 ,2024.

Based on Bloomberg data roughly ¾ of Article 8 and Article 9 funds provide data through the EET.

Accordingly, data on funds that use sustainable-related terms in their name is not complete and does not allow to fully assess which part of the liquid fund market has the potential to fall into the sustainable category. It only gives a very rough indication which funds could aim for such classifications. Once the ESMA guidelines are

[71] FinDatEx (Financial Data Exchange) was established by representatives of the European financial services sector in 2019 to support the development and use of standardised technical templates for the exchange of data between product manufacturers, distributors and other stakeholders when applying EU legislation.

implemented, SI commitments for funds using sustainable terms might be more stringent. However, as long as the methodology is not consistent, such data will remain an indication.

2.2 Taxonomy data for public market funds

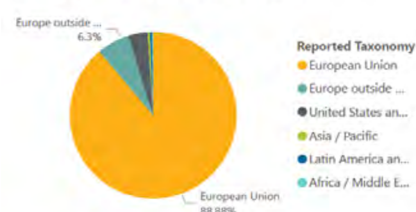
For setting a threshold for the sustainable category, data indicating the level that currently could be relevant for the positive contribution should be considered. For this, the following aspects should be reviewed:

- Taxonomy alignment: What is the average rate of companies' Taxonomy alignment and how is it distributed across regions and activities. Taxonomy-aligned activities count for the positive contribution within the sustainable category.
- Taxonomy eligibility: What is the average rate of companies' Taxonomy eligibility and how is it distributed across regions and activities. The percentage of activities not aligned but eligible would (i) have the potential to be relevant for the threshold measuring the positive contribution in future but (ii) could in the beginning not be included due to the adjusted SI definition where the FMP could not use any own methodology for activities that are already included in the Taxonomy.[72]
- Lastly it appears essential when setting a threshold to consider the fact that the Taxonomy alignment assessment is done at activity-level, and not entity level.

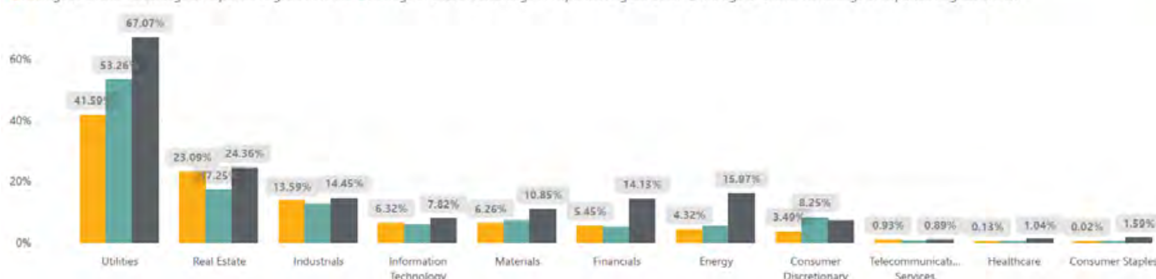
Below chart shows the Taxonomy alignment on climate mitigation and climate adaptation reported by companies in- and outside the EU.

Alignment of companies with reported EU Taxonomy data

Number of Companies with Reported Data



Domicile Region	Count of Company	Count of Overall Percentage of Reported Aligned Revenue	Count of Overall Percentage of Reported Aligned OPEX	Count of Overall Percentage of Reported Aligned CAPEX
European Union	1015	939	902	938
Europe outside of the European Union	72	50	42	48
United States and Canada	43	40	38	40
Latin America and Caribbean	5	5	4	4
Asia / Pacific	5	4	3	3
Africa / Middle East	2	2	2	2
Total	**1142**	**1040**	**991**	**1035**

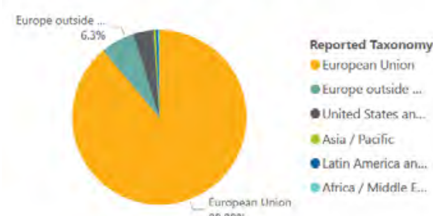


Source: Morningstar / Sustainalytics as of July 2024

[72] Whenever eligibility may be in doubt (e.g. in case data vendors provide diverging numbers or issuers have diverged from reporting guidance), Capex to Valuation ratios or Revenue to Valuation ratios, respectively, may be used as guidance with higher values indicating a stronger need to have only the Taxonomy dictate activity-based environmentally sustainable investments.

Below chart shows the Taxonomy eligibility on climate mitigation and climate adaptation reported by companies in- and outside the EU.

Eligibility of companies reporting EU Taxonomy data



Domicile Region	Count of Company	Count of Overall Percentage of Reported Eligible Revenue	Count of Overall Percentage of Reported Eligible OPEX	Count of Overall Percentage of Reported Eligible CAPEX
European Union	1015	1006	969	1012
Europe outside of the European Union	72	72	49	62
United States and Canada	43	43	38	41
Asia / Pacific	5	5	4	4
Latin America and Caribbean	5	5	5	5
Africa / Middle East	2	2	2	2
Total	**1142**	**1133**	**1067**	**1126**

Source: Morningstar / Sustainalytics as of July 2024

Data shows that between sectors the alignment potential varies significantly. Data shows that the alignment is currently particularly relevant for utilities. The highest potential for increasing Taxonomy alignment is currently shown in the real estate sector. The data currently only shows contributions based on climate change mitigation and adaptation. The sector relevance will change with more Taxonomy data becoming available based on reporting of Taxonomy alignment and eligibility for other EU Taxonomy activities. Taxonomy optimised portfolios bear the risk of concentrating on few industries while at the same time underweighting industries that are less relevant for the positive contribution. Continuing to extend the scope of economic activities covered by the EU Taxonomy, and considering the development of a social taxonomy could partly mitigate this.

While real estate seems to have the highest potential for alignment, the following should be taken into account:

- Progress pace: While new assets being developed are likely to help increase alignment level, shifting the stock of assets to fully aligned is more challenging and requires time also given the level of expectation the Taxonomy sets on energy efficiency. Considering materiality of improvement linked with asset refurbishment, especially for those starting with lowest energy performance level, is also essential in that context.
- Product relevance: Real estate investments are not eligible assets for certain types of products, e.g. UCITS.

The following table is based on a sample size of 463 SFDR Classified 9 funds (mostly equity). The requirement for the analysis was that the funds must have reported Taxonomy holdings (without any estimates) and sufficient enough coverage of the company level EU Taxonomy revenue alignment % and EU Taxonomy revenue eligibility % to enable a fund level aggregation based on the holdings.

	Percentage of Funds in Compliance based on "EU Taxo Revenue Aligned %"*	**Percentage of Funds in Compliance based on "EU Taxo Revenue Eligible %"***
80% Minimum Threshold	1.7%	7.6%

60% Minimum Threshold	5.0%	30.5%
40% Minimum Threshold	17.1%	71.7%
20% Minimum Threshold	44.1%	89.0%
10% Minimum Threshold	71.9%	91.8%
*Based on 463 SFDR Article 9 Funds		

Source: Bloomberg as of September 2024

Based on this sample size and extrapolating the results of this sample size to the remaining universe, with e.g. 1.7% of Article 9 funds would reach 80% minimum threshold and 17.1% of Article 9 funds would reach a 40% minimum threshold. Above data does not take into account any PAB exclusions or DNSH assessments. Setting such threshold as a commitment would not cater for PAB exclusions/DNSH assessments, for sectorial or jurisdictional biases or the need of managed portfolios to react to markets etc. A prudent committed threshold therefore needs to be lower or determined based on the overall investment universe

2.3 Taxonomy data in an exemplary general account

Similar to the listed data analysis, a regional distribution of EU Taxonomy eligibility for two sample European general accounts highlights the low potential for increased Taxonomy shares. Taxonomy alignment in "Alternative/other" mainly driven by renewable energy exposure.

in market values	Sample European General Account I	Sample European General Account II
Africa	0.6%	0.4%
Asia / Pacific	8.1%	3.0%
Central and South America	3.3%	1.9%
Europe	67.1%	81.0%
North America	16.2%	11.3%
Other	4.7%	2.6%
All Regions	**100.0%**	**100.0%**

Source: EU Platform, anonymised, data as of Q3 2024

in market values		Sample European General Account I					Sample European General Account II				
		Alternatives /Other	Fixed Income	Public Equity	Real Estate	All Asset Classes	Alternatives/ Other	Fixed Income	Public Equity	Real Estate	All Asset Classes
Taxon. Alignment (Turnover) (%)	Asia / Pacific	0,0	0,2	0,1	0,0	**0,2**	0,0	0,3	0,1	0,0	**0,1**
	Central and South America	0,0	0,3	0,3	0,0	**0,3**	0,0	0,9	1,1	0,0	**0,9**
	Europe	14,7	4,1	2,6	0,0	**4,4**	9,1	2,2	2,4	4,1	**3,1**
	North America	0,0	0,5	0,7	0,0	**0,4**	0,0	0,4	0,8	0,0	**0,3**
	All Regions	**11,7**	**3,2**	**1,3**	**0,0**	**3,5**	**5,2**	**1,7**	**1,1**	**2,6**	**2,1**
Taxon. Alignment (CapEx) (%)	Asia / Pacific	0,0	0,1	0,2	0,0	**0,1**	0,0	0,2	0,0	0,0	**0,1**
	Central and South America	0,0	0,1	0,0	0,0	**0,1**	0,0	0,1	0,0	0,0	**0,1**
	Europe	1,0	4,6	4,8	0,1	**3,9**	3,3	2,4	5,0	4,1	**2,8**
	North America	0,0	0,5	0,7	0,0	**0,5**	0,0	0,5	0,5	0,0	**0,3**
	All Regions	**0,8**	**3,6**	**2,1**	**0,0**	**3,1**	**1,9**	**1,8**	**1,7**	**2,6**	**1,9**

in market values		Sample European General Account I					Sample European General Account II				
		Alternatives /Other	Fixed Income	Public Equity	Real Estate	All Asset Classes	Alternatives/ Other	Fixed Income	Public Equity	Real Estate	All Asset Classes
Taxon. Eligibility - Taxon. Alignment (Turnover) (%)	Africa	0,0	0,4	0,0	0,0	**0,4**	0,0	0,0	0,0	0,0	**0,0**
	Asia / Pacific	0,0	9,9	4,8	48,8	**9,5**	0,0	6,2	8,5	70,0	**18,6**
	Central and South America	0,0	1,6	21,6	0,0	**2,0**	63,7	4,8	2,2	0,0	**5,4**
	Europe	13,4	11,5	8,8	75,0	**17,7**	2,8	4,3	10,4	76,1	**11,6**
	North America	0,0	7,1	12,8	83,4	**10,5**	3,0	7,9	11,3	84,1	**15,9**
	All Regions	**10,6**	**10,1**	**8,5**	**74,9**	**15,4**	**2,6**	**4,6**	**9,6**	**75,9**	**12,2**
Taxon. Eligibility - Taxon. Alignment (CAPEX) (%)	Africa	0,0	0,9	0,0	0,0	**0,9**	0,0	0,0	0,0	0,0	**0,0**
	Asia / Pacific	0,0	2,3	1,0	48,8	**4,1**	0,0	1,3	3,1	70,0	**15,4**
	Central and South America	0,0	0,6	9,6	0,0	**0,9**	0,0	1,9	1,6	0,0	**1,9**
	Europe	0,0	5,2	11,8	75,0	**11,7**	-1,1	2,6	12,8	76,1	**10,0**
	North America	0,0	5,4	4,7	83,4	**8,1**	0,0	6,3	4,4	84,1	**13,4**
	All Regions	**0,0**	**4,8**	**6,3**	**74,9**	**10,2**	**-0,7**	**2,8**	**6,3**	**75,9**	**10,3**

Source: EU Platform, anonymised, data as of Q3 2024

The table generally shows how much of the respective asset class in % of market values invested is EU Taxonomy eligible, but not aligned (green cells are those regions/asset classes which also have EU Taxonomy-aligned exposure; non-coloured cells indicate that no EU Taxonomy-aligned exposure has been subtracted). The table may provide an indication into the potential of further EU Taxonomy alignment in the respective region/asset class[73]. Especially in combination with the table above (and/or the green colouring) the table further provides an indication into the EU Taxonomy alignment potential with a reality check in the sense of "likelihood for turning eligibility into alignment based on current EU Taxonomy alignment". In practice, there might be limitations for investments outside the EU to identify Taxonomy alignment. In particular, for long-term investments which have been made prior to the Taxonomy Regulation being in place, FMPs have limited means to identify Taxonomy alignment.

