

ESA's SFDR Joint Consultation Paper Taxonomy-related sustainability disclosures – consultation response

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To Joint Committee of European Supervisory Authorities
From DUFAS (the Dutch Fund and Asset Management Association)

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Subject **ESA's SFDR Joint Consultation Paper Taxonomy-related sustainability disclosures**
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DUFAS (the Dutch Fund and Asset Management Association) welcomes the opportunity to respond to the public consultation on ESA's SFDR Joint Consultation Paper Taxonomy-related sustainability disclosures, as published by the ESAs on 17 March 2021.

Executive Summary

In general DUFAS agrees with the ESAs proposal to amend the existing SFDR RTS instead of drafting a new set of draft RTS. This is more practical and logical since the taxonomy disclosures are part of the SFDR, and will ultimately be included in the product disclosures. The same applies to include the Taxonomy disclosures in on and the same product template. Particularly from an investor or other stakeholder this is the preferable way forward. Having said this, we should avoid that confusion arises between terminology and concepts as developed under SFDR and the Taxonomy, which are not one and the same. For example this relates to the circumstances that DNSH criteria under the Taxonomy have a different meaning or will be applied differently than under the SFDR.

Needless to say, but in any event whether or not Taxonomy and SFDR disclosures are being combined, it is essential to note that implementation of the SFDR product templates are heavily depending on the availability of accurate, reliable and comparable data. This goes beyond the influence of the asset manager. Completion of product templates should also reflect that we are in a 'best effort transition period'. This may also imply for example that asset managers may need to disclose 0% taxonomy alignment in a product template only because of the lack of data.

We also have the following additional comments:

- **Alignment with terminology & definitions:** the draft RTS should not in itself define certain terms which are or could be defined in other legislation. For example, it should not define KPIs such as OPEX, CAPEX. Where such terminology should be defined in other legislation, e.g. in the EU Taxonomy of the Ecolabel scheme, these definitions should be incorporated by reference. Furthermore, the same applies to terminology as debt instruments etc. which terms should be clarified and based on legal definitions in EU sectoral financial legislation, such as MiFID. Finally, KPIs, the use of derivatives etc., should be aligned where possible and appropriate with other legislative developments, such as the Ecolabel scheme and the CSRD. In any case, alignment should ensure clarity and consistency.

- **Mirroring periodic templates:** DUFAS agrees that it is logical and consistent to mirror the proposed periodic disclosures with the proposals for precontractual disclosures. However, we believe that the templates intended for financial products such as AIF and UCITS funds on one hand and template for individual portfolio management should differ. We still believe that there is merit in having separate templates in place for individual portfolio management as opposed to the templates for other financial products;
- **Product templates:** our comments on the draft RTS templates are not limited to the proposed amendments caused by the taxonomy disclosures, but also relate to the proposed templates set forth in the Final Report SFDR RTS from the ESAs of 3 February 2021. We would also expect that these product templates may also be subject to the still awaited feedback of the European Commission on the ESAs priorities “Priority issues relating to SFDR application” as reflected in the ESAs letter of 7 January 2021.

Hence, as we expect that these templates may still be subject to changes and therefore we request the ESAs to take our **substantial and significant** comments on the templates set forth in our response into consideration. Our comments are aimed to enhance a better understanding of these templates and are therefore of crucial importance of the functioning of the SFDR.

12 May 2021

DUFAS

RESPONSE TO 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?

DUFAS agrees with the ESAs proposal to amend the existing SFDR RTS instead of drafting a new set of draft RTS. This is more practical and logical since the taxonomy disclosures are part of the SFDR, and will ultimately be included in the product disclosures. However, irrespective of the legislative process of the draft RTS, the ESAs should ensure that the market has sufficient time to implement the RTS and timeliness as to possible amending prospectuses as a result of such amended RTS should be made clear in advance. We therefore stress that availability on data for the implementation of the amended RTS is of crucial importance and determines the anticipated implementation timeliness.

