

## Public consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR)

### Response by Tobacco Europe

Tobacco Europe<sup>1</sup> supports the reporting and disclosure of sustainability-related matters in the financial services sector **and welcomes the approach of the European Commission** to review the implementation of the Sustainable Finance Disclosures Regulation (SFDR) and explore possible options to improve the legislation.

However, Tobacco Europe is concerned about the ESAs' approach to single-out specific sectors from SFDR. Tobacco Europe commented on the ESAs' suggested inclusion of "exposure to companies active in the cultivation and production of tobacco" as a mandatory social PAI indicator under the category of 'indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters'.

While the present consultation document does not specifically propose sector-specific exclusions, it does refer in a number of places to the list in Table I to Annex I to the Delegated Regulation, which would, if the ESAs' draft were to be adopted, include the following principal adverse indicator (PAI): "Share of investments in investee companies active in the cultivation and production of tobacco". For this reason, we have enclosed Tobacco Europe's response to the ESA consultation in July 2023 as an annex to this document for further consideration by the European Commission.

#### 1. How a company makes a product is as important as what it makes: the importance of an inclusive supply chain approach

If 'production and cultivation of tobacco' is singled out, there would be fewer incentives to improve on companies' individual sustainability targets.

Singling out specific sectors in the SFDR serves as a **disincentive** to pursue green investments and uphold the highest labour and environmental standards in their value chain, *de facto* failing in distinguishing companies that are active in seeking to evolve and invest in a more sustainable *modus operandi*. Rather than being penalized and excluded from private investment opportunities, all companies should be incentivized to manage their sustainability risks appropriately and 'do the right thing'.

#### 2. 'A green transition that leaves no one behind'

To uphold the EU green transition principle of 'not leaving anyone behind,' a nuanced and balanced approach is crucial when considering the singling out 'cultivation and production of tobacco' from the SFDR. Rather than opting for a blanket sector-specific exclusion, regulators should carefully assess industry dynamics and evolving consumer preferences.

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<sup>1</sup> [Tobacco Europe](#) is the European association representing three of Europe's largest producers of cigarettes, e-cigarettes, tobacco heated products and modern oral products. Our aim is to put forward the industry's common views on regulation and policy and promote scientific and evidence-based policies that respect the choice of consumers.

### 3. Discouraging investments in the legal tobacco value chain and new product categories hinders innovation.

Tobacco companies are actively investing in the development of smoke-free products in response to changing consumer needs. A growing number of independent scientists recognize the potential benefits of such products in reducing the health risks of smoking at the population level, Creating an environment that fosters the ongoing innovation in this field is key to achieving global harm reduction.

Treating the lawful tobacco industry like controversial weapons or industries violating labor standards lacks logical coherence. The cultivation and production of tobacco is a lawful activity within the EU. This is also a key difference from activities related to 'controversial weapons', which are generally excluded from sustainable finance regulations and are generally banned in the EU.

The singling-out of tobacco could set a precedent, inviting requests to exclude other lawful industries like plastic production, alcoholic beverages or high-fat/high-sugar food manufacturers. Fewer companies would benefit from the European framework for sustainable finance if such exclusions became a norm, sparking legal challenges and debates.

To achieve a more balanced approach, policymakers should consider alternatives that allow for the potential benefits of innovation in the tobacco industry to be realized, e.g., considering the inclusion of "exposure to companies active in the cultivation and production of tobacco" as an additional 'opt-in' social indicator rather than a mandatory one.

### 4. Lack of coherent approach leads to unnecessary complexity and inoperability of Sustainable Finance regulatory systems

The rapid development of EU sustainable finance regulations with differing requirements, definitions and interpretations creates confusion and **inconsistency in the application of regulations** like the SFDR.

ESMA recently published an explanatory note on the application of the Do No Significant Harm ('DNSH') principle that is embedded in several pieces of Sustainable Finance ('SF') legislation: the Taxonomy Regulation ('TR') Sustainable Finance Disclosure Regulation ('SFDR') and the Benchmark Regulation ('BMR'). The above-mentioned document justifies the exclusion of "companies involved in the tobacco cultivation and production" from the BMR by the absence of "*measurable carbon emission reduction targets with specific deadlines that are aligned with the objectives of the Paris Agreement*".