To deepen the understanding of the potential of the sustainable category, the Platform suggests the following next steps:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.
- Assess the potential of products to fall into the sustainable category by testing criteria, where possible on a sample of existing products.
- Analyse the impact of contribution thresholds, in particular Taxonomy thresholds for the allocation within portfolios, also taking into account different asset classes.
- Further analysing SI commitments for SFDR products, though the indication is limited given the proposal of enhancing the SI definition.
- There might also be a merit in identifying data available with a split on social and environmental SI: Depending on further development of criteria to identify social SI and the potential development of a social EU Taxonomy, social SI could remain relevant for setting the thresholds, whereas environmental SI could only be counted for the positive contribution if the activity is not yet covered by the EU Taxonomy.
- Lastly, the coverage and average SI shares of broad market indices (EQ and FI), both in Europe but also globally would be interesting. This could also be done applying the new SI methodology.

3. Sustainable category – Do no significant harm

To identify the effect of the DNSH criteria both for the contribution but also for the remainder of the portfolio, we have analysed the existing holdings in Article 9 funds and the effect on cutting of the worst performers per PAI indicator. When applying the PAI indicators, the analysis differentiates between

- all mandatory PAIs except 2 (since it is a helpful KPI on portfolio level but difficult to be used to assess single companies), 6 (sector specific), 11 (no data),
- only selected PAIs Selected PAI 3, 7, 8, 9.

In addition, it is worth noting that data coverage of single PAIs varies significantly and is very low for some of the PAIs. This is shown in the following graph:

[73] Negative values are possible in cases, where EU Taxonomy eligibility reporting is not available.

Source: Sustainalytics. Data as of May 2024.

The rationale for the selection of PAI is as follows:

PAI	**The rationale for the selection of PAI**
PAI 1: GHG emissions	Exclusion of worst performers at sectoral level
PAI 2: carbon footprint	Relevant on portfolio level but not to assess investments in single companies
PAI 3: carbon intensity	Exclusion of worst performers at sectoral level
PAI 4: fossil fuel sector exposure	Covered with PAB exclusions
PAI 5: share of non-renewable energy	Not applied because FMPs do not control energy mix
PAI 6: energy consumption intensity	Data scarce, sector specific and not estimable
PAI 7: Activities negatively affecting biodiversity-sensitive areas	Exclusion of worst performers at sectoral level
PAI 8: Emissions to water	Data not available and estimable so focus on water consumption intensity instead- Exclusion of worst performers at sectoral level
PAI 9: Hazardous waste and radioactive waste ratio	Exclusion of worst performers at sectoral level
PAI 10: Violators of UNGC and OECD MNE guidelines	Covered with PAB exclusions
PAI 11: Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Covered with PAB exclusions as adjusted
PAI 12: Unadjusted gender pay gap	not considered due to lack of data
PAI 13: Board gender diversity	Exclusion of worst performers at sectoral level
PAI 14: controversial weapons	Covered with PAB exclusions

The DNSH

criterion is tested on a mock-up portfolio made of top 50 held stocks by Article 9 funds (composed of CSRD and non-CSRD companies) and leveraging Morningstar Sustainalytics' data (reported and estimated). The test uses

a portfolio revenue weighted approach. PAB exclusions are applied to the entire portfolio, it leads to the exclusion of only two companies in the mock-up portfolio. This shows that the mock-up portfolio of Article 9 holdings is already very close to adhering to the PAB exclusions. SI is limited to non-Taxonomy eligible activities. For the DNSH criterion the worst 10% of 5 % of companies according to PAI indicators are cut off. This criterion is applied to the entire portfolio except for Taxonomy-aligned investments. If a company has not reported or estimated data on a specific PAI indicator, it is considered as a worst performer. In addition, to illustrate the difference, for the 10% cut of, the test is also applied where companies with no data are not assessed with the PAI DNSH criterion. Finally, the test is applied using selected versus maximum amount of mandatory PAIs based on data relevancy (see below) and availability which varies significantly (see above).

Step 1: identify share of 'eligible' sustainable contribution before PAB exclusions and DNSH	***Step 2: identify Sustainable contribution of portfolio after PAB exclusions and DNSH***				***Step 3: identify Exclusions required with PAB and DNSH (portfolio remainder)***
36% 20% Taxonomy-aligned 16% SFDR SI	Most PAIs	10% cut off	No data **NOT** considered worst performers	**17%** 16.8% Taxonomy-aligned 0.2% SFDR SI	56% to be excluded **28 companies to be excluded** 2 due to PAB, 26 due to DNSH
			No data considered worst performers	**19%** 18% Taxonomy-aligned 1% SFDR SI	42% to be excluded **21 companies to be excluded** 2 due to PAB, 19 due to DNSH
		5% cut off	No data considered worst performers	**21%** 19% Taxonomy-aligned 2% SFDR SI	36% to be excluded **18 companies to be excluded** 2 due to PAB, 16 due to DNSH
	Selected PAIs	10% cut off	No data **NOT** considered worst performers	**20%** 17% Taxonomy-aligned 3% SFDR SI	38% to be excluded **19 companies to be excluded** 2 due to PAB, 17 due to DNSH
			No data considered worst performers	**26%** 17% Taxonomy-aligned 9% SFDR SI	24% to be excluded **12 companies to be excluded** 2 due to PAB, 10 due to DNSH
		5% cut off	No data worst performers	**33%** 19% Taxonomy-aligned 14% SFDR SI	12% to be excluded **6 companies to be excluded** 2 due to PAB, 4 due to DNSH

Source: Sustainalytics, data as of November 2024

The test shows that the contribution varies considerably (between 17% and 33%) depending on the way criterion to exclude companies based on PAI performance is applied including the question what PAI indicators are taken into account and how to treat companies where no data is available. **Where the contribution is mainly derived from the EU Taxonomy, but without the use of Taxonomy estimated data, the contribution of the portfolio would roughly cut by 50%.** More importantly, when applied at the level of the entire portfolio the PAI cut off criterion, require divesting from 4 to 26 stocks depending on the approach used, while the PAB exclusions would require divesting from 2 stocks.

To identify the best safeguards for the remainder of the sustainable category, the Platform suggests the following next steps:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.
- Analyse which types of companies are excluded through the different PAI assessments and the PAB exclusions.
- Analyse whether PAB exclusions and PAI indicators could be combined in one set of safeguards.
- Identify the desired result in terms of perception of investors regarding safeguards and possible investments in the sustainable category.

4. Transition category

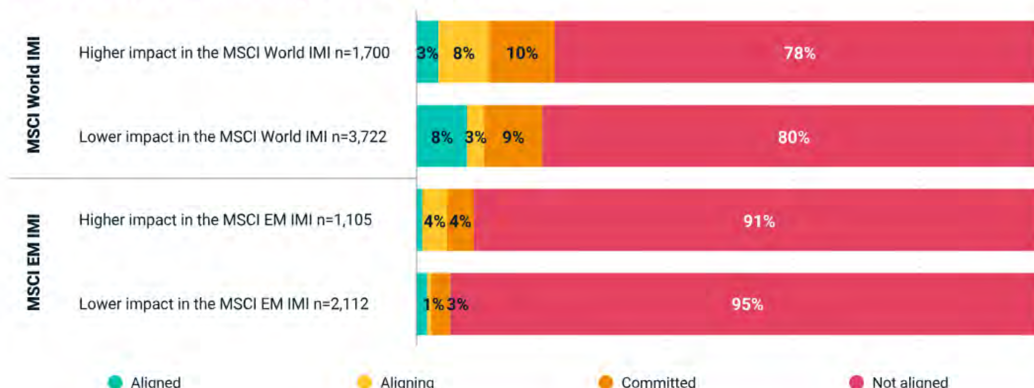
For the transition category, data that implies how existing portfolios are aligned with the goals of the Paris Agreement could be helpful. Assessing the credibility of a transition plan is an exercise which requires to consider

several dimensions and will overtime be facilitated by enhanced disclosures including in the context of the CSRD implementation.

As noted in the 2023 Communication on Transition Finance, the framework developed by the science-based targets initiative can provide a useful source of information in this context, with more than 6,000 companies which have set clearly defined, science-based pathways which have been validated by the Science based target initiative (SBTi) as of August 2024[74].

To support investors in the implementation of their Net Zero commitment, industry methodologies have been developed, providing a framework for such assessment which can help assess the feasibility of proposed thresholds for a transition category.

This includes the Net Zero Investment Framework[75]. MSCI has matched issuers against the Net Zero Investment Framework Climate Criteria and shows the result against the MSCI World Investable Market Index as well as the MSCI Emerging Market Investable Market Index[76].



Source: MSCI ESG Research, data as of April 23, 2024.

Below is an example of an asset manager regarding net zero maturity of investee companies. The analysis combines quantitative and qualitative insights and is based on the Net Zero Investment Framework for listed asset classes (Listed Equity & Corporate Fixed Income)

NZIF/IIGCC categories			-	**Not Aligned**	**Com-mitted to Aligning**	**Aligning towards NZ**	**Aligned to NZ**		**Achie-ving NZ**
Net Zero Investment Framework requirements		NZ ambition	-	No	Yes	No	No	Yes	Yes
		Short & mid-term targets (Scope 1 + 2 + material Scope 3)	-	No	No	Yes	Yes	Yes	Yes
		Effective GHG emission performance (on all Scopes)	-	-	-	No	Yes	Yes	Yes
		Effective disclosure (on all Scopes)	-	-	-	Yes	Yes	Yes	Yes
		Quantified decarbonisation strategy (on all Scopes)	-	-	-	Yes	Yes	Yes	Yes
		Capital allocation alignment	-	-	-	-	-	Yes	Yes
		Climate governance alignment	-	-	-	-	-	Yes	Yes

[74] Climate Action Milestone: 6,000+ Companies Adopt Science-Based Targets - Science Based Targets Initiative.
[75] Net Zero Investment Framework updated: NZIF 2.0 (iigcc.org)
[76] Steering Toward an Aligned Portfolio (msci.com)

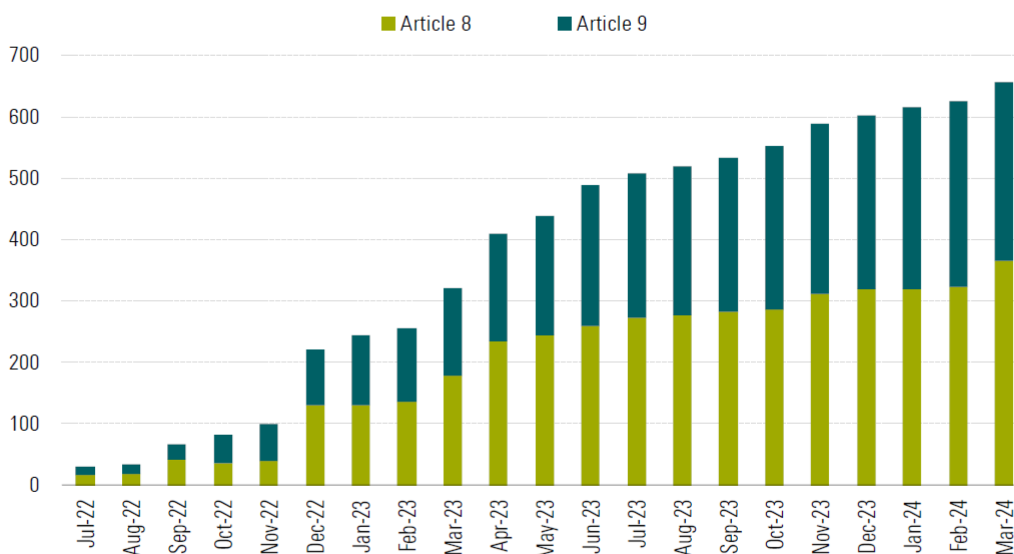
Investor implementation	MSCI All Country World Index (All sectors)	0%	8%	19%	42%	31%	0.8%
	Intercontinental Exchange Bank of America global broad market	5%	5%	18%	42%	30%	0.3%

Source: EU Platform, anonymised, data as of end 2023

Please also refer to the asset class split on the general account examples.

Further, below graph shows **the number of Article 8 and 9 funds with carbon emission reduction objectives, i.e. as of March 2024, 365 Article 8 and 292 Article 9 funds, i.e. a total of 657 funds had identified a carbon emission reduction objective in the EET.** Those could also have the potential to fulfil the criteria of the transition category. However, it would depend on the thresholds set which is not reflected in below graph.

Number of Article 8 and 9 funds with carbon emission reduction objectives



Source: Morningstar Direct. Data as of March 2024, based on a total of 3,948 funds that populated the field, including 3,125 Article 8 funds and 823 Article 9 funds. The increase in the number of funds with carbon-reduction objectives also partly reflects the increase in EET coverage.

To identify which products could fall into the transition category, the Platform suggests the following next steps:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.
- Further analyse the performance of issuers including sovereign issuers against existing Net Zero Frameworks for different asset classes.