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?

DUFAS agrees with the ESAs proposal that the same approach should apply to all investments made by a given financial product. However, having said this we do have some comments on the approach as proposed and reflected in the draft RTS.

- Consistency: consistency in periodic reporting on KPI's is key. Hence, each financial product should report on the same basis on a consistent basis whatever the chosen KPI may be. Therefore where a fund manager reports based on revenues alignment in year 1, the subsequent year should not be based on OPEX alignment, but on revenues alignment, unless a fund manager decides to report in the subsequent year on both KPI's, i.e. e.g. both revenues and OPEX.
- Terminology & definitions: furthermore, the draft RTS does not define OPEX, CAPEX etc. within the meaning of SFDR. Where such terminology should be defined in other legislation, e.g. in the EU Taxonomy in connection with the ESMA provided guidance on how to calculate OPEX and CAPEX in its Article 8 Taxonomy advice that was published in November 2021, these definitions should be incorporated by reference.
- Dependency on data disclosed by undertakings: Needless to say, but obviously there is high dependency on the data published by companies on said KPIs. Turnover, CAPEX and OPEX should be disclosed by the investee companies in order for asset managers and other market parties to be able to make the appropriate disclosures under SFDR.
- Non-availability of data: Furthermore, as to the KPIs the draft RTS nor its templates does not deal with the issue when data is not readily available. The product templates should contain possibilities to clarify this. For example, it could be that certain investments may arguably be taxonomy aligned, but reliable data may not be available. The same applies for principle adverse impact indicators (PAIs). This may possibly be indicated via an extra part in the pie chart which indicates as "possibly taxonomy aligned", but not verified because of the lack of confirmed data.

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?

DUFAS sees less added value in OPEX as KPI in comparison to CAPEX. OPEX is a short term metric and on the long term and during the years this metric may fluctuate heavily. Instead, DUFAS members do value CAPEX as important metric, particularly as for some sectors such KPI is more meaningful.

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

DUFAS is of the opinion that this may depend on the type of derivative. As such, for the retail market, we advise to align this for consistency purposes with e.g. the EU Ecolabel regime as it stand at this stage. According to the draft EU Ecolabel regime, the use of derivatives should be in line with the funds environmental investment policy. Based on the rules of the Ecolabel regime the use of derivatives shall be restricted to the following situations:

- *"Hedging: Derivatives may be used for hedging purposes with regard to currency EU Ecolabel Criteria for Retail financial products risk, duration risk, market risk or/and sensitivity to changes in interest rate structures.*
- *Exposure: The use of derivatives to increase exposure to the underlying assets shall be temporary and respond to significant subscriptions. The management company shall explain in the fund's periodical reports how it proceeds and, in particular, to illustrate the temporary nature of the use of derivatives for exposure purposes. Derivatives shall not be used for the short selling of securities".*

For the institutional market we can imagine that the proposed KPI may also be extended to other type of derivatives.

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?

DUFAS acknowledges terms such as "equities" and "debt instruments" are common known terms used which could refer to both listed and non-listed entities. However, terms should be clarified and based on legal definitions in EU sectoral financial legislation, such as MiFID. Definitions of financial instruments as set for in MiFID should be incorporated by reference into the SFDR.

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?

DUFAS is of the opinion that sovereign bonds, both EU GBS sovereign bonds and bonds based on another green bond framework should be included in the numerator to treat them equally with corporate bonds.

In addition, where all investments should be included, there may be assets where methodologies to calculate possible taxonomy alignment may not be available. The question arises how this should be dealt with.

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?

DUFAS is of the opinion that the answer to the question whether taxonomy statements should be subject to assessment by external or third parties will depend on the assurance of the underlying investments. Where (limited) assurance is provided on the taxonomy data provided by the investee companies that would also automatically feed into taxonomy statements on a financial product level. However, it should not imposed as a legal obligation that taxonomy statements should be subject to assessment by external or third parties.

