JOINT CONSULTATION ON DRAFT REGULATORY TECHNICAL STANDARDS FOR TAXONOMY-RELATED SUSTAINABILITY DISCLOSURE

EUROSIF RESPONDS TO ESAS

BRUSSELS, MAY 2021

Eurosif, the European Sustainable Investment Forum, welcomes the opportunity to respond to the joint consultation of the European Supervisory Authorities on the draft regulatory technical standards (RTS) of the Taxonomy-related sustainability disclosures.

INTRODUCTION

About Eurosif

Eurosif works as a partnership of Europe-based national Sustainable Investment Forums (SIFs). SIF members include institutional investors, asset managers, index providers and ESG research and analysis firms totalling over €8 trillion of assets under management, as well as other stakeholders such as NGOs, trade unions, think-tanks and philanthropic foundations. Eurosif is also a founding member of the Global Sustainable Investment Alliance, the alliance of the largest SIFs around the world.

Our Mission is to promote sustainable development through financial markets by supporting the financing through private and public capital of investments that make a measurable contribution to the sustainable development goals set by the United Nations, the European Union and other European countries.

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General comment

We are broadly supportive of the proposal of the ESAs regarding the amendments to the regulatory technical standards for taxonomy-related sustainability disclosure. Through this consultation response, we want to emphasise three main points.

One set of Regulatory Technical Standards – We fully support amending final RTS to have one set of SFDR RTS, including the original standards and the additional ones related to Taxonomy disclosures seems important for the simplicity of the legal procedure and to have a "single rulebook" for all sustainability-related disclosures.

Choice of KPIs for alignment, but no blending of KPIs across portfolios - We support the proposal of the ESAs to apply one approach and use the same KPI (one out of turnover, Capex and Opex) for all investments when calculating the Taxonomy alignment of a financial product. Allowing a Financial Market Participant (FMP) to use a mix of KPIs ('blending') will make it more challenging to understand the level of alignment as it will require an analysis of the weighting methodology applied between Capex, Opex and turnover. Additionally, we think there is merit in distinguishing between pre-contractual disclosures and periodic reports. The former contains an ex-ante target or commitment by FMPs while the latter provide an ex-post report of how the portfolio has aligned with the Taxonomy during the report period. Therefore, we would understand having one KPI chosen by the FMP in pre-contractual disclosures while maybe having more KPIs such as turnover (revenues) and capex (planned investments for transition) in the periodic report.

Alignment calculated over the entire portfolio of the product, regardless of whether the assets are assessable under the EU Taxonomy - Last, the denominator of the KPI should have all investments of the financial product, including sovereign bonds and other assets for which taxonomy alignments are challenging to assess. Excluding these assets from the denominator could artificially raise the share of taxonomy aligned investment by reducing the asset base in the denominator, hence including them is crucial for transparency and comparability purposes. ESMA also supported this reasoning in its final report on Technical Advice on Article 8 of the Taxonomy regulation.

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PUPLIC CONSULTATION RESPONSE

Question 1: Do you have any views regarding the ESAs' proposed approach to amend the existing SFDR RTS instead of drafting a new set of draft RTS?

We support the proposal of amendment to existing RTS rather than creating a new ruleset of RTS, as the main consideration is the ease of access and the facilitated use the RTS for disclosing entities.

Question 2: Do you have any views on the KPI for the disclosure of the extent to which investments are aligned with the taxonomy, which is based on the share of the taxonomy-aligned turnover, capital expenditure or operational expenditure of all underlying non-financial investee companies? Do you agree with that the same approach should apply to all investments made by a given financial product?

We agree that Financial Market Participants should apply the same consistent approach to all investments within the same financial product for consistency purposes. Allowing an FMP to use a mix of KPIs ('blending') will make it more challenging to understand the level of alignment as it will require an analysis of the weighting methodology applied between Capex, Opex and turnover.

We would like to take the opportunity to draw ESAs attention to the importance of distinguishing between pre-contractual disclosure and periodic reporting when it comes to the KPI choice allowed for FMPs as these two disclosures have a different purpose. The former would contain an ex-ante target or commitment of FMPs to align with the Taxonomy while the latter would provide an ex-post report of how the investment portfolio over a certain period of time has aligned with the Taxonomy.

Following this reasoning, we believe that for pre-contractual disclosure an FMPs should be able to select one or more KPIs out of Turnover, Capex or Opex as the basis of calculation for Taxonomy alignments.

However, for periodic reports we believe that FMPs should report on all three KPIs to allow for the best comparison between products, as the information should be readily available. We see this proposal as additional useful information for the end-investor. Turnover will for example be very important for investors seeking to align their capital with companies that are as much as possible already taxonomy aligned by investing in financial products focusing on this. The Capex indicator may however be more interesting for investors focusing on transition finance and seeking to select financial products focused on this theme. And both together will provide a complete picture of transition challenges for particular industries.