Since the exclusion from the BMR has been used as the underlying rationale for the subsequent (proposed) singling out of tobacco cultivation and production in other pieces of SF legislation, including the SFDR, Tobacco Europe finds it essential to address this in this response. Tobacco Europe finds this justification to be flawed, and consequently the exclusion itself unjustified, since Tobacco Europe member companies do in fact have measurable carbon emission reduction targets which are publicly disclosed<sup>2</sup> and are in line with the Paris Agreement. In light of this, Tobacco Europe would like to once more express concern about the ESAs' proposal to introduce a new mandatory PAI indicator on tobacco cultivation and production.

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<sup>2</sup> [JT Group Recognized on CDP's "Climate Change A List"](#);  
["BAT's ambitious 2030 decarbonisation target approved by SBTi"](#): [BATs combined annual and ESG report 2022](#).  
[Imperial Brands' Annual Report & Accounts 2023 \(pp.48-51\)](#)

It is important to note that, at this stage, a blanket exclusion would be overly restrictive. Certain institutions worldwide, while drafting sustainable finance regulations and frameworks, have **expressed concern that the EU's approach is too restrictive**. For example, in the Consultation on Sustainability Disclosure Requirements (SDR) and Investment Labels, the UK Financial Conduct Authority compares its own proposed requirements with the EU SFDR and states the following: *"We are not proposing to include requirements that mirror the EU SFDR's 'Do No Significant Harm' approach, i.e., disclosures on how a sustainable investment does not significantly harm the sustainability objective. We consider this approach may be too restrictive at this stage"* (UK FCA (2022), Consultation on Sustainability Disclosure Requirements (SDR) and Investment Labels).

We respectfully request the Commission to take the above comments and those in the Annex into account in considering whether and how to propose amendments to the SFDR.

## Annex 1 – Tobacco Europe’s response to the ESA consultation

[One of the comments made by Tobacco Europe in its response to the ESA's consultation was that Including exposure to the tobacco industry as a PAI lacks any legal basis in the current text of the SFDR and would constitute a policy choice specifically prohibited by the governing regulations of the ESAs, and therefore by the SFDR, as well as by Article 290 TFEU.

Tobacco Europe asks that no changes should be proposed to the SFDR that would purport to allow the inclusion of the cultivation and production of tobacco as a PAI factor. Such an inclusion would conflict with and denature the objective of the legislation of promoting environmental, social and governance sustainability.]

### **1. Introduction**

Tobacco Europe<sup>3</sup> welcomes the approach of the ESAs to review Delegated Regulation (EU) 2019/2088 (“SFDR”) regarding PAI and financial product disclosures. Investments can and should support sustainability, including in both environmental and social aspects, as an increasing number of stakeholders are demanding that financial markets shift from perceived short-term, siloed investments to a model of long-term, inclusive, and sustainable economy.

However, **Tobacco Europe remains concerned about the ESAs’ approach to exclude specific sectors** from SFDR. In particular, regarding the inclusion of 'exposure to companies involved in the cultivation and production of tobacco' as a mandatory social PAI indicator under the category of 'indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters’.

Tobacco Europe’s views on the ESAs’ proposal is set out below.

### **2. The Legal Basis**

The legal basis for the proposed measures would be Article 4(7) SFDR, which provides as follows:

*"By 30 December 2021, the ESAs shall develop, through the Joint Committee, draft regulatory technical standards in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on the content, methodologies and presentation of information referred to in paragraphs 1 to 5 of this Article in respect of sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.*

*Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010."*

The concept of a "Regulatory technical standard" is defined as follows in the relevant Regulations:

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*"Regulatory technical standards shall be technical, shall not imply strategic decisions or policy choices and their content shall be delimited by the legislative acts on which they are based."*  
(Emphasis added)

### ***The proposal lacks legal basis***

The above definition is in part based on the rules that apply more generally to delegated acts, laid down in Article 290 TFEU as interpreted and applied by the Court of Justice of the European Union.

Specifically, delegated acts can only concern non-essential elements of an area and can never involve the making of political choices. A delegated act must always respect the bounds of the delegated powers, which must be precisely defined in the legislative act granting the delegated power.

