EFAMA

European Fund and Asset Management Association

EFAMA´s COMMENTS ON THE DRAFT DELEGATED ACT UNDER ARTICLE 8 OF THE TAXONOMY REGULATION

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EFAMA responds to the opportunity to provide feedback to the Article 8 Taxonomy Regulation (EU) 2020/852 ('taxonomy') draft delegated act, which the European Commission published for consultation on 7 May. We highlight that the provisions on investee companies in this delegated act will serve as the primary source of input for asset managers´ own disclosures on taxonomy compliance at both product and entity levels.

EFAMA welcomes the Commission´s proposal for a transitional period introduced in the Article 11 of this delegated act, as it will address numerous practical implementation challenges identified in our consultation responses to ESMA´s technical advice under Article 8 of the taxonomy, the European Commissions´ consultation on the taxonomy climate delegated act and the ESA´s consultation on Taxonomy-related product disclosures in SFDR. Nonetheless, to ensure implementation feasibility and consistency within the EU´s sustainable finance regime, we would like to make the following recommendations:

1. **Alignment of the proposed transitional period with taxonomy-related product disclosures in the Sustainable Finance Disclosures Regulation 2019/2088 (SFDR) and ESG updates to MiFID II and IDD delegated acts**

The taxonomy Article 8 delegated act will mandate the disclosure of all underlying information on the alignment of financial and non-financial undertakings with the taxonomy technical screening criteria. Without this information from companies, financial market participants will not be able to disclose their taxonomy alignment at the entity and product levels. As a result, in 2022, during the transitional period, no product will be able to assess the likely share of taxonomy aligned investments, or make any commitments on their minimum taxonomy alignment proportions in pre-contractual documentation. For example, the product templates in SFDR include a graphical representation of taxonomy alignment, whose disclosure could be possible only as of 1 January 2023 (instead of 1 January 2022), following the termination of the transitional period. Therefore, we call on the Commission to align the entry into force of product-level requirements under Articles 5 and 6 of the taxonomy with the transitional period introduced in this delegated act.

The amending delegated act to MiFID II and IDD introduce the possibility for clients to indicate their preferred minimum proportion of Taxonomy-aligned investments as defined in Article 2(1) of the taxonomy. However, as a result of the transitional period, products will not be able to commit to a "minimum threshold" of such investments already as of October 2022, when the amended delegated acts should become effective. Therefore, the entry into force of these provisions should also commence only after the termination of the transitional period.

Finally, the transitional period implies that the practical applicability of the EU Ecolabel for retail financial products will start only on 1 January 2023, given that its portfolio greenness calculation formula is dependent on company disclosures of Turnover and CapEx aligned with the taxonomy. Company information provided during the transitional period will not be sufficient for meeting Criterion 1 of the EU Ecolabel, as they require only the disclosure of taxonomy eligible (not aligned) activities.

2. **Potential confusion caused by quantitative taxonomy eligibility disclosure requirements during the transitional period**

EFAMA welcomes the proposed transitional period for 2022 in that it requires only a limited amount of quantitative disclosures in 2022 before the full application of this delegated act in January 2023. We also support the qualitative disclosure requirements outlined in Annex XI. However, we highlight that the need

for financial market participants to disclose the proportion of eligible activities in 2022 may be hindered by data requirements and confuse market participants.

First, the transitional period does not provide financial undertakings with sufficient time to prepare the breakdowns of taxonomy eligible activities. Given that this information needs to be gathered from companies, applying this requirement for financial undertakings should better reflect the sequencing of data flows from non-financial to financial entities.

Following this sequencing logic, we emphasise that asset managers will not be able to disclose the Taxonomy alignment ratios at entity and product levels (SFDR Article 8 and 9 products) without the non-financial undertaking disclosure requirements entering into force a sufficient time before the obligations of financial undertakings. Therefore, the complete disclosures on Taxonomy alignment for financial undertakings should enter into force only a year after non-financial undertakings will have disclosed the information by 1 January 2023. Such sequencing becomes even more vital due to the proposed inadmissibility of taxonomy alignment estimates and sector-based coefficients for non-NFRD entities.

