

## Response to the Commission consultation on the Draft Delegated Act on Art. 8 of the Taxonomy Regulation

2 June 2021

### KEY MESSAGES

- We are broadly supportive of the proposal by the European Commission for the Delegated Act (“DA”) on Art 8 of the Taxonomy Regulation (“TR”).
- To ensure credibility of taxonomy-related disclosures and prevent greenwashing, we call for an **external verification / assurance and a board-level approval** of all taxonomy-related disclosures, including a **verification of the CapEx and OpEx plans**.
- We believe that the indicators by financial companies should provide a **comprehensive view of all investments / all balance sheet assets** of the financial company.
  - **Sovereign exposures** should be included in the denominator and, in some specific cases, in the numerator (e.g. green bonds to be issued by sovereigns complying with the EU Green Bonds Standard (EU GBS) expected to be developed in the coming months<sup>1</sup>).
  - We also suggest a specific approach for the **treatment of derivatives**, which should be **always assessed by their nature**, and by default included in the denominator that should represent all investments.
- KPIs for financial companies: we are calling for requiring disclosure of both **separate and aggregated ratios based on turnover, CapEx** of the underlying investee companies. The aggregated ratios should be calculated as a weighted average ratio composed of the taxonomy-aligned turnover and CAPEX. The respective weights should reflect the relative proportion of turnover and CAPEX. We believe that such an approach would properly reflect underlying companies’ taxonomy-alignment and prevent greenwashing.

Please see our full response below for all recommendations and explanations.

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<sup>1</sup> Publication of the Commission proposal to establish an EU Green Bond Standard is currently planned for 6 July 2021.

## FULL POSITION

An appropriate calibration of Art. 8 of the Taxonomy Regulation (TR) related disclosures is of great importance. Together with Art. 5 and 6 TR disclosures, they will define the taxonomy-related disclosures and how they work in practice.

The devil is in the details. The technical specifications of taxonomy-related disclosures will have a major influence on whether the EU Taxonomy will deliver on its objectives which are: 1) to define what investments are sustainable, 2) channel finance to sustainable activities, as well as those supporting the transition towards the sustainable economy, and 3) prevent greenwashing.

We are **broadly supportive** of the proposal by the European Commission for the Delegated Act (“DA”) on Art 8 of the Taxonomy Regulation (“TR”) that will define and specify the methodology and the content of the reporting that companies within the scope of the Non-Financial Reporting Directive (NFRD)<sup>2</sup> will need to deliver.

However, we believe that **several improvements** are needed **to ensure the robustness of the final DA and to prevent greenwashing**. In our feedback, we also **highlight those of the Commission’s proposals** which we believe are crucial to **keep**.

### 1) Non-financial companies: CapEx/OpEx plans

*Please note that while in in this section we refer to CapEx, our considerations are also valid for the calculation of the OpEx KPI, in line with the approach taken by the European Commission in the draft DA.*

We support the Commission’s proposal to include the CapEx plan in the calculation of the CapEx based KPI for non-financial companies, **as long as the CapEx plan is approved by the company’s board of directors**.

CapEx plans also have to meet other conditions as stipulated in the draft DA, including their execution within a timeframe of **maximum five years** (allowing extension to max. seven years where a longer period is objectively justified by specific features of the economic activity and the upgrade concerned).

We find the board approval of the CapEx plan as a **crucial and, for the moment, the only safeguard to ensure credibility of the CapEx KPI based on a yet unrealised CapEx investment plan**. We strongly believe that it is important to ensure that a CapEx plan that such a KPI would be based on, will be realised and will not turn out to be an empty promise.

We recognise that company law and corporate governance structures differ among the EU Members States. In some countries, investment plans are approved by the board of directors, while in two-tier systems investment plans may be approved by the supervisory board. We also understand that in case of small investments or investments within a short time horizon, approval by the board may not be currently required.

However, CapEx plan - which is to form the basis of the CapEx KPI – is of strategic importance and requires a high-level commitment. Board approval means commitment and a level of responsibility which is needed so that investors can trust that the company will execute the plan.

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<sup>2</sup> NFRD is currently being reviewed. On 21 April 2021, the European Commission published a proposal for a Corporate Sustainability Reporting Directive (CSRD), amending NFRD. Scope of the companies covered by the requirements will be determined as part of the review.

**Suggestion for a clarification:** the text of the draft DA refers specifically to an approval by “the management board of non-financial undertakings”. The term “management board” can be interpreted differently and therefore we suggest rather to refer to “board of directors in one tier systems and the supervisory board in two tier systems” or simply the “**supervisory body of the company**”.

With regards to the **timeframe within which CapEx plans need to be executed** in order to be eligible for the inclusion on the CapEx calculation, we agree that in principle the timeframe should be **restricted to five years, allowing for an extension to maximum seven years in justified cases**. As pointed out by ESMA, a maximum period of five years might not be in line with the investment or project cycle in certain industries but at the same time, the period over which the investments can be counted as being on a trajectory towards sustainability cannot be indefinite or arbitrarily long.

We recognise that the draft DA already requires some disclosures to accompany the KPIs of non-financial undertakings with regards to the CapEx and OpEx KPIs. We believe that they should include reporting on the progress made with regards to the execution of the CapEx / OpEx plan.

**Suggestion for an improvement:** require a yearly reporting on the progress made with regards to the implementation of the CapEx / OpEx plan.

## **2) Safeguards to ensure reliability of all taxonomy-related disclosures**

To ensure credibility of taxonomy-related disclosures, we strongly recommend to require:

- a **verification by an independent assurance services provider of the taxonomy-related disclosures**; and
- an **approval by the company board of all taxonomy-related disclosures**.

### **External verification / assurance**

Reliability of information is of paramount importance to investors and other information users such as governments, regulators, supervisory authorities, academia and NGOs. The EU taxonomy will only deliver on its aim to prevent greenwashing and channel finance to sustainable economic activities as long as taxonomy-related disclosures can be relied upon. We therefore strongly believe that an **external verification / assurance and a board-level approval of taxonomy-related disclosures are essential to ensure their credibility**.

We appreciate that assurance of Art. 8 taxonomy-related disclosures is now considered as part of the level 1 negotiations of NFRD Review / CSRD proposal. However, we want to emphasise the need for such assurance as this is of utmost importance for the credibility and success of the EU taxonomy overall.

We agree with ESMA<sup>3</sup> that assurance should not only consist of the verification of the existence of the non-financial statement, but be also applied with regards to verification of the contents of the statement and its consistency with the information provided elsewhere in the management report and in the financial statements. However, contrary to ESMA, we believe that provision of assurance services should not be restricted to audit firms only. There are many well or even better placed firms specialising in assurance of sustainability-related information. Meanwhile, it is questioned by many whether audit firms possess the necessary expertise with regards to sustainability-related information. Moreover, we believe that limiting

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<sup>3</sup> ESMA's Final Report: Advice on Article 8 of the Taxonomy Regulation, para. 109

provision of assurance services to audit firms only would further limit the competition in the market and reinforce the existing dominance of the largest audit firms.