The proposal tries to justify its inclusion of tobacco cultivation and production as a PAI indicator in the "social and employment" category on the basis that the PAI indicators must align with the climate-related "Paris-aligned Benchmarks" (the "**Benchmarks**"). The Benchmarks are concerned with carbon emissions and are aligned with the UNFCCC Paris Agreement on climate change. The Benchmarks are covered by Commission Delegated Regulation 2020/1818 (the "**BMR Regulation**"), which supplements Regulation 2016/1011 on indices used as benchmarks in financial instruments (as amended). The BMR Regulation was adopted on the basis of a power granted by Article 19a(2) of Regulation 2016/1011 on indices used as benchmarks in financial instruments (as amended). That Regulation grants the Commission the power to adopt delegated acts laying down minimum standards for the Benchmarks and "EU Climate Transition Benchmarks".

The BMR Regulation contains a number of exclusions for the Benchmarks in Article 12. Most of these relate to carbon emissions, but Article 12 also excludes "*companies involved in the cultivation and production of tobacco*" (and also "*controversial weapons*").

No reasoning is provided for this exclusion in the BMR Regulation, but this appears to relate to the requirement that the activities of the underlying assets of a Paris-aligned Benchmark "*do not significantly harm other environmental, social and governance (ESG) objectives*" (Article 3(23b)(b) of the Benchmark Regulation (2016/1011)).

The proposed amendment to SFDR is also concerned with the principle of "*doing no significant harm*" and proposes to include "[e]xposure to companies involved in the cultivation and production of tobacco" as a mandatory indicator for principle adverse impacts for "*social and employee matters*". The reason provided is the alleged need to align with the approach adopted for Paris-aligned Benchmarks in the BMR Regulation.

It seems, therefore, that the ESAs and the Commission take the view that the tobacco industry does significant harm to "social" objectives and must be labelled as such for the purposes of the BMR Regulation and SFDR.

This is inappropriate and unlawful for the reasons set out below.

1. Tobacco control is not a "social and employee matter". It is a public health matter.

2. Tobacco control is specifically mentioned in Title XIV (of Part Three) TFEU concerning public health. Social and employee matters, by contrast, are covered by Title IX (Employment) and Title X (Social Policy). Other subject matters include Title XII (Education), Title XIII (Culture), Title XV (Consumer Protection) and Title XX (Environment). For EU law purposes these are different policy areas subject to their own rules on decision making and division of powers between the EU and the Member States. As such, for EU law purposes it is generally not possible to classify these matters as "social", even for the EU legislator (i.e., Parliament and Council). The scenario at hand is no exception, especially as it involves the ESAs and the Commission adopting a regulatory technical standard through delegated powers. When using such powers, the Commission must act strictly within a precisely defined scope which cannot be interpreted widely.
3. SFDR does not define "social and employee matter" but Article 2(17) SFDR does refer to "a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities" (emphasis added). This corresponds to the type of matters that are governed by Title IX (Employment) and Title X (Social Policy) TFEU. The wording of Article 2(17) SFDR does not cover tobacco control or similar public health matters.
4. As such, it would be unlawful to interpret "social" so broadly that it comprises public health objectives, such as tobacco control. Otherwise, "social" could encompass any public interest objective including matters such as culture, consumer protection and education.
5. We are not aware of any context other than this one in which the EU has presented tobacco control as a "social and employee matter".
6. Including exposure to the tobacco industry as a PAI lacks legal basis and it implies a policy choice and a political decision. Therefore, Tobacco Europe believes that taking decision with such implications on the basis of Article 4(7) SFDR is not possible from the legal point of view.
7. Including exposure of the tobacco industry as a PAI also involves a policy/political decision because the ESAs and the Commission effectively distinguish between tobacco and other public health risks, such as alcohol and high calory foods/snacks and drinks. Such policy/political decisions are unlawful when adopting delegated acts on the basis of Article 4(7) SFDR.
8. Article 168(5) TFEU explicitly provides that even the EU legislator cannot harmonise Member State laws "*which have as their directive objective the protection of public health regarding tobacco and the abuse of alcohol*". Therefore, if even the EU legislator cannot do this, the ESAs and the Commission most certainly cannot do so using the delegated power of Article 4(7) SFDR.