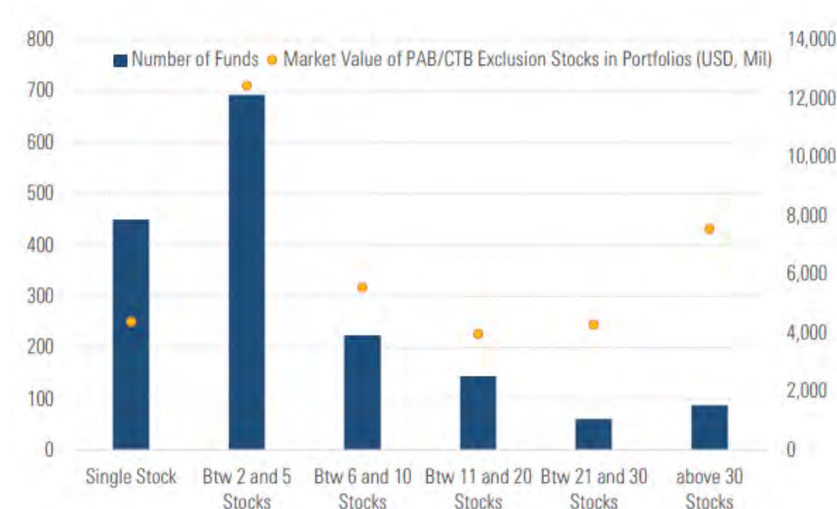
5. Exclusions

For the exclusion criteria (including the proposed changes) the Platform recommends looking at the following:

- Impact on products or holding level: Number of holdings that will be affected by exclusions criteria will give an indication on how much the investment universe will be reduced. However, this is limited based on available data.
- Effect of exclusions on certain industries: Excluding specific industries can lead to overweight other industries which would still need to be in line with the general investment objective.
- Data availability on CapEx.

Below chart shows the potential impact of PAB/CTB Exclusion rules based on a sample of around 4,300 open-end funds and ETFs with ESG or sustainability-related terms in their names that may fall in the scope of the guidelines. Out of these 1,600 European funds were identified that potentially could be in breach of PAB/CTB exclusions. It is to be noted that there is some variability when comparing how many companies are to be excluded by the application of PAB / CTB exclusion rules, which may be due to the lack of underlying data requiring to use proxies as well as some differences in the interpretation of certain exclusion criteria.

Distribution of amount of companies to be excluded from around 1,600 funds when applying PAB / CTB exclusion criteria



Source: Morningstar / Sustainalytics as of May 2024

The chart shows that the majority of the funds hold fewer than five stocks potentially in breach of PAB or CTB exclusion criteria though it does not differentiate between CTB and PAB exclusions.

Below chart shows funds` portfolio holdings in companies exposed to PAB exclusions (except for UNGC violations) based on a sample of 9147 Article 8 and 814 Article 9 funds. **It shows that the average AuM that will have to be excluded are around 4 % for the PAB exclusions and between 6 and 7% for the CTB exclusions. For the latter the main driver of exclusions are the UNGC violations.**

Impact of PAB exclusions on funds using sustainability, environment and impact related terms							
SFDR	sample fund number	thereof using terms related to sustainability, environment and impact	thereof investing in companies with PAB exclusions activities excl. UNGC violations	Total AUM - USD	Total Market Value of positions excluded - USD	Average AuM excluded	Main driver of exclusion
Art. 8	9,147	1,817 (20%)	1,185 (65%)	718,298,419,210	26,032,611,515	4.2 %	Fossil Fuel
Art. 9	814	495 (61%)	245 (49%)	92,436,007,625	2,232,356,725	3.7 %	

Impact of CTB exclusions on funds using social, transition or Governance related terms							
SFDR	sample fund number	thereof using terms related to social, transition or Governance	thereof investing in companies with tobacco, cont. weapons activities or UNGC violations	Total AUM - USD	Total Market Value of positions excluded - USD	Average AuM excluded	Main driver of exclusion
Art. 8	9,147	54 (1%)	50 (93%)	19,989,780,585	1,483,961,978	7 %	UNGC violation
Art. 9	814	42 (5%)	32 (76%)	5,447,729,688	425,612,011	6 %	

Source: Bloomberg as of November 2024

The Platform recommends replacing UNGC violations with UNGP to align with minimum safeguards. Besides the fact that as of today CTB exclusions might conflict with reported minimum safeguards there are the additional

issues to be considered. Applying CTB exclusions without differentiations may lack the clarity needed by the market on what is a relevant divestment signal. Further, flags differ from vendor to vendor.

CTB exclusions: Examples of UNGC violation flags

Below are examples of companies reporting information that could be mapped to the principles of UNGC. The examples are chosen to illustrate situations where it could be considered too extensive to exclude companies only based on such types of flags. Depending upon the approach to divestment that an investor takes, however, it could lead to an exclusion. Hence, guidance is needed, to understand materiality, duration, and proof, in order for a more consistent application of UNGC violations. This is discussed below.

Type of flag	Examples as reported by company
Discrimination and harassment dispute flags	• Confirmed discrimination and harassment reports 9 in 2024; 4 cases in 2023. • Number of formal disputes involving discrimination: 6 • Total of 14 (18) suspected misconducts were reported in person or via the whistleblowing line to the Investigations Group in the following categories: discrimination. • 10 employees in France took their case of gender discrimination related to salary and career advancement in ST to the French court. After three years, the first instance judgement ruled out any discrimination.
Harassment lawsuits flags	• Confirmed discrimination and harassment reports 9 • Number of formal disputes involving harassment: 1 • Total number of complaints about discrimination received through the whistleblowing mechanism in Italy 11
Health and Safety lawsuit flags	• With regard to the year 2022, the Group definitively lost 2 lawsuits concerning employees and former employees, only one of which amounted to more than 10,000 Euro (significance threshold set by the Group). In addition, 7 penalties were paid (of which 1 related to previous years) for health and safety violations, none of which exceeded 10,000 Euro individually. • The authority may submit a case to the public prosecutor for review. In 2023, SEK 100,000 (0) was paid as a corporate fine to the Swedish Police Authority concerning an injured finger in a workplace accident that took place in 2021. In 2023, authorities began an investigation into the tragic fatal accident that occurred at a subcontractor in forestry operations. • XXX (Singapore) fined $SGP280,500 for work related fatal accident that happened in 2017.
Grievances flags	• Stakeholder complaints 2023, 2022, 2021 - Number of complaints - 10 • In 2022, we registered 54 complaints and grievances in the entire Group - mainly from the neighbours of our investments • In 2023, EDPR registered 19 complaints regarding potential impacts on the local communities • In 2023, two complaints were received from environmental associations against the Environmental Impact Statements for the gas pipeline project • During 2022, 141 grievances. The complaints mainly concerned: management of relations with the communities (most recurring category), management of environmental aspects, land management, employment development, and economic diversification. • In 2023, 56 Group companies identified 582 actual and potential issues (high, medium or low risk) related to different topics, such as dust emissions, security - related violations, freedom to speak up and grievance mechanisms, that could negatively impact local communities. These are included in the human rights action plans, and implementation of the defined actions is periodically monitored. As part of the annual human rights and stakeholder questionnaire, in 2023, 118 new or ongoing grievances relating to the impacts of operations were recorded by 33 Group companies. • One factory was the subject of a neighbourhood complaint in 2022, for two reasons: the first involving the noise caused by the use of a chiller and the second involving an odour problem originating from the site’s filtration garden (an installation that uses plants to treat wastewater • During 28 inspections, violations of the terms of applicable permits or decisions, and/or non-compliances with environmental standards were found. The respective companies were required to implement post-inspection measures. In two cases a fine was imposed.

Type of flag	Examples as reported by company
	The inspections covered a variety of areas, including waste management, wastewater management, use of natural resources, and assessment of the quality of surface water and wastewater discharges. Furthermore, the ORLEN Group companies received 36 grievances about their operations concerning, among other things, noise or odour emissions from their sites.

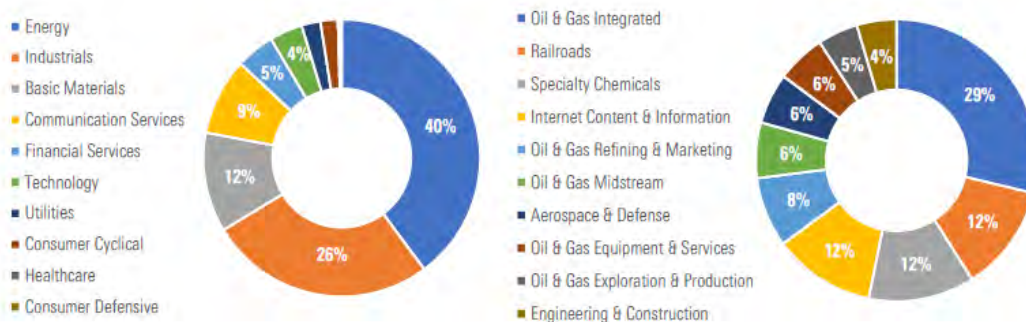
Source: Company reported data related to social fines or issues, sourced from Bloomberg as of November 2024

The table shows the following issues on which guidance could be helpful until UNCG is replaced by UNGP. Currently the market does not apply consistent views on these points:

- Duration: It is not clear for how long a violation should be considered – duration could be identified, e.g. in the last 12 months
- Materiality: some of the cases seem fairly low level and quite normal within a company`s course of business – application of severity could help identifying a common relevant level
- Proof: in many cases the reporting relates to 'claims' but not necessarily settled or resolved cases that found the company in breach (some cases the company was found to be innocent of charges) - stage when a social 'claim' becomes a violation worthy of divestment should be identified, i.e. identifying whether the allegation is relevant or the actual / evidenced occurrence of a violation.

The PAB exclusions also have a specific impact on companies in certain industries. Below graph shows which sectors will potentially be most affected by stock divestments if PAB/CTB exclusions are applied. Nevertheless, the industry would still be able to issue use of proceeds instruments that could be invested in by a sustainable or transition product.

Impact of PAB/CTB exclusions on different industries



Source: Morningstar Sustainalytics and Morningstar Direct, data as of May 2024, For industries only the top 10 are shown.

Below table shows which companies reporting a CapEx Taxonomy alignment would have to be excluded if PAB exclusions are applied (except for use of proceeds instruments that fulfil relevant criteria).

Impact of PAB exclusions on different industries reporting Taxonomy CapEx

Taxo Capex > 0%	Fail PAB Exclusions	Pass PAB Exclusions	Grand Total	% Failure
Energy	31	12	43	72%
Utilities	26	57	83	31%
Communications	3	31	34	9%
Consumer Staples	5	52	57	9%
Materials	7	82	89	8%
Financials	1	17	18	6%
Real Estate	2	47	49	4%
Industrials	9	217	226	4%

Taxo Capex > 0%	Fail PAB Exclusions	Pass PAB Exclusions	Grand Total	% Failure
Health Care	1	26	27	4%
Technology	1	57	58	2%
Consumer Discretionary	1	107	108	1%

Source: Bloomberg as of October 2024

The Platform in its proposal suggests limiting fossil fuel build out through limiting CapEx exclusions. In connection with this, it is important to note that all companies (even those transitioning) will need to invest to maintain critical infrastructure. More specifically, excluding build out of fossil fuels requires data that allows distinguishing in the CapEx information essential maintenance from build out of infrastructure. Should such data not be readily available, analysts would need to identify such data through manual processes triggering respective costs for such data which ultimately will be borne by the investor. The Platform would see a merit for companies to separately report maintenance and build out investments regarding fossil fuel.

The following examples show two sample companies reporting on CapEx investments in fossil fuel where it is unclear whether CapEx is used for maintenance or for building out fossil fuel infrastructure.

Shell

Cash capital expenditure

Cash capital expenditure* was $24,392 million in 2023, compared with $24,833 million in 2022. The cash capital expenditure in 2023 consisted of $12.5 billion investments in oil, oil products and other, $5.6 billion investments in low-carbon energy solutions, $4.0 billion investments in LNG gas and power marketing and trading and $2.3 billion investments in non-energy products.

Ibedrola

- On 12 October 2023, the New York State Public Service Commission (NYPSC) approved the joint proposal by New York State Electric and Gas (NYSEG) and Rochester Gas and Electricity (RGE) for new rates for the period from May 2023 to April 2026. The proposal includes a clause allowing the companies to recover the collection rights generated by the companies between May 2023 and October 2023 as a result of the delay in the approval of the new rates in the November 2023 to April 2026 period. The approved rate plan assumes an increase in revenue of US$430 million, a return on equity of 9.20%, an equity ratio of 48% and a capital expenditure plan of US$6,400 million: US$1,100 million in 2022 and US$5,300 million in 2023-2026. These figures include US$634 million for Phase I of the CLCPA. In addition, the new pricing plan will allow investments to improve the resilience and reliability of the grid and its resistance to cyber-attacks, as well as to increase energy efficiency, heat pumps and electric vehicles.