Moreover, the issue still remains with regards to **the assurance / verification of Art 5 and 6 taxonomy-related fund-level disclosures**. We believe that such verification, at least on an annual basis, should also be required for **fund taxonomy-related disclosures**.

### **Board-level approval**

As explained in the context of CapEx / OpEx plans covered in section 1, board-level approval means commitment and increased level of certainty due to a higher level of responsibility attached to it. We strongly believe that financial and sustainability-related information should be on an equal footing and therefore, taxonomy-related information should be approved by the company board (supervisory body) or at least the same administrative or supervisory body that approves the company's management report.

### **3) Reporting requirements for non-financial and financial companies**

- We strongly support the Commission's proposal for Art. 8 taxonomy-related disclosures which requires: 1) a detailed breakdown of economic activities that contribute to any of the six environmental objectives, 2) reporting on those activities substantial contribution to the remaining five objectives, 3) to specify whenever the underlying economic activities are transitional or enabling, 4) counting only once the turnover from economic activities contributing to more than one objective in the turnover-based KPI to avoid double counting (a consistent approach followed for CapEx and OpEx-based KPIs).
- We also very much support a breakdown into: 1) EU taxonomy-aligned activities, 2) EU taxonomy eligible but not substantially contributing activities, 3) EU taxonomy non-eligible activities. We have, however, some suggestions for further improvements:
  - We believe it is important that companies (especially financial ones) also disclose a proportion of their economic activities which are **EU taxonomy eligible but for which there is no data available to calculate taxonomy-alignment**.
  - We suggest to require **a graphical representation of the taxonomy-alignment breakdown**, in line with what we have suggested for taxonomy-alignment fund disclosures in the annex to our response to the ESAs consultation on Art 5 and 6 TR disclosures (in the annex to this position). This would be particularly useful for retail investors to quickly grasp the big picture.
  - Lastly, we would like to point out a typo in annex II to the draft DA referring to "Turnover of Taxonomy-eligible **not** but not environmentally sustainable activities (not Taxonomy-aligned)".

### **4) Financial institutions' Art. 8 TR KPIs**

#### **a. Need for Consistency between Art. 8 TR entity-level and Art. 5 and 6 TR fund-level disclosures**

There are strong interdependencies between Article 8 TR (entity-level) and Articles 5 and 6 TR (fund-level) disclosures. Art. 5 and 6 TR fund-level disclosures will be calculated on the

basis of the underlying investee companies' Art. 8 TR disclosures. Therefore, ensuring consistency across Art. 8 TR and Art. 5 and 6 TR disclosures is of great importance.

This is particularly important regarding the indicators for financial companies where **Art. 8 TR** disclosures will be, especially in case of asset management and investment companies, to a large extent representing the taxonomy-alignment of their **overall investments, while Art. 5 and 6 TR** will provide a breakdown of the taxonomy-alignment **across their individual funds**. **The underlying methodology for Art. 8 TR disclosures for financial institutions and Art. 5 and 6 disclosures should be consistent.**

#### **b. Composition of the denominator & sovereign exposures**

The Commission proposes that the denominator of the Green Investments Ratio (GIR) and of the Green Asset Ratio (GAR) of financial institutions should give a comprehensive view of the entire balance sheet, which we very much support.

At the same time, the Commission suggests that the exposures to central governments and central banks be excluded from the numerator and denominator of key performance indicators of financial undertakings. Exclusion of sovereign exposures from the KPIs for financial institutions, and especially from the denominator, is in contradiction to the objective to provide a comprehensive view of the entire balance sheet.

We appreciate that for the moment there is no appropriate methodology for assessing sovereign exposures other than when issued in a form of a green bond complying with the forthcoming EU Green Bonds Standard (EU GBS) , and hence their inclusion in the calculation of the nominator is not appropriate for the moment. However, there is a similar situation with regards to the treatment of derivatives, which, in the draft DA, the Commission suggests to include in the denominator of key performance indicators of financial undertakings.

Moreover, exclusion of sovereign exposures from the KPI for financial institutions would discriminate against financial players that invest more in assets related to private entities rather than instruments having sovereign-related exposures. Exclusion of sovereign bonds from the calculation would distort the true taxonomy-alignment of the company's investments and debt-related activities, which we demonstrate with an example below:

#### **Fund X**

Total AuM = 1000 euro

Sovereign exposures in the fund: 0 euro

EU taxonomy-aligned activities = 300 euro

GIR =  $300/1000 = 30\%$

#### **Fund Y**

Total AuM = 1000 euro

Sovereign exposures: 200 euro

Taxo-aligned activities (without counting in any of the sovereign exposures) = 300 euro

GIR =  $300/(1000-200) = 300/800 = 37,5\%$

This examples clearly demonstrates that **excluding sovereign exposures from the calculation of the taxonomy-alignment KPI would clearly artificially and unjustly inflate the taxonomy-alignment of financial companies** investing the same amount of money in taxonomy-aligned investments while also having sovereign exposures.

Therefore, **we strongly call against the exclusion of sovereign exposures** from the denominator, and to properly follow the principle that the denominator of financial institutions' KPIs should include all investments and balance sheet assets.

Such an approach is supported by the Platform on Sustainable Finance, which emphasises that *“all investments independent of their nature or whether the Taxonomy can be applied or not to them should be included in the denominator to represent the true proportion of each euro invested”*.

In its advice on Art. 8 disclosures, ESMA points out that: “On balance, ESMA appreciates the arguments that a denominator based on all investments is a better option for the purposes of comparability and the prevention of greenwashing. ESMA believes that if the calculation has a denominator limited to all eligible investments, the disclosed information would not be as comparable, since an asset manager that has significant “ineligible” investments, e.g. sovereign bonds, would show a greater Taxonomy-alignment compared to an asset manager with similar value of investments but a smaller share of non-eligible sovereign bonds”.

With regards to the inclusion of **sovereign exposures in the numerator**, we appreciate that for the moment there is no appropriate methodology for assessing sovereign exposures. However, in line with the advice by ESMA, the Platform on Sustainable Finance as well as, ESMA Securities and Markets Stakeholder Group, we would like to underline that **bonds that will be issued by sovereigns in compliance with the forthcoming EU Green Bonds Standard, should be considered eligible for the inclusion in the calculation of the KPI's numerator**.

### **c. Treatment of derivatives**

We are very supportive of the general rule to cover the entire balance sheet in the denominator of the KPIs of financial institutions. In that respect, we welcome that derivative transactions are included in the denominator of GAR and GIR in the draft DA.

