

MEMO# 33924

November 26, 2021

EU ESG: ESAs Publish Draft RTS on Taxonomy-Related Product Disclosures Under the SFDR

[33924]

November 29, 2021

TO: ICI Members

ICI Global Members

ESG Task Force

EU ESG Disclosure Regulation Working Group SUBJECTS: ESG

International/Global RE: EU ESG: ESAs Publish Draft RTS on Taxonomy-Related Product Disclosures Under the SFDR

On 22 October 2021, the European Supervisory Authorities (ESAs)[\[1\]](#) published the final report[\[2\]](#) on the draft regulatory technical standards (RTS) on the taxonomy-related disclosures for financial products subject to the disclosure requirements under Article 8 and Article 9 Sustainable Finance Disclosure Regulation (SFDR).[\[3\]](#)

As background, SFDR Article 8 products that promote environmental characteristics, and SFDR Article 9 products that make sustainable investments contributing to an environmental objective are required to make Taxonomy-related disclosures in accordance with Articles 5 and 6 of the EU Taxonomy Regulation.[\[4\]](#) The Taxonomy Regulation empowered the ESAs to develop further RTS on taxonomy-related product disclosures.[\[5\]](#) With the aim of establishing a single rulebook for sustainability disclosures under the SFDR and the Taxonomy Regulation, the final report contains the Draft SFDR Amended RTS that introduces the relevant Taxonomy-related product disclosure obligations by amending the previous set of draft SFDR RTS[\[6\]](#) published on 2 February 2021. The ESAs have also taken the opportunity to make some targeted changes to the draft SFDR RTS.

Notably, in a consultation[\[7\]](#) launched in March 2021 on the initial draft of the SFDR Amended RTS, to which ICI responded[\[8\]](#) in May 2021, the ESAs had proposed that taxonomy-aligned investments would automatically be an SFDR compliant "sustainable investment". However, the ESAs indicate that they are not legally capable to adopt such approach. Hence, all sustainable investments, including taxonomy-aligned investments, will be subject to the SFDR requirements relating to "do no significant harm".

The ESAs have submitted the Draft SFDR Amended RTS to the European Commission for

adoption, but please note that the RTS is not yet final. This memorandum briefly summarizes the main changes to the draft SFDR RTS sets out in the Draft SFDR Amended RTS.

1. Declaration of alignment with the Taxonomy

As background, the draft SFDR RTS requires disclosure of whether the product is classified as Article 8 or 9 in both pre-contractual and periodic reporting templates. An Article 8 product is required to indicate whether it makes sustainable investments.^[9] For ease of reference, Article 8 products making sustainable investments are referred to as "Article 8+ products" in this memorandum.

For the purpose of Taxonomy-related product disclosure, the ESAs identify Article 8 products that make sustainable investments with an environmental objective as a subset of Article 8+ products, and Article 9 products with an environmental objective as a subset of Article 9 products. Nevertheless, the sub-categories presented in the consultation had effectively required all Article 8+ and Article 9 products to identify in the pre-contractual and periodic reporting templates whether the underlying sustainable investments are Taxonomy-aligned. We had expressed concerns about such approach given the limited scope of the current Taxonomy Regulation,^[10] and we were pleased to see that the templates have been amended to clarify only environmentally sustainable investments are required to disclose Taxonomy alignment.

The pre-contractual and periodic reporting templates amended by the Draft SFDR Amended RTS require Article 8+ and Article 9 products to identify whether the underlying sustainable investments are environmental or social, and further for environmentally sustainably investments whether the investments are taxonomy-aligned.

2. Disclosure of Contribution to Taxonomy's environmental objective(s)

As stated in Articles 5 and 6 of the Taxonomy Regulation, in-scope SFDR Article 8 and 9 products should provide information on the Taxonomy's environmental objective(s) to which the investment underlying financial products contribute.

The Draft SFDR Amended RTS requires that Article 8+ and Article 9 describe the objectives of underlying sustainable investments and how such investments contribute to the sustainable investment objective in both pre-contractual and periodic reporting templates. Further, in respect of sustainable investments with environmental objectives, the financial products must specifically list the Taxonomy's environmental objectives to which the underlying sustainable investments contribute.