		2023	2025	2026	2030
Boosting electricity as a clean, autonomous, local, stable, safe and competitive source of energy					
DECARBONISATION	**Carbon Neutral** in electricity generation in **2030** Specific emissions global mix (g CO_2/kWh)	77	60 (<70)[1]	55	Carbon Neutral[2]
	Net Zero in scopes 1, 2 and 3 before **2040**	In progress		SBTi milestone fulfilled[3]	
	NOx emissions kg / MWh	0.34	0.17 **(new)**	0.15	<0.10
	Sustainable light vehicle fleet % of total light vehicle fleet	31%	48% **(new)**	56%	100%
	Storage capacity Cumulative installed storage capacity (GWh)	101.9	108 *(102)*[1]	118	136
INNOVATION AND DIGITALIZATION	**Smart Grids** % automation of high and medium voltage assets	78%	83%	85%	90% **(new)**
	Investment in R&D Million euros (annual)	384.4	420	443	550
	Green hydrogen Annual production (kt H2)	0.42	2 *(35)*[1]	5	120 *(350)*[1]
	Cybersecurity assessments Number of annual assessments or external verifications	2,497	2,000	2,000	2,000
SUSTAINABLE FINANCE	CAPEX **Aligned (new)** % of Taxonomy aligned CapEX[4]	88.8%	~90%	~90%	~90%
	Sustainable financing % of total financing	90%	Min. 80%[5]	Min. 80%[5]	-

These samples show that the data to distinguish required maintenance from build out of fossil fuel production facilities is not necessarily readily available.

To identify how exclusions should best be applied to products, the Platform suggests the following next steps:

- Identify sources, collect and analyse data for SFDR products other than liquid funds, in particular insurance and pension products as well as private market funds.
- Further analyse the availability and impact of exclusion criteria for different asset classes and reasons.

Annex B. Principle aspects and objectives

Key messages:

- It is vital to ensure the categorisation scheme produces the best outcomes for retail investors. It should also be usable for all other investors.
- Categorisation should cover all those parts of the market which address investors´ sustainability preferences and be applied equally across the EU, replacing national schemes.
- Categorisation should build on the positive elements introduced through the SFDR and the wider Sustainable Finance Framework.
- Categories should require fulfilment of precise minimum criteria, clear definition of product´s objective as well as measurable KPIs.
- Categorised products should measure and disclose their sustainability performance.

The categorisation scheme must adhere to the following objectives:

- **User-friendly for retail investors and useful for all investors:** The categorisation should be easy to understand, clearly distinguishing between the different categories and addressing the sustainability concerns of investors. A categorisation scheme should prioritise the needs of retail investors who should easily identify products that match their sustainability preferences. Financial advisors should also effortlessly find products aligned with their clients' sustainability preferences, facilitating contributions to a sustainable economy or its transition. To achieve this, questions around sustainability preferences should mandatorily start with and build upon the categories. Further, it should also consider the specific needs of professional or other institutional investors, who typically possess a deeper understanding of sustainability information and their corresponding needs but may wish to use the categorisation when interested.
- **Ensure Investor Protection**: The categorisation must include sufficient minimum criteria to ensure that, first, investors understand the sustainability aspects of a product and, second, the claims of a product align with its actual performance fostering investors' confidence. Adequate minimum criteria are essential for ensuring that the categorisation system is widely accepted as credible within the market. Additionally, transparency regarding the capabilities and limitations of a product is crucial to prevent misunderstandings and potential mis-selling. The Platform's transparency considerations are addressed in section 7, while governance and assurance considerations are assessed in section 9.1.
- **Unlocking capital to support the Sustainable Finance Agenda**: An effective categorisation scheme, linked to simple and clear sustainability preference options, can unlock much-needed private capital to narrow the EU investment gap. The categorisation system ought to encourage FMPs to create, and investors to invest in, financial products that redirect capital flows towards sustainable investments, including investing in financing the transition to a resilient, circular, more sustainable net zero economy in line with the EU Commission's recommendations.[77] The categorisation must further the decarbonisation of portfolios and resilience of the economy. While allowing for innovation and some niche and very focused products, the overall system needs to be scalable. In other words, categories cannot be structured in a manner that would lead to an overheated market due to a limited availability of investments that fulfil categorisation criteria. To effectively support the channelling of flows to support the EU environmental goals, the scheme should also be usable across different asset classes, ideally be asset class neutral, taking into account their specificities. It should equally aim at incentivising

[77] See European Commission Recommendation on facilitating finance for the transition to a sustainable economy (EU) 2023/1425 of 27 June 2023.

FMPs to adhere to a set of minimum criteria, thereby potentially improving responsible investment practices and sustainability performance of underlying investments.

These objectives need to be balanced and weighted. More specifically, prescriptive features can improve comparability and might make it easier to comprehend what a category entails. At the same time such features can restrict innovation and have an impact on how financial goals can be delivered. Finding the right balance between the objectives is crucial and testing should facilitate identifying the right balance.

The Platform reiterates the principal aspects outlined in the SFDR L1 Brief to be decided upon for developing the categorisation scheme. Based on these, the Platform proposes the following:[78]

Aspects of Categorisation	Platform proposal
Use: Clarify the intended audience or purpose, emphasising user-friendliness for retail investors while allowing flexibility for tailored products for institutional clients. Link categorisation to sustainability preferences.	Addressing retail investors' needs should guide the definition of a categorisation scheme. The more categories, the more information needs to be conveyed. Thus, the number of categories needs to be limited. It does not pre-empt sub-categories or an underlying, more layered system of how products are allocated between categories, e.g. to address asset class specifics or distinguish between different types of financial products.
Clarity: Ensure a clear and objective categorisation system using clear criteria, potentially measurable indicators, minimising doubts about product allocation. Evaluate the use of indicators and the data availability for clarity.	Products should only be allocated to one category. For the allocation of products between categories, the Platform suggests minimum criteria for each category, a high-level list of binding elements as well as mandatory indicators for measurement.
Impact: Assess the impact on market perception and innovation, avoiding limitations on products that do not neatly fit into established categories but also ensure that the categorisation is in line with the overarching policy objective of financing the transition into a sustainable economy. Provide for a category capturing all products that are not categorised. Balance effective changes with feedback from stakeholders and consider the impact on existing systems.	The categorisation scheme should build on existing EU Sustainable Finance Framework features as much as possible and ensure that innovation is not limited. It should consider market reality as follows: • Identifying products that do not fall into any of the defined categories as e.g. "unclassified". Otherwise, the market will on its own identify the remainder of the products (see "Art. 6" products under the SFDR). • The categories should make use of the existing features provided by SFDR,[79] namely using binding elements (that might lead to identify a specific category), (i) indicators to measure compliance with binding elements including adherence to indicator thresholds, where applicable and (ii) report on performance of indicators (publicly or bilaterally depending on the product audience). • Criteria should be used to (i) show a product´s ambitions identified through pre-contractual commitments (ii) provide for guardrails through minimum criteria for specific product categories and (iii) show a product's sustainability performance through reporting (see section 7). The first and second element might overlap. • A product's sustainability objective should be the defining element to differentiate between product categories. Categories should not be built focusing exclusively on one sustainability feature (e.g. exclusion criteria), because, in

[78] More details on the underlying considerations can be found in Annex B.
[79] The relevant features of SFDR are described in detail in Annex F.

Aspects of Categorisation	Platform proposal
	practice, most products combine different features and having a pre-defined list of specific sustainability features could hinder innovation. • Creating an unintentional hierarchy between different categories based on current levels of sustainability performance could unintentionally discourage investments in sectors that urgently need funding to transition away from harmful activities. At this point in time, the Platform does not recommend a hierarchy between the categories but a clear distinction of the sustainability-related credentials of each.[80]
Optionality: Consider giving FMPs the choice to use categorisation for non-retail market/non-tailored products. Propose a minimum disclosure requirement for all products in reporting in lines with the Platform´s proposals for Article 8 products and a categorisation system for the retail market.	FMPs should retain the discretion to categorise products. All products not categorised be identified as "unclassified". Unclassified products should adhere to minimum reporting requirements but face restrictions on communicating their environmental or social characteristics in marketing materials, as per the Platform's previous recommendations.
Committed vs. Actual-Based: Suggest categorising products based on marketed investment strategy and committed indicators.	Categories must be structured to foster innovation without impediment. This requires careful consideration and balance when defining binding elements and minimum criteria, maintaining clarity and ambition.
Accountability: Any categorisation schemes ought to ensure that there is full transparency to the market on any negative or offsetting impact from the non-binding share of the product.	Full transparency is essential to ensure the necessary level of investor protection. Disclosure should include all those elements crucial for investors and cover those aspects of the product not governed by binding elements.

Building on these, the Platform also adds the following considerations:

- **Number of categories**: The number of categories should be limited to be easy understandable. The more categories are foreseen, the harder the distinction will be. This does not preclude that underlying such categories is a more detailed and potentially more layered system in terms of how to define these categories. Rather, it would generally be possible to capture the different product with simple, high-level categories and have a more detailed underlying system how products are allocated to these categories which provides sufficient investor protection, does not hinder innovation and is compatible with different investment strategies and asset classes including private markets. It also does not preclude to consider additional elements such as sub-categories, labels or other ways of distinguishing products within one category. Depending on the type of investors, this might help guiding the investors that have a more specific need.
- **International compatibility**: The scheme should be compatible with international schemes as far as possible. Investors operate on a global scale, allocating capital across borders. Data for indicators that are used within the EU are often not readily available elsewhere. The use of estimates and proxies needs to be considered. Further, global alignment ensures that investors, businesses, and policymakers share a common understanding of what constitutes sustainability and what a sustainable product can offer. This clarity is essential for directing capital flows effectively and achieving goals such as net-zero emissions. Financial products developed within the EU are often distributed beyond its borders. A compatible scheme ensures that these products align with global sustainability standards. The more systems are established with different requirements or different indicators, the more difficult it becomes for FMPs to use economies of scale by distributing a product in diverse jurisdictions increasing the need for launching different products.

[80] See also details in Annex H.