We understand that the Commission intends to exclude derivatives from the numerator of the KPIs of financial undertakings for the time being and re-assess at a later stage whether certain derivatives should be included in the aforementioned KPIs. However, we note that derivatives are not mentioned in the review clause in Article 10 of draft DA.

There also seems to be an inconsistency in Art. 8 of the draft DA on common rules for disclosure by financial undertakings. Para 2 reads that “derivatives shall be excluded from the numerator of key performance indicators of financial undertakings of financial undertakings”. Meanwhile, para 5 (g) stipulates that financial undertakings shall provide for a breakdown in the numerator and denominator of the key performance indicators for exposures and investments in derivatives.

In view of the assessment to be undertaken by the Commission, we would like to share our **proposal on the treatment of derivatives** with respect to their inclusion in the KPIs for financial companies for the Commission's consideration. Overall, we believe that derivative transactions should be assessed by their nature. In particular, we recommend that:

- Their **gross positions can be included** in the fund's taxonomy-alignment ratio when they are used for **hedging** purposes of **investments in taxonomy-aligned economic activities**.
- **Short exposures** to taxonomy-aligned investments should be **netted**.

- **Derivatives that meet neither of the above two conditions** (in other words derivatives used with the principal objective of gaining exposure to the fluctuations of an underlying asset price), should be **excluded from the numerator** of the fund's taxonomy-alignment ratio. However, they should be included in the ratio's denominator covering all investments.

The ESAs or the Platform on Sustainable Finance should develop further specifications based on the above-mentioned principles to prevent any potential abuses.

Please see our response to the ESA's consultation on Art 5 and 6 TR disclosures, in the annex to this paper, with regards to further details of our proposals. We believe that they should be applied consistently to 5 and 6 TR fund-level disclosures as well as Art. 8 TR entity-level disclosures for financial institutions.

#### **d. Treatment of non-NFRD (CSRD) companies' reporting**

We support the overall approach taken by the Commission with regards to the reporting by companies from outside the scope of NFRD (CSRD). The draft DA provides that non-NFRD companies, including non-EU companies and SMEs, can report taxonomy relevant information to financial institutions on a voluntary basis which can be integrated in the calculation of the GAR / GIR.

However, **we are not convinced about the three-year phase-in** for the reporting of non-NFRD exposures by financial companies in the numerator of their green investment/asset ratio (from January 2025), **especially with regards to the large non-EU companies**.

Overall, inclusion of self-disclosures of the taxonomy-alignment by non-NFRD companies in the numerator of KPIs for financial institutions would only benefit financial institutions (by increasing their respective taxonomy alignment) as well as self-disclosing companies by improving their access to finance.

If the inclusion of self-disclosures of the EU taxonomy alignment by non-NFRD companies in the numerator of GAR and GIR were not permitted, this would inhibit the ability of the taxonomy to incentivise financing of taxonomy-aligned economic activities and finance the transition outside the EU, which is probably where such investments are needed the most.

In its feedback, the Platform on Sustainable Finance, underlines that *"the exclusion of non-NFRD companies will misrepresent the sustainable practices of the investment firm and will not satisfy the needs of investors and asset owners to understand the full sustainable nature of their investment. Furthermore, these exclusions inhibit the Taxonomy from its ability to influence decision making or to be a tool to help construct portfolios."* The same can be said about excluding SMEs that may decide to apply the taxonomy on a voluntary basis.

While we understand the intention to protect SMEs from additional compliance burdens, we strongly believe that the **three-year phase-in should be removed at least with respect to non-NFRD companies**. We would also suggest to **allow financial companies to include SME taxonomy-related exposures as from the moment of the application of the rules** (meaning 1 Jan 2023 according to the proposed staged application of the DA).

In case financial companies are not able to obtain the data, they simply will not include it in the numerator of their KPIs. This **would put neither SMEs nor financial companies at a disadvantage as long as our proposal to disclose the proportion of taxonomy eligible activities for which there is no data available** is followed. Such an approach would ensure a fully transparent and just approach.

At minimum we suggest that:

- **Financial companies are required to include taxonomy-related exposures related to large non-NFRD companies** (in practice mostly large non-EU publicly listed companies) in their Art. 8 disclosures as of 1 January 2023. If data is not available, those exposures would not be counted in the numerator. In order to ensure the legibility of information, **transparency on the proportion of taxonomy-eligible economic activities for which data is not available should also be provided.**
- Financial companies are **allowed to include SME-related exposures** in the calculation of their respective Art. 8 disclosures as of 1 January 2023.
- **Exposures to SMEs and other non-NFRD companies should be included in the denominator of financial companies' KPI** from day one of the taxonomy disclosures' rules application. This is in line with the general principle that the denominator should cover all investments / balance sheet assets.

#### **e. Separate vs aggregated disclosure of turnover and CapEx based KPIs of financial institutions**

The draft DA suggests two KPIs for financial institutions (based on turnover and CapEx KPIs of investee / financed companies) to be accounted for as part of a Green Investment (Asset) Ratio. We understand that the Commission is interested to hear views on **whether to require disclosure of two types of Green Investment (Asset) Ratios** (based on the turnover and CapEx KPIs) **or whether they should be aggregated.**

Firstly, we would like to observe that in the draft DA **OpEx-based KPI is not considered** to be included in the calculation of Art. 8 taxonomy-related KPIs of financial companies. In our response to the ESAs' consultation on Art. 5 and 6 taxonomy-related disclosures, we observed that while turnover and CapEx seem to be given the most prominence in the taxonomy-related debate, OpEx is also an important KPI. therefore, we suggested that for the purpose of calculating fund-level disclosures, all three KPIs (based on turnover, CapEx and OpEx) of non-financial companies should be combined in appropriate proportions. However, we appreciate that the Commission strives for a simplification by focusing more on turnover and CapEx based metrics in calculation of Art. 8 KPIs for financial companies. **With the objective to reduce the complexity of taxonomy-related disclosures, we can agree that Art. 8 TR disclosures for financial companies are based on turnover and CapEx KPIs of underlying investee / financed companies**, given that turnover and CapEx metric are the most relevant of three. In such a case, **a consistent approach should be followed with regards to the calculation of Art. 5 and 6 TR fund-level disclosures.**

Secondly, on **whether to require disclosure of two types of Green Investment (Asset) Ratios** – one based on the turnover and one of CapEx KPIs of investee / financed companies)



**-or whether they should be aggregated:** we believe that the **best approach would be to require disclosure of both:**

- **Green Investment (Asset) Ratios based on turnover and CapEx KPIs of investee / financed companies separately, as well as**
- **aggregated Green Investment (Asset) Ratios**, calculated as a weighted average, with the weights reflecting the relative proportion of turnover and CapEx within a company.

