BANKING STAKEHOLDER GROUP

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Joint consultation on Taxonomy-related sustainability disclosures

General considerations

The BSG generally supports the ESAs' proposed approach to amend the existing SFDR RTS instead of drafting a new set of draft RTS. A consolidated single text of RTS appears reasonable in order to rationalize the regulatory framework and to avoid proliferation of rules. This will ensure a "single rulebook" making the rules more accessible.

In any case it is not practical for the two SFDR-RTSs to come into force at different times. Banks would have to implement the templates of the first RTS and then change them again when the second RTS becomes applicable. Since the templates are mandatory, they cannot be implemented on the basis of the draft of the second RTS, as this would risk violating the law if the second RTS should be delayed.

BSG members highlight the importance that the consolidated version of the RTS, which includes the taxonomy-related information in the precontractual and reporting templates, is finalised in time to ensure an appropriate implementation of the templates. Considering the complexity of the regulation, the need to finalize necessary changes to IT and reporting systems and ongoing discussions and analysis of data providers and considering its timing of the coming into force aimed at ensuring the availability of ESG data originating from issuers (art 8 of the TR and revision of the NFRD), BSG members encourage the ESAs to address and discuss the timing issue with the Commission to ensure proper implementation of the templates. It is suggested that an implementation period of at least six months in terms of the mandatory use of the templates is foreseen, as well as a 1-year transition phase where a best effort approach is allowed.

Having said that, the BSG underlines that the new draft RTS raises the following critical issues already outlined with regard to the first set of draft RTS:

- the unavailability of the necessary data in a standardised and reliable way. This is particularly challenging in respect to the Taxonomy alignment information although it is acknowledged that the CSRD will improve the data availability for entities under its scope;

- the excessive complexity of the required information to be published by financial market participants (FMPs);
- the high costs for the implementation of the new requirements and, therefore, the need for a proportionality approach to be used by market players according to their different characteristics, type of activity and dimensions;
- the timing of implementation that is limited in relation to the complexity of the required adjustments to FMPs.

Also, as a general comment, we believe some language used in the templates should be clarified in order to be easily understandable for investors ("sustainable investment", "environmentally sustainable economic activities"). Using very similar wording, it may be difficult for investors to understand the subtleties.

Also, we expect to see more clarity on definitions regarding sustainable investing, to give more guidance to investors and to reduce the risk of greenwashing in sustainable finance. Examples of other potentially confusing subjects are: the ambiguity between taxonomy-eligible and taxonomy-aligned, the need to avoid proxies, unless they are formally defined and allowed by authorities, which is unlikely to occur prior to the implementation date. Ultimately, a rush toward premature implementation, in the absence of clear definitions and feasible data collection timeline will create confusion, including significant liability risks for the banks, as investors and NGOs will undoubtedly be very uncomfortable by the "best effort" approach, even if allowed by regulators. It may be more reasonable to limit the disclosure to what can be safely disclosed, and for the "best effort part", transform the disclosure into a supervisory reporting requirement.

Specific comments

We believe that the proposed KPI for the disclosure of the extent to which investments are aligned with the taxonomy is appropriate (Question 2). However, the chosen approach must be subject to the finalisation of the reporting obligation of non-financial undertakings under Article 8 of the Taxonomy Regulation, which sets out information that can actually be obtained by the financial undertakings.

As an example, if the final delegated regulation under Article 8 of the Taxonomy Regulation provides flexibility for non-financial undertakings to report on some of the KPIs, e.g. operational expenditure (OpEx), the "one approach for all investments" for the financial product disclosure against the taxonomy will not be viable. Turnover is probably the most relevant indicator. Capital expenditure (CapEx) is, however, also important as regards to companies in transition.

From a theoretical point of view, the proposal regarding the methodology for calculating the KPI consistently with the respective technical advice to the European Commission pursuant to Article 8 of the Regulation (EU) 2020/852 (TR) appears reasonable (Question 3). To ensure consistency and clarity to the end investor, at portfolio level, BSG members support the ESAs approach in requiring that the same approach should apply to a given financial product and one indicator to be used for all the issuers of the underlying portfolio. It would be to the Financial Market participants (FMPs) to choose one of the 3 indicators, to clearly state what is the indicators used and explain why that indicator has been selected.

However, from a practical point of view, this proposal is difficult to apply, considering that the objectives of the taxonomy are set in a delegated act (issued on 21 April 2021 which is expected to be published shortly and to be applied from 1 January 2022) only for climate change mitigation and climate change adaptation. The Technical Screening Criteria (TSCs) for the remaining taxonomy environmental objectives (sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems) are far from being finalised, meaning that the proposed draft RTS will have a very limited application for a long time, while investor demand is also rising significantly on other environmental, social and governance investments, including notably biodiversity, healthcare, etc. FMPs should be allowed to complement the disclosure with those other ESG goals, based on available market standards, in order to provide investors more transparency on a broader range of ESG products, beyond the limited scope covered so far by the EU Taxonomy.