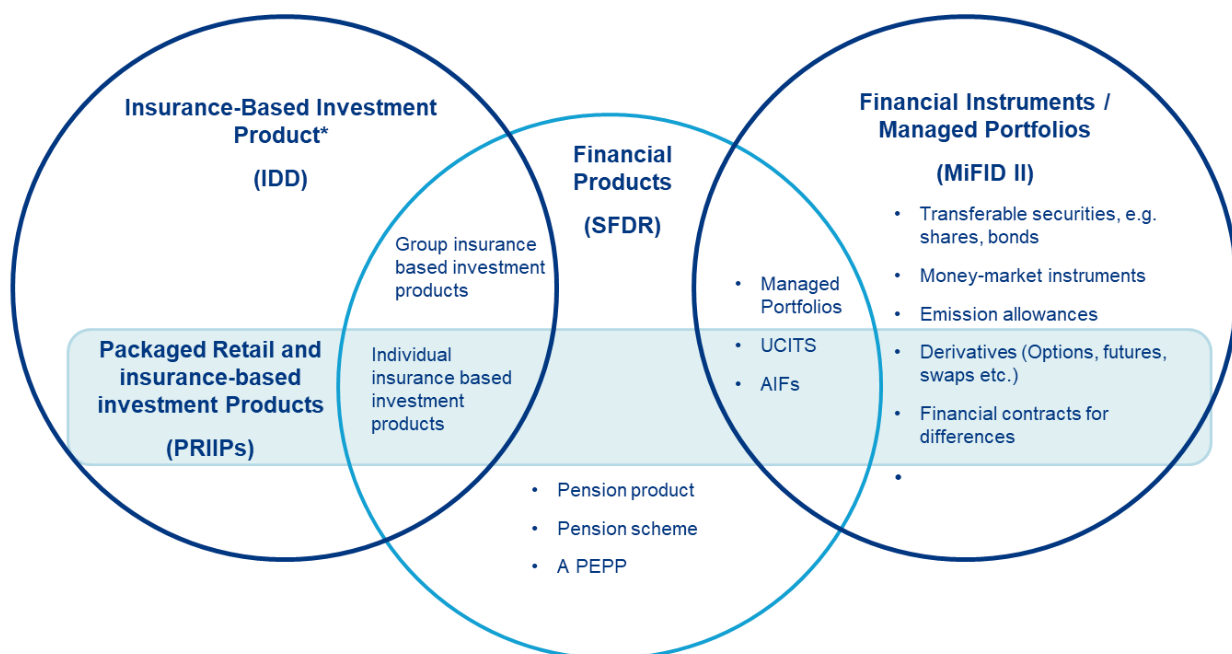
- **Market coverage of categories**: The Platform identified largely three alternatives on what the categories could cover: (1) covering only a smaller part of the overall market, (2) covering the market that today is captured under SFDR as products with environmental or social characteristics or SIs as objective (and in addition those that potentially address sustainability preferences), (3) covering the whole market of products in scope of SFDR (and in addition those that potentially address sustainability preferences). While the first alternative would be closer to a labelling scheme and address potentially higher ambitions, the second and third alternative might allow for a smoother transition from the existing system, thereby addressing concerns in the market of an overhaul of all the work that has been done in the past. Further, though not a categorisation scheme, SFDR has shown the need to identify products that do not provide for specific ESG / sustainability features /elements: The market has named products that do not disclose according to Art. 8 or 9 "Art. 6 products" although the SFDR provision requires disclosure for all products, including those that disclose according to Art. 8 and 9, on how sustainability risks are considered in the investment process and their potential impact on the return. Given the need of the market to identify all products, the Platform recommends option three, i.e., identifying categories for the whole market, whereby products not categorised would be called unclassified. The concern of some market participants that unclassified products with specific ESG / sustainability features /elements or mandatory disclosure for such products on certain sustainability indicators could lead to confusion should avoided through respective naming and explanation of the category, disclaimers and restrictions regarding marketing material.
- **Mandatory or voluntary categorisation**: The Platform appreciates that for certain products, product providers would not want to be required to classify. Further, institutional investors should have full flexibility to use or not use a categorisation scheme. Most professional and other institutional investors have an expertise of the (sustainable) investment market. They invest large sums of capital after having negotiated their entry into a financial product and often possess sufficient sophistication and expertise to review the sustainability claims made and the sustainability information provided in relation to the financial product. Also, they comprise a very diverse spectrum ranking from large corporates, FMPs like insurers, and pension fund providers through family offices in different sizes or set-ups up to smaller municipalities or natural persons which are opted up under MiFID. These diverse needs are best addressed upon request on case-by-case basis. Institutional investors value flexibility allowing for different outcomes and even novel or innovative economic activities to be considered under sustainability. Despite any duties applicable to the FMP (e.g. managing sustainable risks), whether professional clients want to categorise or not should be without prejudice of determining sustainability features in accordance with their respective sustainability preferences. Setting the scheme up as mandatory would mean FPMs would have to analyse all products including products for professional clients. Also, products would fall in certain category because of their features as such which might only be a snapshot. A lack of transparency could be bridged with respective reporting requirements. Anyway, the regulation should already create an incentive for product providers to categorise products if they consistently and effectively address investors' needs.
- **Exclusive or non-exclusive categories**: Categorisations could be set up as exclusive or non-exclusive. The latter would then allow products that potentially fall in two categories to address different preferences. The Platform considers that allowing products falling in one than more category could potentially lead to investor confusion. It also considers that the different features of a product which on a high level might not be addressed by the category could be addressed by the sub-categories / sub-features which could be identifiable to investors and distributors.
- **Naming of categories:** Naming is a crucial element since it gives an important signal to the client. Naming convention should therefore be in line with the categories and should not create confusion or basis for misconception. Consumer testing should also test which names of categories are understood by investors.

Annex C. SFDR vs. IDD/MiFID: Difference in scope

The product / services scope of SFDR on the one hand and sustainability preferences required under MiFID / IDD on the other hand are not identical:

- SFDR products comprise IBIPs, UCITS, AIFs, individual portfolios management services with financial instruments, PEPP, pension product / pension scheme.
- IDD sustainability preferences cover IBIPs.[81]
- MiFID sustainability preferences covers individual portfolio management, UCITS, AIFs as products falling under SFDR but it also covers other financial instruments like shares, bonds, structured products. More precisely, unlike under SFDR, individual portfolio management is not considered a product but a service. Nevertheless, the service also requires matching sustainability preferences with clients within the suitability test for portfolio management.
- Lastly PRIIPs covers packaged products including UCITS, AIFs, IBIPs but also structured products like derivatives.

Overview of products/services in scope
in SFDR vs. MiFID and IDD Sustainability preferences
as well as PRIIPs



* Exclude non-life insurance products, life insurance contracts payable only on death or incapacity, pension products for retirement income with certain benefits, officially recognized occupational pension schemes, and individual pension products requiring employer financial contribution without choice of product or provider.

The scope of products / services covered for sustainability preferences under MiFID is much broader than what is falling under SFDR.

[81] Scope: Art. 2 (17) IDD – no pension and non-life products.

Annex D.Testing of categories

A categorisation system based on sustainability features

In its SFDR Level 1 Brief, the Platform has identified different options for a categorisation, namely (i) a scaling system, (ii) measurement against the benchmark, (iii) theme-based categorisation and (iv) the approach-based categorisation (i.e. based on sustainability objectives/features). Those are derived from categorisations that are proposed or already used in the market. When assessing these against the clients' preferences / needs, credibility as well as potential acceptability of the overall market, the approach-based categorisation is closest to the investor's perspective.[82] Within its outreach sessions, this view was largely supported by stakeholders.

Approach	Ability to identify investors' preferences
Scaling System	System could scale the harmful against sustainable. Reflecting transition in a scaling system is more complex. In particular, to not direct investors only in investments which are already sustainable to allow unlocking retail capital for financing the transition. Theme specifics could be identified with an additional add-on criterion.
Benchmark Measurement	System does not address the different aims of avoiding harmful, investing in sustainable or in transition from the outset. Whether a benchmark or peer group comparison could be set up to show this, would need to be tested.
Themes-based approaches	System does not address the different aims of avoiding harmful, investing in sustainable or in transition from the outset but would require identified criteria. A large range of products cannot be classified with respect to themes. Theme specifics could be identified with an additional add-on criterion.
Sustainability strategy-based classification	A categorisation scheme based on the strategy employed in constructing the financial product from a sustainability perspective. It allows for an easy distinction between avoiding harmful, investing in sustainable or in transition.

Beside this method, a categorisation could also be developed starting from the usable indicators. More specifically, that method would identify which indicators should or could be combined to provide for practical approach and categorise based on this combination of indicators and potential indicator thresholds. It would also include to develop an understanding of what each categorisation represents including the naming of the developed categories. The Platform highlights that for a bottom-up method an in-depth analysis of all indicators considered needs to be done. Given that market participants only started reporting on a large range of these indicators (e.g. Taxonomy, PAI), such analysis should be conducted at a later stage, following at least two to three reporting cycles to allow for the assessment whether reported data is consistent and stable.

In all cases, the categories should be tested. Testing of categories should include:

- Whether the categorisation scheme facilitates investors` (and potentially advisors`) understanding: Consumer testing would aim to assess to what extent the proposed categories are sufficiently clear to retail consumers and (are perceived) to adequately protect against misunderstandings of product objectives. The Platform notes that the categories, i.e., name and description alone only provide one component needed to fully facilitate such understanding. Further components comprise: (i) binding elements including monitoring that these are adhered to, (ii) defined quantitatively or qualitatively measurable indicators and related periodic reporting on their performance and (iii) disclosure. Further, depending on the distribution of the product, further information can be shared either in a non-advised sale or in an advised sale as part of the suitability test or more specifically the sustainability preferences. Testing should be calibrated to take into account the other components.

[82] For the other approaches see the evaluation in detail in Annex H.

- How the categorisations perform against the market: More than half of EU products are already disclosing according to Art. 8 and 9.[83] It is fair to assume that a significant portion of these funds would want to meet one of the categories under the new system. The testing should hence also analyse which products disclosing according to Art. 8 and 9 would fall in which category.
- Any test should be based on real data. The outcome should evaluate whether the client still can create a sufficiently diversified portfolio.

Testing should include in the assessment:

- How other existing or proposed approaches work. This could include comparing understanding of national categorisation/labelling schemes and their acceptance (e.g. the FCA approach) or the effect of the ESMA guidelines on fund naming. Testing should also comprise the naming of the categories including the disclosure to be provided for both the explanation of the categories but also the mandatory disclosure for such products (at least pre-contractual).
- Whether a potential approach for the sustainability preferences delivers effective results, if it is less focusing on specific indicators and more on client's perspective to be matched with product's binding elements.
- Whether disclosure allows clients to understand the product's sustainability features. Best practice examples and design research could facilitate readability and comprehensibility. Usage of visuals and easy to understand summary shall be explored and user tested. Also, one might explore that disclosure reporting shall by default be distributed virtually (Portals/e-mail) to avoid further environmental impact due to paper-based distribution.
- How the existing market of financial products would be classified according to the product categories based on their current characteristics using database of financial products with sufficiently granular metrics to filter for the proposed minimum criteria as follows:
  - the testing could calibrate the minimum requirements to ensure that the standards are achievable for existing sustainability-related financial products (based on existing SFDR disclosures and national labelling schemes).
  - Depending on how the criteria are set, the testing could also help to find the right balance between incentivising product providers currently disclosing under Art 8 SFDR to reach a higher level of performance without overhauling pre-defined/committed investment strategies and ensuring acceptance in the market.

  The Platform could support such testing by e.g. calibrating the correct indicators (including potential thresholds) to be used for the consumer testing.

While testing whether the categorisation is facilitating the understanding of consumers, the Platform recommends to first test the categories against the existing market and only in a second step, ones the potential approaches are identified, test these against consumer perception.

[83] Morningstar / Sustainalytics: SFDR Article 8 and Article 9 Funds: Q2 2024 in Review.

Annex E. Difference between categories and labels

Views on what comprises a label and what a categorisation are summarised in below table.

	Sustainable Categorisations	Sustainable Product Labels
Purpose	• guides investors towards environment or social choices, supports advisors	• guides investors towards environment or social choices, supports advisors
	• enhances clarity, comparability, and consistency across sustainable financial products • accompanying transparency aims at investor protection	• aims to ensure that products' claims made match up to what is does in practice
	• Clusters financial products in a simplified way to foster a unified understanding of different/all sustainable financial products within the EU capturing a larger part of the market than labels	• Captures a comparably small part of the market of sustainable financial products within the EU based on certain performance criteria
Requirements & structure	• Minimum criteria to facilitate market structure • Defined minimum transparency • No presumption to apply hierarchy (e.g. certain approaches, themes)	• Usually stricter criteria to ensure label only covers market partially • Different labels define different requirements/thresholds • Label conveys higher ESG performance • Defined transparency • Could be hierarchical
Verification / Assurance	• Providers assess which category product fits in • General verification / assurance for products applies, e.g. approval of product or disclosure by regulators and/or by auditors where required by law • Official stamp not decisive	• Generally external verification by third-party providers to ensure credibility and accuracy • Third-party grants the label to the product upon check (stamped)
Costs / Benefits	• Follows common process, additional costs could be triggered by audit, NCA approval or review process • Accepted categorisation could allow investors easy identification • On EU level could replace national labels	• Additional costs for labelling could be triggered by external party verification and / or audit • Accepted label could allow investor easy identification • On EU level could overcome national labels

In summary, while product labels focus on individual items, categorisations address broader market challenges and promote a unified approach to sustainability. There might be overlaps between labels and categorisation. Regardless of the exact terms used, its mostly important to define the objectives of categorisation.

Combined assets in Article 8 and Article 9 funds inched marginally to almost EUR 6 trillion, accounting for 61% of the EU fund assets.[84]

Since application of the SFDR, the Art. 8 and Art. 9 universe remained fairly stable with a market share of Article 8 funds of 57.6% as of June 2024 and Article 9 funds with a steady share of 3.4 %.[85] Compared to this, different labelling regimes cover only a fraction of the EU market. Nevertheless, though some of the labels can be used on a cross-border basis, there is no EU wide common label. Though the differences between labelling and categorisation might be blurred, the Platform sees a specific need to address the existing fragmentation and confusion in the EU market for SFDR products and potentially additional products relevant for sustainability preferences. The Platform is therefore focussing on the elements of a categorisation scheme but suggests evaluating whether some elements would be better addressed by a label or separate recognition.