Such an approach is in line with our response to the ESAs' consultation on Art. 5 and 6 taxonomy-related disclosures, where we suggest that for each non-financial company within a fund, a financial market participant (FMP) should calculate a **weighted average ratio composed of the taxonomy-aligned turnover, CAPEX and OPEX**. The respective weights should reflect the relative proportion of turnover, CAPEX and OPEX. Such a weighted ratio should then be included in the calculation of the fund's taxonomy-alignment portfolio.

We believe that leaving flexibility to an FMP to choose between the metrics when calculating the taxonomy-alignment ratio of a fund, could result in major greenwashing and insufficient comparability across funds for end-investors. Please see our position in the annex for further details on this subject.

Meanwhile, **in the context of Art. 8 TR entity-level disclosures**, which will serve as the basis for the calculation of Art. 5 and 6 TR disclosures, **separate disclosures of turnover, CapEx based KPIs are crucial** to provide a full overview to investors and other information users and prevent greenwashing. Therefore, with regards to Art. 8 TR disclosures, **we are calling for requiring a separate disclosure of financial companies' KPIs based on turnover and CapEx of investee / financed companies, as well as of the aggregated ones.**

We suggest **that the same logic is applied to Art. 8 disclosures by insurers / reinsurers**. The draft DA proposes that insurance or reinsurance undertakings disclose the KPIs related to both their investments and underwriting activities. We understand that the Commission is considering whether an investor assessing the taxonomy alignment of financial institutions' exposures to insurers (e.g. an equity holding in an insurance company), should consider both ratios separately, or a combination of both. We believe that both separate and aggregated taxonomy KPIs should be provided to investors and other stakeholders to give them a full picture enabling to make informed decisions.

We **support the Commission's proposal** made in the draft DA, to disclose a flow GAR KPI, a KPI for trading book (where relevant), a KPI for off balance sheet assets, and a KPI for commissions and fees related to other activities than financing **in addition to the main KPI for on balance sheet assets stock, credit institutions**. These additional disclosures of KPIs will enable one to have a better and fuller understanding of credit institutions' exposures to taxonomy-aligned economic activities.

#### **f. Reporting in light of the dynamic nature of the taxonomy and grandfathering**

The EU taxonomy is still under development and is designed as a dynamic tool. The technical screening criteria ('TSC') defining environmentally sustainable activities are likely to evolve overtime. This raises questions about how this may affect reporting of taxonomy-aligned activities, especially in the case of financial companies' indicators. Also, another question is how it may affect the status of certain instruments such as bonds to be issued in line with the

EU Green Bonds Standard and other products awarded a “green” / “sustainable” label. We believe that:

- The KPIs of non-financial as well as financial institutions need to reflect the progressive evolution of the technical screening criteria (TSC) and need to be adjusted in line with the latest taxonomy criteria as soon as possible.
- In case of debt products, like bonds that will be issued in compliance with the EU GBS and which were granted such status at the moment of the issuance, we believe that **grandfathering should be applied**. Absence of grandfathering in such cases could undermine investors’ confidence. Please read our [response](#) to the Commission’s consultation on the EU GBS for more details.
- The situation is different for the taxonomy alignment of equity-based instruments. Given the absence of maturity inherent to equity, an assessment of the taxonomy alignment of equity-based instruments should be performed each time the EU taxonomy criteria evolve.

We hope you will find our suggestions useful and we remain at your disposal to discuss and answer any questions you may have.

We attach below our response to the ESA’s consultation on Art. 5 and 6 TR disclosures for your consideration, given close interlinks with the Art. 8 TR disclosures especially with regards to the disclosures by financial companies.

## Annex

# Response to the ESAs consultation on EU taxonomy-related sustainability product-level disclosures

12 May 2021

### KEY MESSAGES

- Finance Watch favours the creation of a **“single rulebook” for sustainability disclosures** with the aim to reduce the complexity, duplication, potential inconsistencies or overlaps. A coherent approach is of great importance given that the EU Taxonomy Regulation (TR) and the regulation on sustainability-related disclosure in the financial services sector (SFDR) are closely intertwined. Following the same logic, we support the proposal for using the same, unified template for Art. 5 and 6 TR disclosures as for Art. 8 and 9 SFDR product pre-contractual and periodic disclosures.

- **Funds’ taxonomy-alignment ratio:** we strongly believe that **giving flexibility to a financial market participant (FMP) to choose between three metrics** (the taxonomy-aligned turnover, CAPEX or OPEX) in case of non-financial companies when calculating fund’s taxonomy-alignment ratio, **could result in major greenwashing and insufficient comparability** across funds for the end-investors.

Instead, we suggest that for each non-financial company within a fund, an FMP calculates a **weighted average ratio composed of the taxonomy-aligned turnover, CAPEX and OPEX**. The respective weights should reflect the relative proportion of turnover, CAPEX and OPEX.

- **DNSH criteria:** we are calling against **exempting EU taxonomy-compliant investments from screening against the “Do No Significant Harm” (DNSH) criteria in SFDR** for the following reasons:
  - DNSH criteria in TR are assessed at economic activity-level while DNSH criteria in SFDR are assessed at company-level.
  - The only DNSH criteria in TR developed so far are for climate change adaptation and climate change mitigation objectives, with the on-going work for the remaining four environmental objectives.
  - DNSH criteria in TR for climate change adaptation and climate change mitigation do not cover all sectors.
- **Treatment of derivatives:** derivative transactions should be assessed by their nature:

- Their **gross positions can be included** in the fund's taxonomy-alignment ratio when they are used for **hedging** purposes of **investments in taxonomy-aligned economic activities**.
- **Short exposures** to taxonomy-aligned investments should be **netted**.
- **Derivatives that meet neither of the above two conditions** (in other words derivatives used with the principal objective of gaining exposure to the fluctuations of an underlying asset price), should be **excluded from the numerator** of the fund's taxonomy-alignment ratio. However, they should be included in the ratio's denominator covering all investments.

The ESAs or the Platform on Sustainable Finance should develop further specifications based on the above-mentioned principles to prevent any potential abuses.

- We call for a **mandatory external verification / assurance of the taxonomy alignment** disclosed by investee companies in line with Art. 8 TR as well as the taxonomy alignment disclosed by FMPs in line with Art. 5 and 6 TR. This is essential to avoid greenwashing and provide certainty and reliability of information to end investors. We also caution against a box-ticking approach with regards to assurance of the taxonomy-alignment statement. Verification of the substance, including the ratios, is of great importance.

Please see our responses to specific questions below where we make several additional suggestions, including on how pre-contractual and periodic disclosures could be improved.

## RESPONSES TO SPECIFIC QUESTIONS

### **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 **suggested approach to create a “single rulebook” for sustainability disclosures** at Level 2 for both the original empowerments in SFDR and the additional ones added by the EU Taxonomy Regulation (TR).