If a choice is made for only KPI to be disclosed in pre-contractual disclosures and one in periodic reporting, we would insist on the same KPI being required to avoid situations where on KPI is displayed ex-ante and another one ex-post.

Question 3: Do you have any views on the benefits and drawbacks of including specifically operational expenditure of underlying non-financial investee companies as one of the possible ways to calculate the KPI referred to in question 2?

Of the three KPIs for non-financial companies identified in Article 8 Taxonomy, Opex seems the less useful of the three. We are therefore relatively sceptical about the use of Opex to calculate Taxonomy alignments and the extent to which it will inform investors in the most transparent way, if a fund chooses this KPI as the only one to disclose its taxonomy alignment. Whereas Capex gives a clear signal about the strategy of a company around investments in a long-term horizon, Opex indicates the expenditures generally linked with the immediate short-term operations of the company. The latter will hence not reflect appropriately the – mostly long-term - ambition of investee companies in term of environmental sustainability. And for short-term developments, turnover aligned with the Taxonomy may be a more useful KPI.

Question 4: The proposed KPI includes equity and debt instruments issued by financial and non-financial undertakings and real estate assets, do you agree that this could also be extended to derivatives such as contracts for differences?

At this stage, there has been no evidence on how derivatives – given their various types and nature of underlying - could align with the Taxonomy.
We do not support the idea of derivatives being eligible for taxonomy-aligned investments, therefore such asset should not be included in the KPI. Whereas the KPI aims to indicate "how and to what extent" the economic activities underlying the financial product qualify as environmentally sustainable under the TR, we firmly believe it should only include asset types that enable FMPs to hold shares, have the voting rights and engage with the company management on the strategy. This is the one way that FMPs may have a voice and potential impact on the revenues and CAPEX plans of companies.

We point two main arguments not to include derivatives in the KPI. First, derivatives products do not allow any opportunities to engage with the company as shareholder/bondholder. Second, whereas each company can issue a limited number of shares or bonds, the intrinsic characteristic of derivatives potentially providing limitless position vis-à-vis one company could artificially increase the exposure of FMPs to taxonomy-aligned activities, and therefore not truthfully reflecting the extent to which activities the product invests in qualify as environmentally sustainable under the TR.

We therefore believe it is more cautious to exclude derivatives from calculations, at the very least until it has been examined whether they can align with the Taxonomy and under what conditions – type of derivative, underlying asset, etc.

Question 5: Is the use of "equities" and "debt instruments" sufficiently clear to capture relevant instruments issued by investee companies? If not, how could that be clarified? Are any specific valuation criteria necessary to ensure that the disclosures are comparable?

In our view, the RTS explains sufficiently clearly how equities of investee companies and different categories of bonds' proceeds should enter the numerator of the calculation. We expect that Taxonomy alignments will provide FMPs an extra tool to assess portfolio exposure to companies, thereby they understand where they could most influence.

Question 6: Do you have any views about including all investments, including sovereign bonds and other assets that cannot be assessed for taxonomy-alignment, of the financial product in the denominator for the KPI?

We are very supportive of the proposal to have in the denominator of the KPI all investments of the financial product.

For transparency and comparability purposes, the denominator should contain the value of all assets in the funds, including sovereign bonds and other assets whose taxonomy alignment are challenging to assess. Excluding these assets from the denominator could artificially raise the share of taxonomy aligned investment by reducing the asset base in the denominator. We believe in such a case that the disclosure would not be in line with the principle of fair, clear and not misleading communications as required by MiFID II.

Furthermore, ESMA supported this reasoning in its final report on Technical Advice on Article 8 of the Taxonomy regulation. It advised for asset managers to include sovereign bonds in the denominator. Therefore, to ensure consistency between the Technical Advice, the future Article 8 delegated act and the RTS under Article 5 and 6 of the Taxonomy, the denominator should include all assets of the financial product.

Question 7: Do you have any views on the statement of taxonomy compliance of the activities the financial product invests in and whether those statements should be subject to assessment by external or third parties?

We believe that the choice whether to have the taxonomy alignment/compliance assessed by external or third parties should be left at the choice of the FMP, while recognising that external verification, auditing or assurances will generally enhance the quality and trust of the disclosure for its intended users.

Financial products who are investing predominantly in European large-cap companies who themselves are subject to the EU NFRD and therefore Article 8 of the Taxonomy should have access to the necessary underlying information which may itself already be verified. Therefore, it may not be necessary to verify a second time the same information.