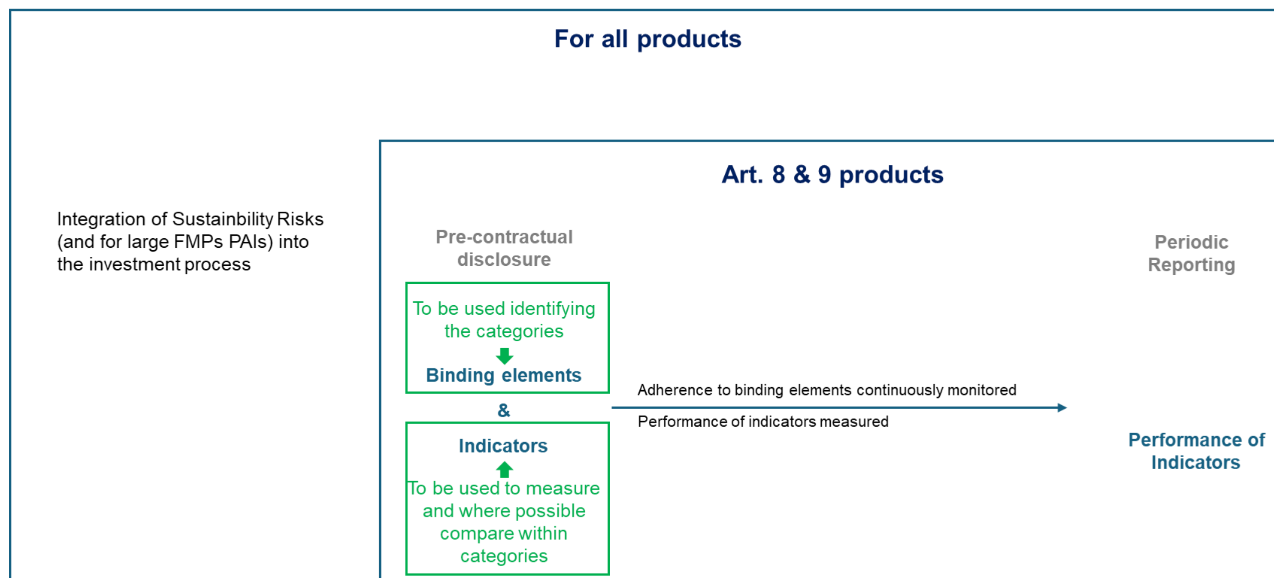
[84] Morningstar: SFDR Article 8 and Article 9 Funds: Q2 2024 in Review | July 2024

[85] Morningstar: SFDR Article 8 and Article 9 Funds: Q2 2024 in Review | July 2024

Annex F. SFDR Features

SFDR has led to the following positive evolution which should not be discarded but built on for the categorisation:

- **Identifying commitments/binding elements**: Prior to SFDR, FMPs were used to retain as much flexibility as possible, by not being bound to certain decisions or actions. This resulted in the use of disclosure language such as "aims at", "intends to" or similar. SFDR requires each product to identify elements which the FMP is bound to. The possibility to retain flexibility is limited including marketing sustainable features without identifying binding elements (e.g. exclusions) or commitments (e.g. minimum of Taxonomy-aligned or Sustainable Investments) and indicators to measure. Article 8 and 9 SFDR concepts have been implemented by FMPs and investors alike and they have shaped their reporting systems in line with these concepts.
- **Identification of indicators to measure adherence to commitments/binding elements**: Prior to SFDR, FMPs where not required to systematically report on how they have adhered to any commitments or binding elements in relation to sustainability. SFDR requires not only that indicators are defined to measure the adherence to commitments and binding elements but also to report on the results.
- **Systematic assessment of sustainability risks and for some FMPs PAIs**: Sectorial legislation such as Solvency II, AIFMD and UCITS-Directive require FMPs to assess sustainability risks systematically. Large FMPs also need to assess PAIs systematically in their investment process. It embeds a mandatory assessment of sustainability risks and for large FMPs PAIs in the investment process introducing the inside-out perspective systematically, thereby broadly capturing what the market generally understands as ESG integration.



SFDR Elements to be used in categorisation

Building on these elements, the categorisation scheme should differentiate between binding elements (that might lead to identify a specific category) and the indicators to be used as follows: (i) adhere to certain indicators or even indicator thresholds and (ii) report on certain indicators including identifying the audience for such reporting.

Annex G. Impact investing

Impact investing is a term used in the market globally. The understanding is that impact investments are made with intention to generate positive, measurable social and environmental impact alongside financial returns. Further, additionality (i.e. investment that would otherwise not have happened) is seen as a relevant element for impact investing by a significant part of the market. Moreover, academic research, industry participants, and regulators distinguish between "company impact" and "investor impact". Company impact describes a real-world change of company activities (e.g. building out green technologies), while investor impact is caused by investor`s actions change is generated by the investor (also referred to as "impact-generating"). However, there is neither a common definition (internationally or on EU level) nor a clear understanding of impact. ESMA highlighted the potential for misleading claims around real-world impact in particular the lack of clarity where and how exactly the impact is factored in or achieved.

According to the Global Impact Investment Network (GIIN), impact investments are "investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets and target a range of returns from below market to market rate, depending upon investors´ objectives". Impact investors intentionally seek a positive social and/or environmental impact, alongside a financial return, and ask products that they invest in to follow an impact methodology on the basis of a Theory of Change (ToC) that includes setting KPIs which are related to the investee companies' activities and impact ambitions. These KPIs are then monitored over the course of the investment to make sure that the company achieves the intended impact. Impact products can thus be defined as products with an explicit pre-defined intention to achieve a positive and measurable social and/or environmental impact, investing in assets that offer relevant and measurable solutions to problems affecting otherwise underserved people and/or the planet[86].

Many FMPs engaged in impact investing – while recognizing the fact that impact investing is still a niche of the overall investment market – call for the creation of a separate impact product category. This is partly because the current SFDR does not include a specific definition of "impact" and thus makes the use of impact terminology difficult if it does not fit within the SFDR definition of sustainable investment though it is related to "company impact". Therefore, impact-oriented investors feel to be put in a disadvantageous position when it comes to fund raising, as both retail and institutional investors have started requesting to only have Article 8 or 9 funds and often do not understand why SFDR-related indicators, such as Taxonomy alignment percentages, are either very low or non-existing for impact products. This is for instance the case where impact is mostly created through solution providers supporting other companies in transition (e.g. solution for energy efficiency). The Platform hence appreciates that impact could be relevant for both the sustainable and the transition category.

In order to address this issue, a common understanding should be developed how impact investments relate the Sustainable Finance Framework. This should include, clarifying how impact investments and Taxonomy-aligned investments fit together: One of the core elements of the Taxonomy is a positive contribution to environmental objectives which is similar to the idea of generating impact. Based on this, it should be considered how to integrate impact investments in the categorisation scheme. It would be important that such category/recognition appropriately reflects the specificities of impact investing, which differ from those of other types of sustainable investing. While the SFDR currently does not provide for a definition of impact, impact aligned or impact generating investments, going forward the Platform would see a merit in adding such definition to serve as a basis for the horizontal recognition and to be used in the SFDR disclosure, to create transparency to investors. **The Platform therefore recommends the European Commission to develop a common understanding on impact investing in the EU sustainable finance framework and how it relates to the Taxonomy and subsequently determine how to integrate it in the categorisation scheme.**

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[86] Definition by Impact Europe, as defined in their response to the SFDR Level 1 review consultation: Joint-letter-how-to-tailor-SFDR-to-impact.pdf (impacteurope.net)

In defining which type of investments may or may not qualify for an impact category, minimum quality requirements along with minimum mandatory reporting requirements could be considered:

- focused on company impact, i.e. relevant for impact aligned products, as proposed by Impact Europe and a number of other impact-related networks in their response to the Commission on the SFDR Level 1 review[87]. These requirements revolve around minimum thresholds for intentionality and reporting on ToC-details, KPIs financial and non-financial additionality, and organisational set-up.
- investor impact / impact generation of financial products will depend on their actual ability to leverage the mechanisms which they have at their disposal to achieve impact. Academic research has identified certain factors which are related to the achievement of real-world effects. These impact success factors could be used as basis to develop indicators relevant for impact category disclosures. They comprise:
    - Signalling that impact matters
    - Grow new or undersupplied markets
    - Provide flexible capital
    - Engage actively with investees and other relevant stakeholders,

  whereby the support for each of these factors varies but they could be used as basis to develop indicators relevant for the impact sub-category[88]. In general, for secondary markets investments, engagement and voting is the most effective mechanism with respect to impact generation. Primary market investments are better suited to provide new and flexible capital and to grow new/undersupplied markets. The Platform will provide guidance on stewardship and voting and related disclosure.

When further considering indicators to use as part of the disclosures for this product category, it should be considered that Taxonomy-related metrics so far not used to their full extent by impact investors. Some convey the view the Taxonomy does not develop quickly enough to be able to capture the more novel economic activities which are interesting from an impact investors' perspective. Instead, most impact investors use the Sustainable Development Goals (SDGs) framework as a typology of the societal and/or environmental problems they are aiming to address, including the use of a contribution methodology. The SDGs with contribution methodology also play a prominent role in the IRIS+ System[89], which is the generally accepted system developed by the Global Impact Investing Network (GIIN) for impact investors to measure, manage and optimise their impact. The Platform notes that the use of SDGs for assessing environmental or social characteristics, SI or impact investments follow very different methodologies. The Platform supports the view provide in the ESG Rating Regulation[90] that it is crucial to remove obstacles to the efficient movement of capital towards sustainable investments in the internal market and to prevent such obstacles from emerging and to set rules and standards to promote sustainable finance and disincentivise investments that can adversely impact the achievement of environmental or social objectives. Hence, in developing the indicators relevant for impact category disclosures, it would thus be important to consider the key metrics included in this system. In relation to the Taxonomy, it could be explored how enabling activities could be used or enhanced to be usable for impact investments.

Lastly, given the evolution of the impact understanding in recent years, the Platform recommends to the EU Commission to take stock of the status of such discussion in case of an SFDR revision. The legal definition should build upon the market understanding (also to limit confusion and allow compatibility with approaches outside the EU) while appropriately taking into account investor protection considerations.

[87] Joint-letter-how-to-tailor-SFDR-to-impact.pdf (impacteurope.net)
[88] See for instance 2DII's Impact Potential Assessment Framework (IPAF) for financial products or IFD's Assessment Grid of a fund's potential contribution to the sustainable transformation
[89] Information about the IRIS+ System available on their website IRIS+ System | About | IRIS+ System (thegiin.org) as well as this 2-page IRIS_2-Pager.pdf.
[90] Regulation of the European Parliament and of the Council on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities.

Annex H. Considerations on additional categories or sub-categories

The following categories are discussed, mentioned in the market or have been proposed to or by regulators but are not considered by the Platform as needed or helpful at that point in time for below outlined reasons:

- **Separate category for MOPs, FoF and standardised portfolios**: Splitting the ESG collection category in two by carving out products that invest in other products or sub-portfolios might allow investors to identify products more easily with multi-sustainability features. However, also within the ESG collection category even products that are not necessarily investing in different target vehicles, sustainability features can be combined. The Platform sees the risk that it would be more confusing to differentiate in practice between the ESG collection and a separate category for MOPs, FoFs and multi-asset products. The Platform therefore recommends a solution for integrating Mixed Products in these categories and does not see the need for a separate mixed category.

- **Scaling system within a category**: Some market participants see a value in providing a scaling (ranking) within a category. Using a scaling system within the categories could potentially be helpful for investors to compare the products. It could be set up through numbers (1-5), letters (A-F) or colours (red to green or more neutral in grey shades). To find the right scaling / ranking within a category, the products would need to be sufficiently comparable. Within certain categories, there can still be significant differences, e.g.:
  - how to compare strategies focusing on social elements against those that are focussing on environmental elements?
  - how to compare climate strategies against biodiversity where the progress is very different?
  - how to compare products focussing on certain industries or certain regions with those with a different focus?
  - how to compare transition products by using speed of the transformation if the product is focussing on different asset classes, sectors, regions, themes?

  A scaling would have to ensure that only comparable products are compared. Otherwise, it risks creating a bias towards a certain type of investments and could discriminate other, very important investments. It might be very complex to properly identify which products can and should be compared. The effect of a scaling system, such as inducing FMPs to be more ambitious and seemingly helping retail investors with their decision should not be completely disregarded, but rather re-assessed at a later stage after market experience has been gathered.

- **Theme-based category**: Theme-based (sub-)categories could on the environmental side be linked to the six Taxonomy objectives. They could also be measured against similar criteria. Depending on how specific the indicators for each category will be defined, an assessment on whether addressing specific themes and identifying specific indicators to measure such themes should be conducted. At this stage, information on themes could also be conveyed with product descriptions or even with a respective product name.

- **Process-based category**: There is little to no need for a separate process-based category. Process based approaches do not necessarily look or **promise** a specific result, they adhere to certain rules in their investment process. This includes selecting investees based on a scoring (e.g. best in class selection), excluding investments in sectors or issuers. As such, they could already be captured by the ESG collection category. Process based could, however, also include ESG integration, where only the process might be considered as a binding element with no clear commitment in what to invest or not invest or a specific outcome. It would be hard for an investor to distinguish such approach from the general requirement to consider ESG risks and PAIs. There is no general need to add a process-based category even where such products today disclose according to Art. 8 SFDR in order to simply recognise ESG integration. Depending on the approach they could either be captured by the ESG collection category or being not categorised. ESG

integration is generally a less stringent approach than others, and hardly justifies the need to establish a separate category. It is worth remining that the assessment of Sustainability Risks is required by sectorial legislation and in general part of most FMP's fiduciary duty or prudential requirements.