3. Disclosure of Taxonomy-alignment

In-scope Article 8 and 9 products are required to provide a description of how and to what extent the investments underlying the financial products are in environmentally sustainable economic activities defined in the Taxonomy Regulation.^[11]

A. Disclosure on the extent to which investments are Taxonomy-aligned

Dual approach in calculating Taxonomy-alignment. The Taxonomy alignment of investments will be calculated in accordance with the below formula:

Our comments had noted that the inability of assessing Taxonomy-alignment for certain

assets, e.g. sovereign bonds, may lead to a low Taxonomy-alignment percentage at the outset and cause confusion to investors. Due to these concerns, the Draft SFDR Amended RTS proposes a dual approach to the KPI calculation - one showing the Taxonomy-aligned activities as a proportion of all investments and one showing the Taxonomy-alignment excluding all sovereign exposures (including any investment that results in exposure to central governments, central banks and supranational issuers) from both the numerator and the denominator. The second KPI is calculated the same way as the KPI provided in the Delegated Regulation under Article 8 of the Taxonomy Regulation.[\[12\]](#)

Nevertheless, if the extent to which the contribution of sovereign exposures to Taxonomy-aligned economic activities cannot be assessed, a narrative explanation of such proportion of investments should be provided.

Derivatives and netting. Acknowledging the lack of reliable methodologies to determine the Taxonomy-alignment of exposures achieved through derivatives, the Draft SFDR Amended RTS states that such exposures should be excluded from the numerator. Also, to ensure a fair representation of the economic exposure to securities in the numerator, the methodology for net short positions under the Short Selling Regulation should be used for calculating the numerator. This aligns with the Delegated Regulation under Article 8 of the Taxonomy Regulation.

Choice of Taxonomy key performance indicators (KPIs). For pre-contractual disclosures, one Taxonomy KPI should be selected to measure the Taxonomy alignment. The Draft SFDR Amended RTS clearly states that such KPI should by default be turnover. Capital expenditure (CapEx) or operational expenditure (OpEx) should be used only where the features of the financial product justify it. For investee companies that are financial undertakings, the same KPI should be used for the same type of financial undertaking. The selection of KPI should be explained, including by reference to how suitable it is to inform end investors.

For periodic disclosures, while the consultation had proposed using the same KPI selected for pre-contractual disclosures, the Draft SFDR Amended RTS requires the Taxonomy-alignment calculation to be based on all three KPIs - turnover, CapEx and OpEx.

Pre-contractual disclosure on minimum Taxonomy-alignment. Both Article 8+ and Article 9 products are required to disclose the minimum share of Taxonomy-aligned environmentally sustainable investments underlying financial products in a pre-contractual disclosure template. Such alignment should be calculated in two ways - one for all aggregated investments and one for all aggregated investments without sovereign exposures. The minimum Taxonomy alignment should be presented as pie charts. Financial market participants should also disclose the minimum share of environmentally sustainable investments that do not align with the Taxonomy's environmental objectives and the minimum share of socially sustainable investments.

Periodic disclosures on Taxonomy alignment. Article 8+ and Article 9 products should show the representation of Taxonomy alignment during the reference period in the form of a bar chart. Similarly, the Taxonomy-alignment should be presented in relation to all aggregated investments and all aggregated investments excluding sovereign exposures. The share of socially sustainable investments and the share of environmentally sustainable investments that do not align with Taxonomy during the reference period should also be disclosed.

Enabling and transitional activities. As proposed in the consultation, the Taxonomy

alignment disclosures in both pre-contractual and periodic reporting templates should be supplemented by a breakdown between enabling and transitional activities under the Taxonomy Regulation. The breakdown should be expressed as a percentage of all investments of the financial products.

Explanation of investing in non-Taxonomy-aligned activities. For Article 8+ and Article 9 products making sustainable investments with an environmental objective, where the product invests in economic activities that are not Taxonomy-aligned economic activities, a clear explanation of the reasons for doing so should be provided in both pre-contractual and periodic reporting templates.

Data source for investee companies beyond the scope of Taxonomy disclosure. For the assessment of investments in investee companies that are not subject to the disclosure requirement under Taxonomy Article 8, public reporting of data should be prioritized, followed by privately obtained data, either directly from investee companies or third parties.

If Taxonomy-alignment information is not readily available from public disclosures by investee companies, financial market participants should provide details of how equivalent information was obtained directly from investee companies or third-party providers.

B. Disclosure on how the investments are Taxonomy-aligned

SFDR and Taxonomy "do no significant harm" requirements apply cumulatively. The SFDR and the Taxonomy Regulation have two separate principles on "do no significant harm" (DNSH).^[13] It was proposed in the ESAs consultation paper to derogate from the general SFDR DNSH requirements for Taxonomy-aligned sustainable investment on the basis that the Taxonomy-aligned investments would already be subject to the DNSH requirements under the Taxonomy Regulation. However, after further legal analysis, the ESAs have determined that it is not possible to make such derogation. Thus, the SFDR DNSH requirements will be applied to all sustainable investments, including Taxonomy-aligned investments. The ESAs acknowledge that this will adversely affect Taxonomy-aligned investments.

Indication of Taxonomy compliance. The consultation, based on the derogation mentioned above, had proposed requiring a statement of Taxonomy compliance of activities for financial products making Taxonomy-aligned investments. Given the derogation is removed, such statement of Taxonomy compliance is no longer required. Instead, the financial products should provide in both pre-contractual and periodic reporting templates a description of underlying investments in Taxonomy-aligned economic activities and whether the compliance of these activities with the Taxonomy will be assured or reviewed by an auditor or third party.