Financial products investing in companies located outside Europe as well as small and mid-caps may not readily have access to Taxonomy alignment information from underlying companies because these companies are out of scope of Article 8 Taxonomy. For this part of their 'investable universe', FMPs are likely to rely heavily on external data providers. This information may not be subject to the same verification mechanisms. However, we would also expect it not to be straightforward for FMPs to find third party verifiers willing to verify these numbers.

Therefore, we would recommend making verification optional at this stage for FMPs and let the market evolve. We are however hopeful that the data quality from SMEs and non-EU companies may improve under market pressure from data providers, financiers, and institutional investors.

Question 8: Do you have any views on the proposed periodic disclosures which mirror the proposals for pre-contractual amendments?

As state in our response to Question 2, we believe that a distinction could be made between pre-contractual disclosures and periodic disclosures as they are of a different nature and serve a different purpose. It is perfectly understandable that an FMP may want in pre-contractual disclosures to choose one particular KPI, either because of the investment strategy followed or because the type of KPI that may resonate with the target set of clients. Furthermore, a KPI in pre-contractual disclosures by the FMP is target commitment to align in the future the investment portfolio with the EU Taxonomy.

Periodic reporting disclosures are different in that they are ex-post and report back to clients on how the investment portfolio performed in the previous period. We do not see why an FMP is not required to report on more than one KPI in the periodic reporting. We suggest amending RTS Article 67a 2(b) and Article 61a 2(b) to include three graphical representations in the form of pie charts of the taxonomy alignment for each turnover, capital expenditure and operational expenditure taxonomy aligenment. Article 16b (3) should also be amended to allow the choice of one KPI for pre-contractual disclosures and mandate to use the three KPIs in period reports.

Question 9: Do you have any views on the amended pre-contractual and periodic templates?

We do not have additional remarks from those expressed in other answers.

Question 10: The draft RTS propose unified pre-contractual and periodic templates applicable to all Article 8 and 9 SFDR products (including Article 5 and 6 TR products which are a sub-set of Article 8 and 9 SFDR products). Do you believe it would be preferable to have separate pre-contractual and periodic templates for Article 5-6 TR products, instead of using the same template for all Article 8-9 SFDR products?

We believe keeping pre-contractual and periodic templates for products 8 and 9 SFDR is appropriate as we agree to consider Article 5 and 6 TR products as sub-categories of Article 8 and 9 SFDR products. Keeping the established templates instead of adding separate ones for products of Article 5 and 6 TR and adding ticking boxes to verify if activities are aligned with the TR as proposed in the amended templates will precisely help to identify better these sub-categories of Articles 8 and 9 SFDR products.

Question 11: The draft RTS propose in the amended templates to identify whether products making sustainable investments do so according to the EU taxonomy. While this is done to clearly indicate whether Article 5 and 6 TR products (that make sustainable investments with environmental objectives) use the taxonomy, arguably this would have the effect of requiring Article 8 and 9 SFDR products making sustainable investments with social objectives to indicate that too. Do you agree with this proposal?

A consequence of this proposal is that Article 8 and 9 SFDR products that make investments with social objectives would have to indicate whether they invest in activities aligned with the EU taxonomy. Since their prime focus is not environmentally sustainable investments, they may have to display very low alignment with the EU Taxonomy as long as no social Taxonomy is developed. Article 9 and Article 8 products having some share of sustainable investments will have investments that are required to meet the DNSH principle of Article 2(17) SFDR. However, satisfying the DNSH principle for environmental matters may not amount to making a Significant Contribution (SC) as defined under the Taxonomy.

Products pursuing or promoting solely the social aspect, would be required to tick the box "in activities not aligned with the EU Taxonomy". This may mis-lead some uninformed investors that would interpret this unticked box as a product of lesser quality. For simplicity and transparency purposes, we suggest reviewing the templates to allow FMPs to indicate whether their products pursue social, environmental or both objectives/ characteristics. In practical terms, the following box could be added below:

- ☐ "in activities not aligned with the EU Taxonomy"
  - ☐ **but promoting/pursuing social characteristics/ objectives**

Following these reviewed templates, the Taxonomy alignment boxes should only be ticked for FMP that have (partly or fully) environmental objectives/ characteristics.

[tick when relevant]

This product: ✖ Promotes environmental or social characteristics, but does not have as its objective a sustainable investment

- ☐ It does not invest in sustainable investments
- ☐ It invests partially in sustainable investments
  - ☐ In activities aligned with the EU Taxonomy
  - ☐ In activities not aligned with the EU Taxonomy

☐ Has sustainable investment as its objective. Sustainable investment means an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

- ☐ In activities aligned with the EU Taxonomy
- ☐ In activities not aligned with the EU Taxonomy

ABOUT EUROSIF

Eurosif is the leading European association for the promotion and advancement of sustainable and responsible investment making a measurable impact in meeting long-term sustainability goals of the EU and the UN.

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