- **Exclusion-only category**: There is no real need for a category only covering exclusion strategies. Such strategies can be well captured in the ESG collection category. Exclusion only category is sometimes referred to as being able to address investors' needs directly: Investors might be interested only in refraining from investing in certain industry or sectors. Exclusions are also apparently easy to explain, in particular, if a full sector is completely excluded. While the Platform appreciates investors' needs, it does not recommend a separate exclusion category for the following reasons:
    - Exclusion approaches limit financing to industries in need of transition. For financing Sustainable Growth, it is preferable to provide financial support to investees performing better in a given sector, in particular for sectors requiring transition.
    - While it might be easy to explain to investors, efforts need to be made to educate investors and advisors on the need for transitioning the real economy and the fact that exclusions are not the ideal means to achieve this aim.

An exclusion only category should not be established since it would emphasise an approach which exists and might be helpful for a limited number of investors but does hardly serve the overall Sustainable Finance Agenda. Exclusions though can serve a valuable purpose as minimum criteria for certain products and services.

Annex I. Indicators and their readiness

The following principles are to be noted to ensure they can be used effectively in the investment process, e.g. for investment products:

- **Sufficient coverage of underlying assets**. This is as an example of a pre-requisite for a product aiming to invest in sustainable assets with an environmental focus with a global scope, which would require information to be available for non-EU issuers to be able to properly use EU Taxonomy metrics to guide investment decisions.
- **Sufficient comparability and reliability of metrics.** Taking the example of some of the Principal Adverse Impact indicators (e.g., PAI 7 and 8), significant discrepancy is still observed at this stage in the information made available by data providers, partly due to the fact that the underlying indicators are not reported by investee companies. The CSRD will improve comparability for the entities in scope over time, and the Platform on Sustainable Finance's ongoing work on estimates will also support in this perspective.
- **Relevance for specific asset classes.** The specific characteristics of certain asset classes may necessitate the use of tailored indicators, particularly for non-listed assets such as real estate and private market investments. For instance, in the case of venture capital investments, a voluntarily reported Taxonomy-aligned OpEx metric, based on the *streamlined approach* for unlisted SMEs proposed by the Platform, may prove relevant.
- **No tick the box.** Indicators may be useful for certain products, certain asset classes in standard circumstances. They might not always work for more specific situations, e.g. revenue or CapEx for Venture Capital investments which on the other hand serve an important role in financing new technologies. The Platform therefore believes that the restrictions should be kept to a minimum at this stage, also to avoid that committing to indicators becomes a tick the box exercise rather than a tool in identifying which indicator is useful for the product approach and features.

In addition, to effectively help deliver the sustainability outcomes targeted by the product, the following has to be considered:

- Where transition is relevant, in particular, for the transition category, FMPs might need to combine up to two metrics to assess at holding level how e.g., investee companies are investing to transform their business models (the "means") and how this is effectively delivering an improved sustainability performance (the "progress"). There will typically be a time lag between the two.
- When assessing a metric at portfolio level, and comparing a metric between different portfolios, it will be important to understand sectorial specificities, and what they can mean in terms of performance on a given indicator. As an example, a utility company with high Taxonomy alignment both in terms of Capex and Revenues may continue to disclose high GHG emissions, when compared with other sectors, or certain peers, depending on their business mix.

The tables below consider:

- Indicators which could be used to limit negative impacts of the investment product
- Indicators which could be used to deliver the sustainability-related objective of the investment product
- Indicators which help track the transition of the holdings but also the product

Thereby addressing the potential product categories. In addition, the table outlines indicators how the investor aims to contribute to the achievement of the investment product's objective through its own stewardship which could be relevant for all three categories but is of particular importance for the transition category.

Below table analyses potential indicators which could be used for the sustainable category. For the Commitment and reporting requirements the following abbreviations are used:

- CM = pre-contractual commitment mandatory,
- CMLCO = pre-contractual commitment mandatory, level in FMPs discretion,
- CO = pre-contractual commitment optional,
- RM = reporting mandatory,
- RO = reporting optional, where indicator is chosen as commitment, RO becomes RM.

Indicator	Readiness / Evolution requirements	How to use
Taxonomy alignment, revenue Defined in: Taxonomy Regulation	**Readiness:** Comparable information on alignment of revenues with EU Taxonomy criteria, at economic activity level, to measure how a company contributes to the Taxonomy objectives either by offering solutions which enable the transition (e.g. manufacture of batteries), or by having already transformed their processes to ensure they are "net zero" (e.g. electricity generation from renewable sources). Allows to compare investees' performance within a sector and to track progress over time. Complementary metrics - PAI 1 and 2 will enable to track reduction in GHG emissions which may be observe as investee companies increase the share of Taxonomy-aligned revenues, for instance in the energy sector. The correlation between the two indicators is not a systematic one and should be looked at with a sector lens, especially for a strategy with an outcome/ impact objective (E). Indeed, certain solutions providers including in the utilities sector will by nature have a higher carbon intensity than other sectors. - ESRS E1 information on climate transition plan will allow to better understand how Taxonomy-aligned revenues will evolve over time. **Evolution Requirements** Current limitations may relate notably to geographical scope (information for non-EU issuers likely to be missing), coverage in terms of economic activities as well as usability issues with criteria, meaning the metric may be less relevant for certain sectors.	**Complementary Metrics** PAI 1 & 2 ESRS E **Type of products** Sustainable Transition (to some extent) ESG collection **Commitment** Sustainable (CMLCO) Transition (CO) ESG collection (CO) **Reporting** Relevant criteria (RM)
Taxonomy alignment share, CapEx Defined in: Taxonomy Regulation	**Readiness** Comparable information on alignment of CapEx with EU Taxonomy criteria, at economic activity level. Allows to measure how a company's investments will facilitate transition towards a more sustainable business model. Capex metric provides an effective way to measure the extent to which a company is transitioning its activities and helps assess the credibility of the climate transition plan of an investee company through comparable data at economic activity level. Complementary metrics	**Complementary Metrics** PAI 1 & 2 ESRS E See also in the Transition section Transition KPIs and Net Zero Alignment share.

Indicator	Readiness / Evolution requirements	How to use
	- PAI 1 and 2 will enable to track reduction in GHG emissions which should be observed as investee companies increase the share of Taxonomy-aligned revenues, for instance in the energy sector. - ESRS E disclosures will provide more information, e.g. ESRS E1 information on climate transition plan will allow to better understand how Taxonomy-aligned revenues will evolve over time. Allows to compare investees' performance within a sector and to track progress over time. **Evolution Requirements** Current limitations may relate notably to geographical scope (information for non-EU issuers likely to be missing) and coverage in terms of economic activities.	**Type of products** Sustainable Transition ESG collection **Commitment** Sustainable (CO) Transition (CMLCO) ESG collection (CO) **Reporting** Relevant criteria (RM)
Taxonomy Always Significantly Harmful Defined in: Taxonomy Regulation (partially)	**Readiness** No distinct disclosure on activities for always significantly harmful activities. CSRD ESRS E reporting could provide information allowing to derive such activities **Evolution Requirements** As outlined by the previous Platform, the current Article 19 (3) Taxonomy Regulation recognises only power generation from solid fossil fuels to be excluded from the green Taxonomy. There are other economic activities for which no technological possibility of improving their environmental performance to avoid significant harm exists across all objectives and which might be thought of as "Always Significantly Harmful" activities. These could be identified for any of the six environmental objectives and could include activities such as: - Thermal coal mining and peat extraction (climate change mitigation). - Construction of new housing in extreme high-risk flood areas (climate change adaptation). - Activities destroying ecosystems with high biodiversity value	**Complementary Metrics** CSRD ESRS E **Type of products** Sustainable Transition ESG collection Unclassified **Commitment** Sustainable (CM) Transition (CM) ESG collection (CM) Unclassified (CO) **Reporting** Relevant criteria (RM)
Climate Transition Benchmark exclusions Defined in: Art. 10 Delegated Regulation 2020/1818	**Readiness:** The Climate Transition Benchmark exclusions could serve as part of the proposed introduction of minimum criteria for some of the categories, noting the introduction of ESMA guidelines on fund naming will lead to a wider application of those exclusions across the market. **Evolution requirements:** Exclusions should be adjusted in line with the amendments proposed by the Platform recommendations, as follows: (1) Excluding companies that violate UNGP instead of UNGC, (2) not applying to issuers of use-of-proceeds bonds financing sustainable projects provided issuers have a CapEx plan in line with EU GBS and of (3) excluding companies investing in first-time production, expansion or exploration of fossil fuels, i.e. ≥ 0.5% CapEx from coal exploration or processing activities,	**Complementary Metrics** Consistent with PAI 10, 14 and new PAI on Tobacco. Taxonomy Minimum Safeguards **Type of products** Transition ESG collection **Commitment** Transition (CM) ESG collection (CM) **Reporting**

Indicator	Readiness / Evolution requirements	How to use
	≥ 5% or more of CapEx from oil exploration or processing activities, ≥ 25% or more of CapEx from gas exploration or processing activities except where activity is Taxonomy-aligned.	Transition (RM) ESG Collection (RM)
Paris Aligned Benchmark exclusions Defined in: Art. 12 Delegated Regulation 2020/1818	**Readiness** The Paris Aligned Benchmark exclusions could serve as part of the proposed introduction of minimum criteria for the "Sustainable" category, noting the introduction of ESMA guidelines on fund naming will lead to a wider application of those exclusions across the market. **Evolution requirements** Exclusions should be adjusted in line with the amendments proposed by the Platform recommendations, as follows: (1) Excluding companies that violate UNGP instead of UNGC, (2) not applying to issuers of use-of-proceeds bonds financing sustainable projects provided issuers have a CapEx plan in line with EU GBS and of (3) excluding companies investing in first-time production, expansion or exploration of fossil fuels, i.e. ≥ 0.5% CapEx from coal exploration or processing activities, ≥ 5% or more of CapEx from oil exploration or processing activities, ≥ 25% or more of CapEx from gas exploration or processing activities except where activity is Taxonomy-aligned.	**Complementary Metrics** Consistent with PAI 4, 5, 6 and PAI 10, 14 and new PAI on Tobacco. Taxonomy Minimum Safeguards **Type of products** Sustainable **Commitment** Sustainable (CM) **Reporting** Sustainable (RM)
Principal adverse impact indicators Defined in: SFDR Level 2	**Readiness:** Certain PAIs could support the introduction of minimum criteria, which appear supported by the market, and already used by some European labelling regime which draw direct parallels with SFDR PAI (incl. Towards Sustainability Quality Standard, Label ISR). PAI could be used either to support a systematic exclusionary approach, or to measure remaining exposures and guide engagement activities with those issuers. Such minimum criteria could include PAI 14 (Controversial Weapons), PAI 10 (violations of international norms and standards) and the new proposed PAI on tobacco (ESAs report on SFDR RTS, December 2023) – in alignment with the Climate Transition benchmark exclusions. For the sustainable category, additional PAI could be added including PAI 4 (companies active in the fossil fuels sector). For the transition category, while a systematic exclusion of PAI 4 would not be the most effective way for the strategy to support real-world decarbonization, there could be an expectation to engage with companies active in the fossil fuel sector, based on an engagement policy referred to in the ex-ante disclosure, and reported on in the periodic reporting. **Evolution requirements:** Improvements remain necessary to ensure full usability of the PAIs, allowing a sufficient level of coverage and comparability in reported figures. The upcoming CSRD as well as Platform work on estimates should provide a basis for further progress on this.	**Complementary Metrics** For guidance on setting thresholds on PAI indicators, please refer to Annex 1 of the SFDR L1 Brief[91].