In the short run, financial market participants (FMPs), applying the rules, may find amending the soon to be finalised SFDR RTS inconvenient and more difficult to prepare. Level 1 requirements for pre-contractual disclosures for products promoting environmental or social characteristics and products with sustainable investment objectives apply already as of 10 March 2021. Detailed requirements in line with the soon to be finalised SFDR RTS with regards to the aforementioned disclosures shall apply as of 1 January 2022, while those disclosures that are consulted on in this paper, shall apply as of 1 January 2022 for climate objectives and as of 1 January 2023 for other environmental objectives.

In the long term, amending the soon to be finalised SFDR RTS with the aim to **create a “single rulebook” for sustainability disclosures** will reduce the complexity, duplication, potential inconsistencies or overlaps. Having one consistent set of disclosure requirements will make it easier for those applying the rules to understand them and prepare the required disclosures.

A coherent approach is of great importance given that TR and SFDR are closely intertwined and as Art. 5 and 6 TR products are defined as subsets of Art. 8 and 9 SFDR products.

We would like to highlight the importance of closely aligning the entity-level Art. 8 TR disclosures with the product-level Art.5 and 6 TR disclosures as the latter will be built on the former.

### **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 **support the ESAs proposal** for the KPI for the disclosure of the extent to which investments are aligned with the taxonomy **except for one crucial point**. Whilst we understand the challenges around designing one taxonomy-alignment ratio of the fund, we strongly believe that **leaving it up to an FMP to choose between three metrics** (the taxonomy-aligned turnover, CAPEX or OPEX) **for the underlying investee companies, could result in major greenwashing and lack of comparability across funds** for end-investors.

For instance, an FMP could choose CAPEX as a metric for a fund which includes businesses which have 0% taxonomy-aligned turnover but that are investing in taxonomy-aligned economic activities resulting in a 100% taxonomy-aligned CAPEX. Such a fund could be marketed as an Art. 9 product and sold to an end-investor as a sustainable investment with a

high proportion of taxonomy-alignment, but such an alignment would not be a fair reflection of the sustainability of the companies it has invested in. Moreover, it would fail to capture the momentum of the evolution towards sustainability of activities on a transition pathway, as taxonomy-aligned CAPEX has to translate into taxonomy-aligned turnover at one point to reflect the effectiveness of the transition towards sustainability.

In order to reflect more adequately the taxonomy-alignment of non-financial companies in a fund, we suggest that for each non-financial company within a fund, an FMP calculates a **weighted average ratio composed of the taxonomy-aligned turnover, CAPEX and OPEX**. The respective weights should reflect the relative proportion of turnover, CAPEX and OPEX. Those ratios should be incorporated in the fund's taxonomy-aligned ratio, after being weighted to reflect the share of the company in the fund (in line with the ESAs' proposal).

Such a solution would prevent greenwashing, or misrepresentation, by removing the flexibility to choose the metrics which make funds look "greener" than they actually are. Moreover, what is truly interesting is the company's transition to sustainability. To understand whether a company is truly on a transition pathway, you need disclosures of both taxonomy-aligned turnover and CAPEX over a period of several years. Such disclosure would enable to analyse whether the taxonomy-aligned turnover is evolving over time and to what extent CAPEX from previous years converts into turnover. This is why in Art. 8 TR, co-legislators required investee companies to disclose taxonomy-aligned **turnover, CAPEX AND OPEX**. We strongly believe **the same logic should apply to fund-level disclosures in Art. 5 and 6 TR**.

**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?**

While taxonomy-aligned turnover and CAPEX seem to be given the most prominence in the taxonomy-related debate, OPEX is also an important KPI, providing an overview of company's operating expenses, e.g. on salaries & wages, office rent & supplies, advertisement & marketing, trips & travels, repairs & maintenance, variety of fees (legal, financial), etc. It is useful to understand to which extent a company's operating expenditures are funding sustainable investments as classified by the EU taxonomy. Therefore, it should be seen as an addition to turnover and CAPEX metrics rather than instead of them.

As mentioned in our response to question 2, in line with the requirements of Art. 8 of TR (clearly demonstrating the intention of the co-legislators), to have a full picture of the EU taxonomy alignment, non-financial companies should disclose all three metrics: taxonomy-aligned turnover, CAPEX AND OPEX. We warn against enabling FMPs to freely swap one ratio with another, which would create serious greenwashing concerns and very limited comparability across funds for end-investors.

Please see also our response to question 2.

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

Derivatives, including CfDs, should not be treated in the same way as plain vanilla equity and debt instruments with regards to the Taxonomy-alignment fund ratio, as they do not have the same effect in terms of financing sustainable investments.

Contracts for differences are in their nature similar with equity swaps and forward contracts - these are simply different legal wrappers used while gaining exposure to an asset price. Derivatives can, by construction, be used simply for gaining exposure to fluctuations of an asset price without bringing capital to the activity or company whose asset price fluctuations is replicated.

However, as reflected in the disclosures proposed in the draft RTS (Article 23), some derivatives can be used with the aim to support the sustainable investment objective(s). This includes derivatives used to hedge certain risks (e.g., of currency or interest rates fluctuations) in particular in the case of project finance, or other types of investments in environmentally sustainable activities. In some cases, hedging through derivatives is even a prerequisite to such investments, and in that context using derivatives can support or even enable financing of taxonomy-aligned economic activities. Such use of derivatives for hedging purposes is therefore fundamentally different, and must be distinguished from the use of derivatives for gaining exposure to the underlying assets.

Given that many derivative transactions result in short positions, which bet against the performance of an investment in a sustainable activity, excluding all derivative transactions from the taxonomy-alignment ratio's numerator will not provide a true picture of the proportion of the fund's investments in the taxonomy-aligned activities.

We therefore suggest the following approach with regards to the treatment of derivatives while calculating fund's taxonomy-alignment:

- Derivatives used for hedging purposes of investments in taxonomy-aligned economic activities can be included (gross positions) in the numerator of the fund's taxonomy-alignment ratio.
- Whenever derivatives provide a short exposure to taxonomy-aligned investments, such transactions should be netted in the numerator of the taxonomy-alignment ratio. This way, these short exposures will appropriately balance out the fund's long taxonomy-aligned exposures.
- Derivatives that meet neither of the above two conditions (in other words derivatives used with the principal objective of gaining exposure to the fluctuations of an underlying asset price), should be excluded from the numerator of the fund's taxonomy-alignment ratio. However, in line with the ESAs' proposals, together with all other investments they should be included in the ratio's denominator.

The ESAs or the Platform on Sustainable Finance should develop further specifications based on the above-mentioned principles to prevent any potential abuses.