Moreover, their application will be further limited by the lack of information disclosed by non-financial undertakings. In this respect the Commission has specified that the first annual report under the New Corporate Sustainability Reporting Directive (CSRD) previously named NFRD will be 2023 (first data Q2 2024). It is very unlikely that it will be feasible for non-financial undertakings to disclose the required information from 1 January 2022 (date of application of the SFDR RTS). Therefore, FMPs will not be in a position to consider data reported by non-financial undertakings. In addition, a significant part of the underlyings in investment products are issued by non-financial undertakings that are not in the scope of the NFRD, whether they are under the current NFRD (and/or future CSRD) threshold, or because they are not based in the EU. For example, we see significant interest in investment products with IFIs green underlying, such as Worldbank securities aiming at financing ESG investment in Emerging markets, a key component of the global Paris agreement. It would be paradoxical to be unable to include such underlyings in the “green” part of the financial products offered to our clients.

Considering the above, it would seem reasonable to either postpone the application of these additional disclosure obligations or alternatively allow the FMPs to carry out purely qualitative assessments (e.g., on the basis of proxies provided by information providers and formally endorsed by authorities) due to the lack of quantitative data. This appears to be very important, especially for the precontractual disclosure.

The proposed KPI includes equity and debt instruments issued by financial and non-financial undertakings and real estate assets. The question is raised whether this could also be extended to derivatives such as contracts for differences (Question 4).

It appears to be fine from a theoretical point of view. Still, it is very difficult to be implemented in the case of derivatives because it would require a look through approach, and it might be disproportionate for portfolios managed on individual basis where the use of derivatives is very limited. Therefore, it might be opportune to develop shared guidelines on how and to what extent derivatives could be considered. In practice, we believe that there should be a differenciation between derivatives that are used to get exposure on an ESG underlying risk, and derivatives that are used for hedging risks in the product, without any ESG objective.

An example of derivatives that are used to get exposure on an ESG underlying risk is the case of ETFs. In most cases, ETFs are build using equity swaps, rather than buying the underlying cash equity in the market. When an ETFs is designed to meet a Low-Carbon Benchmark, the synthetic equity exposure should be included in the KPI, otherwise the ETF will show a zero alignment, despite its explicit goal.

An example for derivatives that should NOT be included in the KPI is the case where FX or IRS derivatives are used to hedge currency or interest rate risk in the portfolio, for example if a € denominated fund includes some limited share of non-€ underlying, in order to avoid any currency risk for the investor. In this case, the FX swap has no ESG purpose whatsoever, and should be excluded.

<u>On the question whether the use of “equities” and “debt instruments” is sufficiently clear to capture relevant instruments issued by investee companies (Question 5),</u> BSG members believe that it would be very useful that the ESAs publish a list of indicative examples in order to help FMPs to better understand the use of equities and debt instruments and what valuation criteria should be adopted for each of them, in line with the rules also needed to calculate the Green Asset Ratio.

On the <u>question 6 whether or not to include 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,</u> considering that the main objective of these indicators is to offer clarity to the end investor though a concise, high level, comparable figure showing the share of the amount of money invested in taxonomy aligned activities, BSG members are of the opinion that it is indeed appropriate to include all investments in the denominator. While this may not give a thoroughly accurate view of the composition of the portfolio with regards to the non-taxonomy aligned share of the portfolio (which could be made of both non assessable and not aligned activities), we do consider this to be acceptable as long as the meaning of the % is clearly stated and understood by investors. Otherwise, the method will risk pushing taxonomy-focused investors away from products that might suit them well (but which appear non-aligned due to the inclusion of sovereign bonds and other assets that cannot be assessed for taxonomy-alignment). Including sovereigns in the denominator, for example in a life insurance product, while being unable to include any sovereign exposure in the numerator, would significantly reduce the disclosed ratio, even in the case where there would be a strict “ESG filter” in the non-sovereign portion of the portfolio. Life insurance, retirement savings programs, are generally managed with a combination of sovereign (risk-free) and higher yielding assets, depending on the risk profile of the client. It should be possible to advise the client, on one hand, on the appropriate proportion of govies vs other asset classes, in particular as a function of his/her investment horizon, and separately, to advise on a proportion of ESG investment in the non-govies allocation. The reporting framework should follow this logic.