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

DUFAS agrees that it is logical and consistent to mirror the proposed periodic disclosures with the proposals for precontractual disclosures. This is particularly applicable for templates for investment funds. However, we believe that the templates intended for financial products such as AIF and UCITS funds on one hand and template for individual portfolio management should differ. Article 8 (4), 9 (6) and 11 (5) SFDR require the ESA's when developing the templates, to take into account the various types of financial products, their characteristics and objectives and differences between them. This is particularly relevant because for individual portfolio management monthly reporting may be applicable (in case leverage is permitted), whilst for funds this takes place on an annual basis.

The reason why the periodic template should differ from individual portfolio management, i.e. mandates, is twofold. First of all, mandates reporting needs to take place more frequently, i.e. on a quarterly basis. However, data based on which taxonomy alignment may be assessed, i.e. taxonomy data from investee companies, normally becomes available on an annual basis, hence taxonomy progress on a line by line basis may be reflected in the monthly reports. Secondly, for individual mandates reports on a client level, such report will often be part of an overall MiFID II report. Hence, we would advocate more flexibility where the asset manager is able to incorporate the periodic updates in the MiFID report.

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

Yes, DUFAS has the following comments and questions related to the templates.

Inclusion of comments on entire templates:

Our comments are not limited to the proposed amendments caused by the taxonomy disclosures, but also relate to the proposed template set forth in the Final Report SFDR RTS from the ESAs of 3 February 2021.

Although we realize that the entire product templates are not subject of the consultation, we do stress the importance of taking our considerations into account. Furthermore, we would also expect that the product templates set forth in the Final Report SFDR RTS from the ESAs of 3 February 2021, may also be subject to the still awaited feedback of the European Commission on the ESAs priorities “Priority issues relating to SFDR application” as reflected in the ESAs letter of 7 January 2021. The answer to the questions submitted to the European Commission (i) what is considered to be ‘promoting’ within the meaning of article 8 SFDR and (ii) whether minimum share of sustainable investments is required for article 8 or 9 products, also will define the final outcome and usage of the product templates.

“Waterfall”: completion of the product templates is challenging exercise. For both the user and the reader of the templates, we would advise to include a certain waterfall or decision tree which makes clear how certain information connect and interact with each other. We therefore encourage the drafting of a decision tree and suggest to include this as part of the RTS.

Article 8 – precontractual template

Main block in yellow (page 33)

- *Definition “sustainable investment”:* it is not defined what is meant by ‘sustainable investment’. Furthermore, the text block does not explain what is meant by the taxonomy, and its relation to sustainable investment. Particularly for a retail investor these terms will not be well understood without further explanation in an easy and understandable manner.
 - Proposal: We advise the ESAs to explain these terms in a separate text block. i.e. to move the grey box explaining the EU Taxonomy to this block.
- *Precontractual nature and sustainable investments:* investment managers that offer funds without the objective of investing in sustainable investments, may still at hindsight have invested in sustainable investments, without having such commitment. This may for example be relevant for those funds tracking a certain benchmark. Hence, such investment manager will have problems ticking the box that it does not invest in sustainable investment. The same applies to the box whether the product partially invests in sustainable investments or not.
 - Proposal: as it is a precontractual template, we propose for actively managed funds to replace the phrase “it does not invest in sustainable investment” by “it does not **commit to** invest in sustainable investments”. Likewise, the phrase “it partially invests in sustainable investments” should be replaced by “it partially **commits to** invest in sustainable investments. However, for passive managed funds, the intention should rather be focused on following a certain benchmark which benchmark include ESG characteristics. This is particularly true as for an investment manager you cannot express your intent for striving to a certain percentage of taxonomy alignment or to keep such alignment.