**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?**

For the success of the sustainability-related disclosures framework, including the EU Taxonomy, it is important to clearly define what financial instruments are eligible and whether and how they should be included in the ratio depicting the Taxonomy-alignment of financial products. Equity and debt are relatively straightforward instruments, but clear specification is needed regarding non-plain vanilla instruments, etc. We suggest that the final RTS is as specific as possible regarding different types of financial instruments and their “eligibility” for inclusion in the taxonomy-alignment ratio.

**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?**

In line with the advice of ESMA and EIOPA regarding Art. 8 disclosures, we believe that all investments should be included in the denominator for the KPI. Otherwise, portfolios with investments which currently cannot be assessed by the Taxonomy, would seem more Taxonomy-aligned, and hence more sustainable, than portfolios with measurable but non-aligned investments. This would open the door to greenwashing and encourage investments in instruments which currently cannot be measured against the Taxonomy. On the contrary, FMPs should be encouraged to invest as much as possible in taxonomy-aligned activities. Inclusion of all investments in the denominator would also incentivize FMPs to screen “other assets” some of which might be assessed for taxonomy-alignment but simply have not been assessed because of high costs or missing competences.

We appreciate that including all investments in the denominator implies that certain products will never be 100% taxonomy-aligned due to the choice of sector allocation or the choice of financial instrument used. But this is only coherent with the way the taxonomy is structured and with its objectives.

We also support the ESAs’ proposal to allow disclosure of a proportion of the taxonomy-alignment calculated by an FMP, based on the data obtained from the investee company or a third data provider. However, we believe that the **taxonomy-alignment calculated this way should be clearly distinguished from the taxonomy-alignment in case of disclosures by companies within the scope of the Non-Financial Reporting Directive (NFRD / CSRD), currently being reviewed, or in case of self-disclosures by companies from outside the scope of NFRD (CSRD).** Whenever data on the taxonomy-alignment of the underlying investee companies’ activities is publicly not available, FMPs should be transparent about it. We suggest labelling such disclosures differently, e.g. **EU taxonomy-alignment based on non-public data”**.

In principle, **we are against allowing FMPs or third data providers to use proxies or estimates to calculate taxonomy-alignment** as this could lead to greenwashing and goes against ‘raison d’être’ of the EU taxonomy, which is to create a scientific and objective classification system of the environmentally sustainable economic activities. However, **if**



**proxies or estimates to calculate the taxonomy-alignment were to be permitted, we would insist that they be based on a methodology** developed by the Platform on Sustainable Finance and adopted by the European Commission.

To provide full clarity to end-investors, we **call for a detailed breakdown of the taxonomy-alignment ratio**, including its graphical representation to demonstrate what is the proportion of the investments which are: 1) taxonomy-aligned, 2) taxonomy-aligned based on non-public data, and 3) taxonomy non-aligned further broken down into: a) not meeting taxonomy criteria, b) taxonomy not-eligible, and c) investments for which there is no data available. Please see our proposal for a fund's taxonomy-alignment breakdown in the annex.

**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 call for assurance / external verification of the taxonomy-alignment of both Art. 8 entity-level disclosures and Art. 5 and 6 fund-level disclosures. This is in line with the Commission's proposal requiring assurance of Art. 8 disclosures in the context of the ongoing review of Non-Financial Reporting Directive (CSRD). We strongly believe that **Art. 5 and 6 disclosures should also be subject to a mandatory assurance obligation**. This is essential to prevent greenwashing and provide certainty and reliability of information to end investors.

At the same time, we would like to point out the importance of an appropriate wording of such an obligation. Requiring assurance of a statement of taxonomy compliance could result in auditors' / external verifiers' merely checking whether such a statement is provided and whether the statement is in compliance with the requirements in Art. 5 and 6 of TR and Art. 8 and 9 of SFDR, i.e. whether the appropriate statement was selected for an appropriate product category.

Such an assessment is useful, but the essential would be to provide assurance of the accuracy of taxonomy-alignment disclosures: whether the information provided is correct, are ratios properly calculated, etc.

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

We support the proposal for the periodic disclosures to be properly aligned with pre-contractual disclosures and therefore for the templates to mirror each other to the extent possible (same language, graphics, sequencing, etc.).

We also have several additional content-related comments applicable to the proposed periodic disclosures:

- We strongly suggest defining **a minimum reference period of at least five years** that would allow understanding the track record and progression of the share of sustainable investments, in particular in the EU taxonomy-aligned activities.

- Periodic disclosures should provide information on **whether** and to **what extent** the **minimum share of sustainable investments set as a target in pre-contractual disclosures**, in particular **with regards to the EU taxonomy-aligned activities, was met**.
- We are calling for bringing back the original ESAs proposal to require the disclosures of the **top 10 investments** of the financial product in the periodic disclosures. Leaving full flexibility to an FMP would create an opportunity for greenwashing and reduce comparability across the products for the end investor.

Please also see our response to question 9 where we make comments on the amended templates for pre-contractual and periodic disclosures.

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

#### **Mock-ups with exemplary answers would prove useful**

We **regret that the templates in the consultation paper do not provide examples of answers to the questions**. Mock-ups in the ESAs' consultation on product disclosure templates under SFDR, which closed in October last year, were very useful. Such answers, even if not legally binding, would help the industry to implement the rules, would result in their more harmonised application and an increased supervisory convergence.

#### **Overview of SFDR and TR-related product categories & assets' allocation**

We would like to take this opportunity to comment on the **infographic providing an overview of SFDR and TR-related product categories** which was shared during the ESAs' hearing on Art. 5 and Art. 6 TR disclosures (see in the annex to this response). The infographic as such is a very useful attempt to provide more clarity on the interlinks between different product categories and different SFDR and TR disclosure obligations. However, we believe that it could benefit from a simpler approach.

We appreciate that from a legal standpoint, Art. 8 and Art. 9 of SFDR are seen as creating two distinct financial product categories by prescribing specific disclosures. Furthermore, Art. 5 and Art. 6 of TR are adding an additional layer of disclosures to both Art. 8 and Art. 9 products. From a practical standpoint, **presenting Art. 9** (product pursuing sustainable investment, referred to as "dark green") **as a subset of Art. 8** (product with ESG characteristics, referred to as "light green") **would simplify matters** both for FMPs and end-investors. This would also reduce complexity of pre-contractual and periodic disclosures.

#### **Art. 9 products are investments with a sustainable objective(s).**

We question **why the asset allocation in the template for Art. 9 products allows for an inclusion of non-sustainable investments** by dividing investments into two categories: "sustainable investments" and "other".