[91] See Platform on Sustainable Finance briefing on EC targeted consultation regarding SFDR Implementation - December 2023 (europa.eu)

Indicator	Readiness / Evolution requirements	How to use
	This could also allow to better tackle issues related to biodiversity, with the PAI 7, 8 and 9 currently facing significant challenges in terms of data reliability and comparability.	
Sustainable investment share (Revenue, CapEx, and eventually OpEx for special asset classes) Defined in: Art. 2 (17) SFDR	**Readiness** SI is already used largely since SFDR implementation. It is also a key metric for MIFID and IDD sustainability preferences assessment, as well as relevant for in the ESMA guidelines on fund naming. **Evolution requirements** Responsibility for defining SI methodologies lies with FMPs as confirmed by the EU Commission. This has allowed FMPs to define methodologies aligned with their convictions, while following regulatory guidance. Since the SI share is also used for the purpose of MIFID / IDD sustainability preferences assessment, the heterogeneity in practices has not facilitated the understanding of clients. Building on the Platform previous proposals, it outlines its vision on further evolution below (see section 4.3.1). Evolving measurement of positive contribution to social aspects should build on ESRS S 1 to 4 which relate to own workforce, workers in the value chain, affected communities and consumers and end-users. Additionally, a number of FMPs have developed an SI methodology to assess Government bonds. These can form a useful metric in particular in the context of strategies with a focus on transition.	**Complementary Metrics** ESRS E&S **Type of products** Sustainable Transition ESG collection **Commitment** Sustainable (CMLCO (revenue)) Transition (CMLCO (CapEx)) ESG collection (CO) **Reporting** Relevant criteria (RM)
Transition KPIs or Target KPIs Defined in: Art. 14a, 18 (3) draft SFDR RTS, ESRS E Market frameworks	**Readiness** Range of indicators could be used derived from both the legal framework (e.g. SFDR PAIs or ESRS E) as well as market standards. Important to define whether the measurement is done at product level or at asset level. **Evolution requirements** Analysis should be done to identify existing used KPIs within the market including Net Zero Alignment Share in order to define common understanding.	**Complementary Metrics** **Type of products** Sustainable Transition **Commitment** Sustainable (CMLCO) Transition (CMLCO) **Reporting** Relevant criteria (RM)

Indicator	Readiness / Evolution requirements	How to use
		Commitment Sustainable (CMLCO) Transition (CMLCO) **Reporting** Relevant criteria (RM)
ESG Ratings Use of: ESG Rating Regulation	**Readiness:** ESG scores are already largely used by investors as a way to assess the performance of investee companies. Local regulations as well as local regimes rely on ESG score with binding expectations (e.g. expectation to outperform investment universe or to perform selectivity based on ESG score), including in some cases for funds to be able to communicate on ESG claims. **Evolution requirements** ESG scoring methodologies however at this stage differ greatly in terms of analysis, with a low correlation from one provider to another – therefore not necessarily providing the comparability which is sought by end investors. Identifying differences to create greater transparency could be the next step.	**Complementary Metrics** **Type of products** Sustainable Transition ESG Collection **Commitment** Sustainable (CO), Transition (CO) ESG Collection (CO) **Reporting** Relevant criteria (RM)
Voting / engagement Defined in: SRD II	**Readiness** SRD II requires investors to set voting and engagement policies and processes, and to report on those with details required notably on significant votes. It does not define the metrics to be reported on in a systematic manner. Market voluntary initiatives have proposed metrics to track coverage of voting and engagement, as well as report on activities. As it enables the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society[92], stewardship seems especially relevant for transition and sustainable categories. While it can support change within investee companies, such change is however often the result of several combined factors, and while there could be a requirement for those categories to commit to voting and engaging with a proportion of underlying companies, using escalation techniques where engagement does not progress effectively, this should not create an expectation to see systematic correlation between engagement and change. Lastly, engagement is often led at the level of the investment firm, rather than solely at the level of the fund, enabling greater impact of such engagement due to larger size of holdings. Disclosures should allow to clearly understand the scope of the engagement. **Evolution requirements**	**Complementary Metrics** **Type of products** Sustainable Transition **Commitment** Sustainable (CO) Transition (CO) **Reporting** Relevant criteria (RM)

[92] UK Financial Reporting Council definition

Indicator	Readiness / Evolution requirements	How to use
	Ex-ante requirement could relate to the existence of voting and engagement policies with an appropriate governance, clarity on use of escalation and indication of targeted coverage of such activities. Ex-post requirements could include proportion of AGMs voted for equities, proportion of votes against management, information in relation with vote on Environmental or Social resolutions depending on the theme of the fund, proportion of portfolio subject to engagement, use of escalation by type (e.g. vote-driven / public letter / divestment). This will be developed in the Stewardship section of Usability report, including considerations in relation with engagement in fixed income and private markets.	

Annex J. Distinction between commitments and reporting

In order to identify the objective criteria relevant for the categorisation, it should be **distinguished between commitments and reporting**, which could be either mandatory or optional in both cases. Hence, the Platform identifies the indicators in the assessments of the categorisation as follows:

- **Mandatory Commitment (CM)**: This necessitates that FMPs commit to specific criteria for a product. These commitments must be maintained throughout the product's lifecycle or within any timeframe specified (e.g. for private market products ramp up and divestment periods need to be recognised). The process for the commitment and the data availability ratio (coverage) are included. Commitments must always be reported on, reflecting actual results or adherence to the commitment.
- **Optional Commitment (CO):** FMPs have the choice to voluntarily commit to certain criteria for a product. These commitments also need to be upheld throughout the product's lifecycle or within any timeframe set by the FMP. The process for the commitment and the data availability ratio (coverage) are part of this option. Commitments must always be reported on, reflecting actual results or adherence to the commitment.
- **Mandatory Reporting (RM):** This obliges FMPs to disclose the actuals of the criteria in periodic reports, such as Taxonomy alignment or adherence to exclusions.
- **Optional Reporting (RO):** This allows FMPs to disclose the actuals of certain criteria in periodic reports, which are not part of mandatory reporting.

It is also useful to **distinguish between process/practice-based commitments/reporting** (such as engagement, exclusions, and best-in-class selection) **and outcome-based commitments/reporting** (Taxonomy alignment, GHG reduction target).

Outcome-based commitments are typically much trickier to make (which explains why current levels of Taxonomy commitments at the fund level are so low) - but periodic reporting of outcome on them is essential and hence should be mandatory, especially if they claim to contribute to a specific outcome (e.g., with a net-zero global equity fund).

Annex K. Examples of asset coverage requirements

Regulator / Rules	Proportion (minimum)	Asset Coverage Requirements
ESMA Fund Naming Guidelines	80%	At least 80% minimum proportion of investments used to meet the sustainability characteristics or objectives
FCA SDR Labels	70%	The product must have at least 70% of its assets invested in accordance with the sustainability objective
AMF Doctrine 2020-03	90%	The non-financial analysis, non-financial indicator or non-financial rating coverage rate must be higher than 90%
Hong Kong Securities and Futures Commission (SFC): Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds	70%	At least 70% of its total net asset value is invested in portfolio holdings which reflect the stated green or ESG related investment focus
Monetary Authority of Singapore (MAS): Disclosure and reporting guidelines for retail ESG funds	66%	At least two-thirds of a scheme's net asset value is invested in accordance with the scheme's investment strategy
Financial Supervisory Commission (FSC) Taiwan: Disclosure Rule for ESG funds issued by Securities Investment Trust Enterprise	60%	At least 60% of the fund's net asset value is invested in ESG related priority targets, and how the overall use of the fund assets can be ensured not to cause significant damage to the sustainable investment objectives must be explained

The Platform recommends assessing the different approaches and its market impact according to the following elements:

- To what the minimum proportion refers. This includes the question for which of the binding elements the relevant percentages should be adhered to, for instance, would exclusion criteria that apply to all investments be sufficient for the selective category.
- How the denominator is identified, including whether any hedging or liquidity instruments should be included in the denominator.
- what are the operational implications of changes in how an asset performs / is assessed (e.g., issuer becomes non-SI, or breaches DNSH threshold at some point in time). Sufficient time needs to be allowed for a divestment in the best interest of the product / client.
- Whether rules could be applied to other products than funds under SFDR or even to the remaining MiFID financial instruments. In addition, the rules should also identify to what type of assets the minimum criteria apply. Not necessarily all assets can be assessed against minimum criteria. In particular, hedging and liquidity instruments provide a respective challenge in this respect.

Annex L. Considerations regarding disclosure

- **Easy to understand**: The Platform notes the challenges of disclosure to be precise enough in line with the legal text (in particular, as being part of the prospectus as a document serving to determine potential liability claims) but at the same time provide for easy to understand and concise information. It is in the interest of regulators, investors, and FMPs to agree on a common understanding of what the disclosure needs to comprise and how the approaches need to be explained in a way that it is not misleading in order to avoid greenwashing allegations and greenwashing. In this respect, the Platform appreciates the ESAs proposal to improve and simplify the SFDR templates[93]. While this already addresses considerable elements, the results of the consumer testing done for the templates should be taken into account when adjusting disclosure for setting up categories. This includes as mentioned in the consumer testing[94] the use of technical jargon or complicated grammar.

  Disclosure could follow the questions asked within the suitability test for sustainability preferences. This would allow investors and advisors to steer through the document more easily. More specifically, the question on investor's perspective should be the starting point of the disclosure showing in which category the product falls. The Platform appreciates that already the way in which the categories are displayed could be understood as a hierarchy by the investor and should therefore be considered carefully. For instance, it might make a significant difference whether the default category is the first or the last and the same holds true for the sustainable category.

- **Quick to read**: The increasing use of digital tools also affects how investors make decisions and the amount of information to which they pay attention. The constant influx of information from various sources can lead to an information overload. The Platform strongly recommends testing the right amount of information for the disclosure to investors. It also recommends using multilayered ways to display information. This is easily be done by an electronic disclosure, as e.g. suggested by the ESAs (and supported by the Platform) for the revised SFDR RTS. Also, a QR code could be used like foreseen in the Green Claims Directive to be used for investors who would like to access more detailed information.

- **Consistent throughout the process and for all relevant products / services**: The disclosure should follow the same logic in all relevant documents: Pre-contractual disclosure in the prospectus but also the PRIIPs-KID, on the website, in the periodic reporting and any information that distributors need to provide to the client in addition as well as any information that is voluntarily produced by FMPs or distributors. With respect to any voluntary disclosure, where applicable, the Green Claims and Green Transaction Directive would need to be considered. The Platform recommends providing some guidance for FMPs how these Directives would relate to a categorisation scheme and disclosure thereunder. Any information provided to describe the products/services approach should consider the need to substantiate.

The Platform has also assessed the benefits and detriments of requiring FMPs to disclose how their specific approach would perform within a broad market index (e.g. MSCI World). For approaches with no common understanding, such as the current SI definition. This could provide some transparency on the FMP's methodology.

[93] See JC 2023 55 - Final Report SFDR Delegated Regulation amending RTS (europa.eu)

[94] See Final Report on draft Regulatory Technical Standards on the review of PAI and financial product disclosures in the SFDR Delegated Regulation - European Union (europa.eu)

Option	Pro	Con
Disclosure how FMP's methodologies perform in a broad market index	• Increased transparency for the market • FMPs methods might align over time	• Unclear whether retail investors and advisors would be able to understand the difference and not come to the wrong conclusion in particular for products that are not comparable due to different focus • FMPs could optimise the performance of the methodology against the market without really improving sustainability performance • Risk of losing purpose of methodology, i.e. to find a robust way to measure the sustainability performance

The Platform is not fully convinced that this approach would be beneficial. It recognises the alignment of certain methodologies either through legislative clarifications (in particular, SI) or through market practices and guidance are preferable.

Annex M. Consequences for Article 9 products

While products disclosing under Article 8 SFDR provide for a very diverse range of strategies and degrees of sustainability, Article 9 products apply stricter strategies. Nevertheless, Article 9 products are not necessarily impact aligned or impact generating[95]. Although some Article 9 products can contribute to the transition, they not always do so. To minimise disruption for investors and the market, it may be beneficial to, in addition, recognise products currently disclosing under Article 9 (and future products meeting that standard) for a certain limited time until the market has adjusted to the categorisation (e.g. one year). The following table describes benefits and detriments on potential options how to facilitate transition of Article 9 products into a new categorisation scheme.

Option	Pro	Con
1. Transition Article 9 products into the new system without separate recognition	• Would create less confusion in the market if sustainable category includes more products • Would limit the numbers of categories	• Very distinct Article 9 products would not as easy be identifiable as of today • Could reduce support for categorisation system by FMPs offering Article 9 products
2. Creating a separate category for Article 9 products	• Would facilitate transition by making it easy for the market to understand what the change means for existing products	• Would increase the number of categories • The very need for a separate category might confuse the market • Could be outdated at one point in time
3. Creating a separate sub-category or recognition for Article 9 products	• Would facilitate transition by making it easy for the market to understand what the change means for existing products • Would limit the numbers of categories	• Could be outdated at one point in time

Applying option three, FMPs could allocate their existing products in the new system as follows:

WORKING TITLE TO DIFFERENTIATE	Sustainable	Transition	ESG collection	Unclassified
So-called Article 6	X	X	X	√
Article 8	√	√	√	√
Article 9	√ "Article 9 level"	(√) "Article 9 level"	X	X
Article 9 tracking Climate Benchmark	(√) "Article 9 level"	√ "Article 9 level"	X	X

* FMPs should be able to decide to not categorise their products which then would be unclassified.

[95] Scheitza et al. (2024) SFDR Article 9: Is it all about impact? P. 5 et seq.