Org chart block in yellow (page 34)

- *Percentages:* In the yellow block under the heading “asset allocation”, no reference is made to percentages. The question arises whether the intention of the org chart is to show the various categories to the investor or other stakeholder. If that is the case, how should the org chart be completed? Or is the org chart for illustrative purposes only and static, and is it not the intention that it needs to be completed per product? If it is the intention that the org chart needs to be completed, although it is unclear whether a minimum sustainable investments may be required, we do think that for the purposes of the block, the asset allocation should possibly be presented in percentages (%) where funds are actively managed. This is also consistent with the taxonomy disclosures

breakdown, where presentation of percentages in are mandatory in accordance with article 6 Taxonomy Regulation (for article 8 products). For passive funds that tracking a benchmark, showing percentages or refer to a breakdown may be less relevant, as the ESG components are depending on the benchmark or index.

- *Bandwidths of percentages:* Furthermore, in addition hereto, given the precontractual nature of the template and the typically used investment strategies of fund managers, we also advise to included bandwidths as such allocation, as investment managers often set their targets of asset allocation in terms of bandwidths.
 - Proposal: please add percentages in the text box, preferably in bandwidths for actively managed funds.
- *Look and feel/use of an org chart:* we feel that the use of an org chart for presenting the ESG and non-ESG asset allocation of a product, is not our preferred method. Instead, we advise to show such asset allocation by means of a pie, in a same manner for the taxonomy breakdown. Consistency is key;
- *One pie?:* moreover for a good overview of the asset allocation between non-ESG investment, ESG investments and taxonomy aligned investments as a subset of ESG investments, we advise to include this in one pie, accompanied with a proper explanation, comparable with the proposal product templates which were consulted by the ESAs last year.
 - Proposal: we propose to have one pie for both non-ESG/ESG investments and the taxonomy aligned investments. If this is not possible or desirable, we propose to present both asset allocation by means of a pie chart. Note that we find this a good solution for the product disclosures on the website, though we do not think that pie chart and icons should become part of a prospectus, although content wise these information should be included therein
- *Clarification of the text blocks:* category #1 Aligned with E/S characteristics covers (i) the subcategory #1A Sustainable covers investments that qualify as sustainable investments and (ii) the sub-category #1B Other E/S characteristics covers investments aligned with the environmental or social characteristics that do not qualify as sustainable investments. In the org chart in red it is explained that for both #1A and # 1B this subcategory where the financial product **commits** to making sustainable investments. First of all, apparently such commitment applies to both subcategories, though this has not been reflected in the explanatory text. We advise to clarify this. Secondly, the distinction between both #1A and # 1B this subcategory, may not always be very clear. Does this #1B category contain such investments that have E&S characteristics, but they are not sustainable investments as DNSH criterion and the minimum social or good governance safeguards are not applicable?

Further comments on the template:

- *Superfluous question (page 36):* the template contains a question "*Why does the financial product invest in economic activities that are not environmentally sustainable?*". This question goes beyond the task of the ESAs to draft product templates in accordance with the taxonomy in the periodical reports and the pre-contractual disclosures by means of a RTS. A product template should not include a requirement for asset managers to motivate why they are not committed to certain investments for which no legal obligation or explanation thereof exists. In addition, there is no added value of this question as the investment strategy is already reflected in the template. Furthermore, the question seems to insinuate that a product may not be sustainable. On the contrary, a financial product may have a social sustainable strategy, and therefore meet the requirements for a sustainable fund, although not focused on the promotion of environmentally characteristics.
 - Proposal: we advise to delete this question.

- *Question on DNSH (page 36):* the template contains a question “How will sustainable investments contribute to a sustainable investment objective and not significantly harm any sustainable investment objective?”. It is unclear whether DNSH should be applied to the activity of an investee company or at the entire company. For example, where you invest in a car company, do you apply DNSH on the *electric* car or to all cars manufactured by such car company? And how will this be reflected in the product template? Reference is made to alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. How will you apply OECD Guidelines? On activity or enterprise level?
- Furthermore, in addition to reference to the OECD Guidelines, we suggest to also including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the ILO, as stipulated in article 16(3)(b) SFDR RTS.
- Last, but not least it is unclear how the DNSH of the SFDR relates to the DNSH under the Taxonomy Regulation. The template does not make this clear, and we doubt whether an investor understands the differences of the DNSH criteria under the SFDR and the under the Taxonomy. Furthermore, it looks confusing that PAI indicators may reflect the DNSH criteria. The PAIs do not restrict whether a certain investment may be considered to be taxonomy aligned, whilst the DNSH criteria does. How will this reflect the reporting on taxonomy alignment?