This is in contradiction with Art. 9 SFDR which reads:

*“Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, the information to be disclosed pursuant to Article 6(1) and (3) shall be accompanied by the following (...).”*

This is by contrast to Art. 8 which does allow products to promote characteristics other than ESG characteristics:

*“Where a financial product promotes, **among other characteristics**, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, the information to be disclosed pursuant to Article 6(1) and (3) shall include the following (...).”*

We request that the template for sustainable investments be **amended clarifying that Art. 9 products can only make investments with a sustainable objective(s)**.

We also have several more specific suggestions with regards to the amended pre-contractual and periodic templates:

- Regarding the graphical representation of the assets' allocation, we think it would be useful to **require a pie chart or another graph** that would demonstrate an **indicative proportion of the targeted assets per category in pre-contractual disclosures**, as well as **investments made in each of the categories in the periodic disclosures**. Such visuals are very helpful to end-investors.
- We support the requirement to provide a pie-chart depicting a share of the investment's taxonomy-alignment. However, we think that a **more detailed breakdown of investments which are not taxonomy-aligned**, showing a share of investments which are taxonomy-eligible but not meeting criteria of the taxonomy, non-eligible and those for which there is no data available, would be very helpful for end-investors. Similarly, it would be useful that **taxonomy-aligned investments differentiate between** 1) a proportion of investments which are **“properly” taxonomy-aligned**, meaning those based on disclosures in line with Art. 8 TR as well as externally certified self-disclosed taxonomy-alignment; and 2) a proportion of **investments assessed as taxonomy-aligned by FMPs or third parties based on the data gathered from the underlying investee companies or data vendors**. Please see our proposal for an infographic in the annex.
- While we understand the rationale for asking to disclose what is the **minimum** share of investments aligned with the EU taxonomy in the pre-contractual disclosures, we **question the logic of requiring a disclosure of the minimum share of sustainable investments that are not aligned with the EU taxonomy** in the same document. This seems to lead to pursuing two, mutually exclusive objectives.

- We advise that FMPs are specifically required to disclose what is the reference benchmark in case there is one followed. The proposed templates are not specific enough. In case of both Art. 8 and Art. 9 products there is a “yes or no answer” question on whether a benchmark has been designated. In case of Art. 9 products there are further questions asking:

- 1) How does the reference benchmark take into account sustainability factors in a way that is continuously aligned with the sustainable investment objective?
- 2) How is the alignment of the investment strategy with the methodology of the index ensured on a continuous basis?
- 3) Why and how does the designated index differ from a relevant broad market index?

There are similar two follow up questions for Art. 8 products. However, neither in case of Art. 8 nor in case of Art. 9 there is a question asking to specify what the actual benchmark is. We therefore suggest to adjust the aforementioned questions as follows:

**Art. 8 products:** “Is a specific index designated as a reference benchmark to determine whether this financial product is aligned with the environmental or social characteristics that it promotes? **If yes, please name and describe this benchmark.**”

**Art. 9 products:** “Is a specific index designated as a reference sustainable benchmark to meet the sustainable investment objective? **If yes, please name and describe this benchmark.**”

- Regarding the section on **principal adverse impacts (PAIs)** on sustainability factors, we strongly suggest that an **incorporation by reference with an active hyperlink** is required to a document where there is a **detailed description of the evaluation of the aforementioned PAIs**. A mere “yes or no” answer to a question “Does this financial product take into account principal adverse impacts on sustainability factors?” is not sufficient.
- At the end of the template, there is a statement: “More product-specific information can be found on the website” with an instruction to insert a hyperlink to the website. We are wondering how the ESAs are planning to address the investor protection here. To our knowledge, website disclosures do not offer the same level of investor protection due to no requirements with regards to external verification / assurance and there is a reduced legal liability in terms of the information provided.
- Last but not least, there seems to be a mistake in the infographic on page 42 of the consultation paper where the description of #1B Other E/S characteristics is the same one as for #1 Sustainable investments.

**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?**

As Art. 5 and 6 of TR specify further disclosure obligations for Art. 8 and 9 products, **we fully support the proposal for using the same, unified template for pre-contractual and periodic disclosures**. This also follows the logic of creating a “single rulebook” for sustainable disclosures and would be particularly beneficial for retail investors who prefer to have all product disclosures in one place (or at least with links / references to all of the information in one place allowing them to take an informed decision).

**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?**

Yes, we concur with the ESA's proposal.

The work on the EU taxonomy, including in terms of extending it to cover social objectives, is on-going. For the moment, the EU taxonomy does not define socially sustainable investments, however the Platform on Sustainable Finance is doing the preparatory work in that regard, which will form the basis for the Commission's recommendations to be presented towards the end of this year.

To avoid too frequent revisions of SFDR, similarly to the ESAs' proposals with regards to disclosures on TR environmental objectives beyond the climate ones, we suggest that the **RTS requires FMPs to disclose whether and to what extent Art. 8 and Art. 9 products, including those making sustainable investments with a social objective(s), are aligned with the EU taxonomy.**

The benefit would be three-fold:

- 1) Once the scope of TR is expanded to include social objectives, FMPs would have to automatically disclose the social taxonomy alignment of Art. 8 and Art. 9 products, without the necessity to revise the rules.
- 2) There may be products contributing to a mix of environmental and social objectives at the same time. We should avoid a potential situation where an FMP may try to “escape” taxonomy-related disclosure obligations by referring only to a social objective pursued by the product. We therefore suggest that Art. 8 and Art. 9 products contributing to a social objective(s) also disclose how and to what extent they meet the criteria of the EU taxonomy, even if for the time being TR is confined to environmentally sustainable economic activities.

3) Some investments with a positive social impact may have a negative environmental impact, and vice-versa. Therefore, we suggest requiring disclosure of the taxonomy-alignment with regards to environmentally sustainable activities by funds pursuing social objectives. This would avoid misleading investors (who may assume Art. 9 products with social objectives are also environmentally sustainable) and contribute to achieving the EU climate goals.

We would also like to express our views on the ESAs proposal with regards **to DNSH criteria for investments that are in taxonomy-aligned activities**. We understand the logic of suggesting to supersede the broader 2(17) SFDR DNSH provision in case of investments that qualify as environmentally sustainable as per the EU taxonomy and hence meeting DNSH harm criteria included in the screening criteria accompanying TR. However, we would like to point out the following:

- DNSH criteria which are part of the EU taxonomy disclosure framework are assessed at the economic activity level. Meanwhile, DNSH criteria covered by SFDR are assessed at the investee company level. An investee company can very well be conducting a number of taxonomy-compliant activities, meeting the DNSH taxonomy criteria, and other activities not respecting the DNSH taxonomy criteria.
- The EU taxonomy is work in progress and for the moment DNSH criteria in TR have been developed only for the climate mitigation and climate adaptation objectives. Work is ongoing for the remaining 4 environmental objectives. Moreover, even for the two climate objectives, taxonomy DNSH criteria do not exist for all sectors.