On <u>question 7</u>, it might be an unnecessary complication to request certification downstream of the process and, in consideration of the already heavy burden placed on FMP to align with the regulation, we would recommend not to prescribe a third-party assessment. In our opinion it is more efficient to place the certification upstream of the process, i.e., with reference to the data produced by the info providers, in which case the inclusion of information on, whether the statement has been subject to an assurance provided by an auditor or a review by a third party, can be supported. But, the efforts to develop further reporting standards able strengthen accountability and transparency of information provided to the investors and other market participants should be complemented by defining some benchmarks of good practices.

On the amended pre-contractual and periodic templates (Question 9), we believe that including mandatory information on taxonomy-alignment may (see also comments to question 6) pose a risk that some investors are deterred by a low – or even zero – percent minimum taxonomy-investments. If this low number is caused by – for example – an investment strategy related to activities for which no taxonomy-criteria exist, it could be misleading rather than informative. It is suggested therefore that the relevant parts of the templates are supplemented with an additional option stating: "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities".

To enhance transparency, financial market participants should clearly state in a check box solution whether the financial product (a) invests in economic activities that contribute to an environmental objective or promote environmental characteristics, or (b) does not invest in economic activities that contribute to an environmental objective or promote environmental characteristics. Only financial products ticking off option (a) should provide the taxonomy statement, whereas financial products ticking off option (b) should provide the disclaimer. Also, and in line with the previous comment, it is suggested that the section on "what is the minimum share of sustainable investments that are not aligned with the EU Taxonomy " is supplemented by an option to confirm that the financial product does or does not have a minimum share of other sustainable investments.

Also, it is considered not appropriate to require information on, why a financial product has invested in economic activities that are not environmentally sustainable. As stated several times by the European Commission, the Taxonomy Regulation is primary a transparency tool and do not represent a mandatory list of activities to invest into, we do not consider it appropriate to demand a "justification" regarding the choice to invest in taxonomy compliant activities or not. It is not a requirement to only invest in taxonomy-aligned activities. Instead, the periodic reporting templates should allow for a more qualitative description on the taxonomy investments.

On Article 8 – pre-contractual: it is not a pre-requisite for Article 8 products to invest in sustainable investments. Accordingly, the heading "To which objectives do the sustainable investments contribute and how do they not cause significant harm" should be supplemented with a "N/A" option for products, which confirm initially in the template not to invest in sustainable investments. Subject to our comments above, the section on "minimum share of sustainable investments that are not aligned with the Taxonomy Regulation" should not be included for Article 8 products. The level 1 text provides no basis for such specific disclosure requirement on Article 8 products. Such language could mislead investors in assuming that products not aligned with the EU Taxonomy do not pursue any E,S or G characteristics which may not necessary be the case.

The pre-contractual disclosure should not focus on data from a specific date, but rather on the investment strategy and what the portfolio manager is bound to do when making investment decisions (otherwise this could lead to information being misleading for the customer). The formerly mentioned data could instead be included in the periodic report.

Moreover, setting a minimum proportion of Taxonomy-aligned investments at the pre-contractual level instead of a target could lead to the situation that FMPs put very low thresholds, considering in particular that data on taxonomy-aligned investments is lacking.

Finally, one could also question the proposal to divide the minimum proportion of Taxonomy alignment into transitional and enabling activities. Firstly, and linked to the argument on minimum proportion described above, this limits the portfolio manager even further. Secondly, a customer would often not understand what this means. Thirdly, the Taxonomy is based on three categories, i.e. green, transitional and enabling activities. Defining only two of those, the third category would not be visible for the customer.

For question 10, again from a theoretical point of view, it appears reasonable to propose unified pre-contractual and periodic templates applicable to all Article 8 and 9 SFDR financial products as using the same templates can make it easier for investors (especially retail investors) to get comfortable with the structure. In terms feasibility however, the availability of clear criteria and data to qualify and report all the different types of sustainable investments is essential. If it is not the case, only few sections/parts of the proposed templates could be filled. It may therefore be preferable to have different templates for different product types.

On question 11, it might be important to mitigate any possible misunderstandings with an additional text, e.g. stating that no detailed taxonomy-criteria for social sustainability currently exist.

The identification of sustainable investments for all the 6 environmental objectives has to be finalised first in the EU Taxonomy (so far, only mitigation and adaptation are in the Taxonomy) and also for social objectives. We know that the Platform for Sustainable Finance is committed to issue before the end of this year its first proposal for a social Taxonomy. Therefore, we foreseen a long period ahead having a clear and common tool (delegated act) to identify social sustainable investments. It is again important here to underline the data gap issue (in part depending on the lack of the Taxonomy) and the absolute necessity to give banks a sound period to implement all the bank's processes before making anything compulsory in terms of disclosure.