Neither the BMR Regulation nor any associated document (including legislative history) contains any indication that tobacco was targeted for reasons related to climate change. In fact, the BMR Regulation does not contain any reasoning concerning tobacco at all.

As a result, the discussion on and reasoning for targeting tobacco in both the existing BMR Regulation, and the proposal, is limited, circular, and unrelated to climate change. The BMR Regulation targets tobacco for reasons that are not explained and that are in fact linked to neither the “social” or “climate change” indicators. Tobacco Europe believes tobacco should have not been included in the BMR Regulation on climate change benchmarking. By extension, the alleged need to ‘align’ the proposal with the Benchmarks is a misleading and incorrect argument.

The inclusion of tobacco as a PAI sets a potentially problematic precedent. It may open the door for similar demands to include other industries, such as alcoholic beverages, leading to legal challenges and debates. Member States that support their respective wine and other alcohol industries might strongly oppose such a precedent as it could have far-reaching consequences.

### **3. The Proposal falls short of good rulemaking**

#### ***Principles of coherence and proportionality***

For the reasons outlined above, the ESAs’ proposal is unlawful. Even if we were to entertain the idea that it is founded on a proper legal basis, the proposal does not observe principles of coherence and proportionality.

While EU regulations aim to generate transparency on sustainability practice, singling out certain activities without due justification questions the regulatory evidence-based approach and does not support transparency, standardisation and comparability. Based on this, **the ESAs have not provided concrete arguments on the rationale for excluding the ‘production and cultivation of tobacco’ in comparison to the production and cultivation of any other commodities.**

Instead of implementing a blanket sector-specific exclusion, regulators should carefully consider the current business dynamics of the industry and the evolving preferences of consumers. It is crucial to avoid discouraging private investments in the legal value chain of the tobacco industry, which includes small and medium sized European domestic actors, and the development of new product categories, as innovation requires both time and investments.

Tobacco companies are actively investing in the development of non-combustible products in response to changing consumer needs. These products have the potential to reduce health risks associated with smoking and accelerate global harm reduction. Moreover, a growing number of independent scientists are recognizing the potential benefits of non-combustible products in its potential to reduce health risks, further highlighting the importance of fostering innovation in this field.

To achieve a more balanced approach, policymakers should consider alternatives that allow for the potential benefits of innovation in the tobacco industry to be realized.

As an industry, we support the EU’s vision of a sustainable transition, and share the view that investment across both environmental and social aspects can promote a more inclusive and sustainable economy. Excluding ‘production and cultivation of tobacco’ from SFDR would go against the vision of a sustainable transition that the EU expects to accelerate, which is to develop a more sustainable economic growth,



ensure the stability of the financial system, and foster more transparency and long-termism in the economy<sup>4</sup>. Rather than being penalised and excluded from private investment opportunities, companies should be incentivized to evolve and invest in a more sustainable *modus operandi*.

#### ***Unnecessary complexity and inoperability of Sustainable Finance regulatory systems***

The rapid development of EU Sustainable Finance regulations with differing requirements, definitions and interpretations creates confusion and inconsistency in the application of regulations like SFDR.

It is important to note that, at this stage, a blanket exclusion would be overly restrictive. Certain institutions worldwide, while drafting Sustainable Finance regulations and frameworks, have expressed concerns about the EU's approach 'being too restrictive'. For example, in the Consultation on Sustainability Disclosure Requirements (SDR) and Investment Labels, the UK Financial Conduct Authority compares its own proposed requirements with SFDR and states the following: *"We are not proposing to include requirements that mirror the EU SFDR's 'Do No Significant Harm' approach, i.e., disclosures on how a sustainable investment does not significantly harm the sustainability objective. We consider this approach may be too restrictive at this stage."*<sup>5</sup>

#### **4. Conclusion**

For the reasons outlined above, the ESAs' proposal is unlawful and would not withstand legal scrutiny.

Further, putting aside the legality of the proposal to one side, a binary approach on inclusion or exclusion/limitation of law-abiding actors in this way is incoherent, premature and simplistic.

Therefore, Tobacco Europe would recommend adopting a step-by-step approach with a proper legal basis and rationale while assessing the spillover effects of excluding an entire law-abiding industry as a whole, which also comprehends small and middle sized European domestic actors.

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<sup>4</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0097>