Considering the above, we are calling against **exempting investments in environmentally sustainable activities which are EU taxonomy-compliant from screening against DNSH in SFDR**. We see them as complementary.

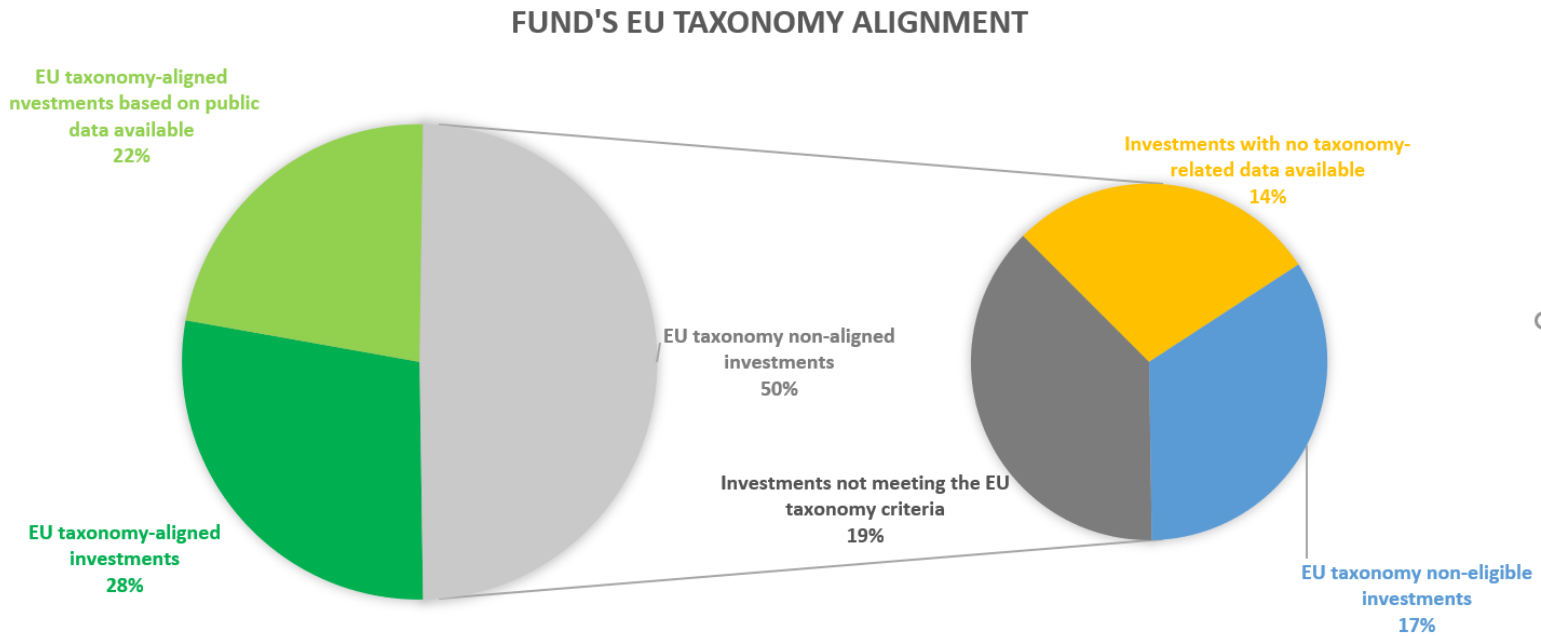
**Question 12: Do you have any views regarding the preliminary impact assessments?  
Can you provide more granular examples of costs associated with the policy options?**

No comment.

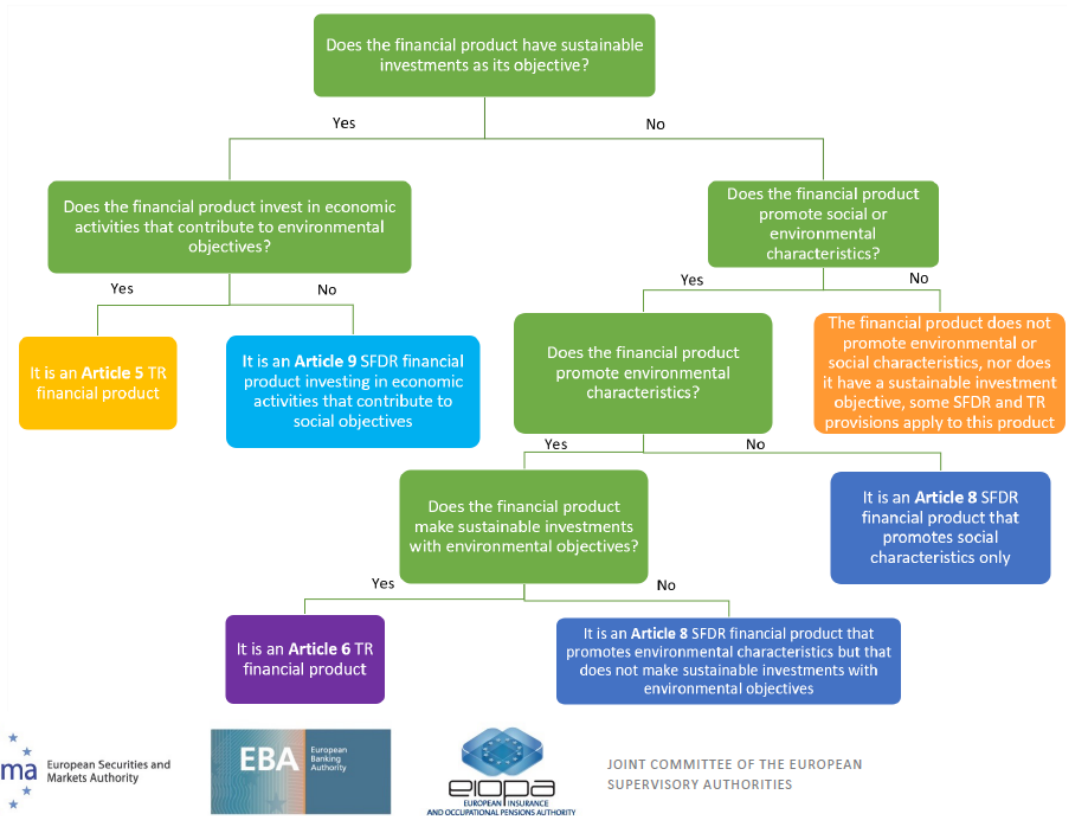
## Annex

Figure 1: Finance Watch proposal for illustrating a fund's EU taxonomy-alignment

Values have been selected randomly only for the purpose of presenting an alternative way to illustrate a fund's EU taxonomy-alignment.



## Article 5 – 6 TR financial products



6

Figure 1: ESAs infographic presented at the ESA's public hearing on 29 April 2021