4. Compliance timeline for Taxonomy-related disclosures

ICI's consultation response urged the ESAs to clearly communicate the timeline of compliance with Taxonomy-alignment disclosure requirements. We appreciate that the Draft SFDR Amended RTS clarifies at the outset that it will apply in respect of the two Taxonomy's environmental objectives, namely, climate change mitigation and climate change adaptation, in January 2022. For the remaining four Taxonomy's environmental objectives, the Taxonomy-alignment disclosure requirements will apply from 1 January 2023.

5. Further disclosure on consideration of principal adverse impacts

The draft SFDR RTS requires that Article 8 and 9 products identify in the pre-contractual disclosures if principal adverse impacts on sustainable factors are considered. The Draft SFDR Amended RTS adds that these products should further provide information on how these principal adverse impacts are considered, along with a statement that information on principal adverse impacts on sustainability is available in the entity-level website disclosure on principal adverse impact indicators, disclosed pursuant to Article 11(2) of the SFDR. This statement should also be provided in the periodic reporting templates. These additional requirements will apply from 30 December 2022.

6. Next steps

The European Commission will scrutinize the Draft SFDR Amended RTS and decide whether to endorse them within three months of their publication. As the Commission announced earlier, it intends to combine this Draft SFDR Amended RTS with the SFDR RTS into a single delegated act.

The ESAs have noted that the SFDR RTS has an expected application date of 1 July 2022 and therefore anticipate that this Draft SFDR Amended RTS will also apply from this date.

Lisa Cheng
Research Analyst
ICI Global

Elizabeth Lance
Assistant Chief Counsel
ICI Global

endnotes

[1] There are three ESAs, namely, European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA).

[2] See Final Report on draft Regulatory Technical Standards with regard to the content and presentation of disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088 (22 October 2021), *available at* https://www.esma.europa.eu/sites/default/files/library/jc_2021_50_-_final_report_on_taxonomy-related_product_disclosure_rts.pdf.

[3] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector, *available at* <https://eur-lex.europa.eu/eli/reg/2019/2088/oj>.

[4] REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=EN#d>

[1e40-13-1](#).

[5] See Taxonomy Regulation, *supra* note 4, at Article 25.

[6] See Final Report on draft Regulatory Technical Standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088 (2 February 2021), *available at* <https://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/joint-rti-esg-disclosure-standards-financial-market-participants>.

[7] See Joint Consultation Paper on Taxonomy-related sustainability disclosures (15 March 2021), *available at* https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2021/Joint%20CP%20on%20Taxonomy%E2%80%93related%20product%20disclosures/964004/JC%202021%2022%20-%20Joint%20consultation%20paper%20on%20taxonomy-related%20sustainability%20disclosures.pdf.

[8] See ICI Memorandum No.33535 (13 May 2021), *available at* <https://www.ici.org/memo33535>.

[9] Article 8 products are required to tick a box in both the pre-contractual and periodic reporting templates to show whether the product (i) does not invest in sustainable investments or (ii) invests partially in sustainable investments. See draft SFDR RTS, *supra* note 6, at Annex II and IV.

[10] The Taxonomy Regulation technical screening criteria are not yet developed for all six environmental objectives, only those for climate change mitigation and climate change adaptation have been released. The technical screening criteria for the remaining four environmental objectives are set to be complete by 2023. Moreover, the European Commission is considering extending the Taxonomy Regulation to cover social issues as well.

[11] The Taxonomy Regulation defines an economic activity as environmentally sustainable if such activity (i) contributes substantially to one or more of the Taxonomy environmental objectives, (ii) does not significantly harm any of the Taxonomy environmental objectives, and (iii) complies with technical screening criteria. See Taxonomy Regulation, *supra* note 4, at Article 3.

[12] The Delegated Regulation under Article 8 of the Taxonomy Regulation exclude sovereign and central bank exposures in the numerator and denominator of the KPIs of financial undertakings. The Commission will assess at a later stage whether and how to develop a methodology for assessing the environmental performance of sovereign exposures. See COMMISSION DELEGATED REGULATION (EU) .../...of 6.7.2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation, *available at* https://ec.europa.eu/finance/docs/level-2-measures/taxonomy-regulation-delegated-act-2021-4987_en.pdf.

[\[13\]](#) Under the SFDR, DNSH for sustainable investment is assessed by reference to the adverse impact indicators in Annex I of the draft SFDR RTS. For economic activity to be Taxonomy-aligned, it is subject to a separate DNSH requirement in respect of that economic activity's impact on the Taxonomy's environmental objectives.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.