Article 9 – precontractual template

- Most of our comments on the article 8 product, also apply to the article 9 product template.
- In addition, under the heading “*what is the asset allocation planned for this financial product?*” (page 38), it is questionable whether in a precontractual template, there is room for having a text block “other” for article 9 products. Although, article 9 products may not be fully invested in sustainable investments, having as an intention to invest a certain part in non-sustainable investments seems to be inconsistent with the character of article 9 products. Unless, for example, the fund may not always be fully invested. The text block other will need to be part of a periodic article 9 template, however not as part of a precontractual one. We suggest to clarify the text block “other” further.

Article 8 – periodic reporting template

- *Top investments (page 42):* the part of the template where the top 25 investments should be listed may not always be a good reflection of the entire portfolio. We advise that asset managers may also list the top investments per asset class, i.e. we wish to have the possibility of including such a breakdown
- *Asset allocation (page 42):* the template refers to the term asset allocation. We propose to use the term “asset composition” as the reporting reflects the composition not the allocation. Such periodic report should indicate where the composition deviates from the original asset allocation as reflected in the original precontractual product template;
- *Reference to the most recent precontractual template:* conditions of a financial product may change over the years. The question arises how you will reflect such changes in a periodic template. Say for example, you have published a product template at launch of a new fund on 1 January 2022. Periodic reporting takes place based on such precontractual product template. Where you have changed your investment strategy and intended asset allocation on 1 January 2025. How will this be reflected in the periodic template? Should such periodic template not always refer to the last known product template where changes are reflected? Actually the same applies to the “interim phase”, where fund managers may decide to complete the SFDR product templates based on existing financial products in the market. How will this be reflected?

- *Actions taken (page 44):* the template refers to the question “*What actions have been taken to meet the environmental and/or social characteristics during the reference period?*” We understand that here e.g. your shareholders engagement may be listed. For practical purposes, we propose such information may be provided by including a link to the relevant information, as these actions are normally being included in shareholders engagements reports.

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?

DUFAS agrees with the ESAs proposal to unify the precontractual and periodic templates applicable to all Article 8 and 9 SFDR products which includes article 5 and 6 Taxonomy Regulation which are a sub-set of Article 8 and 9 SFDR products. This is the most practical, but particularly from an investor or other stakeholder the preferable way forward.

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?

DUFAS in principle agrees. However, the Taxonomy Regulation refers at this stage to environmental objective only. From that perspective, it is too early to include the social taxonomy in these templates, where this has not been developed yet. We advise to include the social taxonomy in a later stage in the product templates when the social taxonomy is finalized and reporting standards hereon are clear, and data is readily available.

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?

It is hard to assess what the costs of implementation will be at this stage. A substantial number of data is not available yet, therefore the costs are hard to estimate. Given the comprehensiveness of the product templates, and the reliance on data for *inter alia* taxonomy alignment, it is hard to assess the costs in advance. Costs relate to *inter alia* (i) the acquisition of external data from data vendors, (ii) additional internal research and engagement with companies, (iii) costs of implementation of SFDR, which includes all internal FTEs who are engaged and consulted (iv) at least annually maintaining obligations under the SFDR, such as periodic reporting, and last but not least (v) significant IT related costs related costs required to implement the required disclosures.

More information

Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS, manager strategy & regulatory affairs, at rp@dufas.nl.

DUFAS: Dutch Fund and Asset Management Association

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.