Finally, there is a high risk that the disclosure of breakdowns of taxonomy eligible activities by financial undertakings could mislead market participants in their interpretation of what this indicator means. Investors might interpret this percentage as the proportion of taxonomy aligned activities, whereas it only informs about the ratio of economic activities covered by the taxonomy. Moreover, further confusion of investors would stem from the termination of the transitional period, given that an asset manager may have 50% of investments that are taxonomy eligible, but only 1% of investments taxonomy aligned. To avoid misleading investors, we invite the Commission to consider removing this quantitative breakdown for financial undertakings during the transitional period.

3. Need for consistent taxonomy alignment methodologies at entity and product level

The basis on which financial undertakings report against taxonomy under NFRD should be consistent with the basis on which product manufacturers report under SFDR for Article 8 and 9 products, as mandated by Articles 5 and 6 of the taxonomy. The representation and measurement of taxonomy alignment must be consistent in terms of methodologies at the entity (Article 8 of the taxonomy) and product levels. Otherwise, an SFDR assessment of taxonomy alignment could deviate from the NFRD's issuer's assessment of taxonomy alignment and therefore require financial undertakings in the scope of NFRD (and later CSRD) to apply two separate methodologies.

We recommend that the treatment of non-assessable assets (cash, sovereign bonds, derivatives) in the Taxonomy-related amendments to the draft SFDR RTS is fully aligned with the final text of this underlying delegated act. Currently, we see several inconsistencies between the KPIs in this draft delegated act and the draft Taxonomy-related product disclosure templates in SFDR. For example, the latter recommended the inclusion of sovereign bonds in the denominator, whereas this delegated act upholds the recommendation of the European Banking Authority by excluding sovereign bonds altogether. Such inconsistencies, which hinder the comparability of Taxonomy alignment information, must be avoided.

The delegated act proposes excluding derivatives from the numerator while they are included in the denominator. From a methodological consistency point of view, this is a sub-optimal solution as it disables this asset class from becoming aligned. Due to the complexity of this asset class and its growing use for ESG purposes, we recommend excluding derivatives altogether (from both nominator and denominator), until shared guidelines for their taxonomy aligned uses are developed by EU regulators. Once consistent guidelines are developed, they should gradually become eligible for both the numerator and denominator. We note that derivatives can facilitate and raise capital allocation for green finance and help business manage the risks they are exposed to. While conventional derivatives can be used to hedge non-ESG related risks associated with green instruments, including credit, FX and interest rate risks, a new wave of sustainability-linked derivatives and exchange-traded ESG derivatives has also developed in recent

years, alongside existing derivatives, such as emissions trading derivatives, renewable energy and renewable fuels derivatives, and catastrophe and weather derivatives. Finally, we highlight that Contracts for Difference (CFDs) should not be included as derivatives, since in many geographies, notably the UK, investors commonly use CFDs to simply avoid stamp duty.

4. Taxonomy alignment of firms not in the scope of NFRD

We note that the recommendation to base financial undertakings´ disclosures on actual, comparable, audited and regulated disclosures reported under the NFRD, and the forthcoming CSRD, runs contrary to the advice of ESMA on using estimates and sector-based coefficients for non-NFRD firms. Consistent guidelines within the EU´s sustainable finance regime on the admissibility of information based on estimates and third-party screenings on taxonomy alignment at product and entity levels are urgently needed. We emphasise that the inadmissibility of estimation methodologies for firms not subject to NFRD/CSRD implies that asset managers will be able to screen only a fraction of their portfolio against the taxonomy, thereby diminishing the representativeness of such a figure. In its technical advice, ESMA highlighted the importance of "using a reliable and consistent methodology to estimate taxonomy-alignment of non-disclosing firms, including smaller EU firms" given that a quarter of EU funds have no exposure at all to NFRD firms, and around half of EU funds have less than 20% exposure NFRD firms[1].

We caution the European Commission against unintended consequences of including exposures to entities that are not covered by NFRD (and future CSRD) in the denominator but not in the numerator of the KPI for financial institutions. If the delegated act allows voluntary disclosures of non-NFRD companies only as of 2025, two years after the disclosures of entities in scope of NFRD, it could result in a jurisdictional bias in sustainable investment flows in favour of NFRD entities. SMEs and non-EU entities would have no chance of being aligned. By limiting the firms that can be eligible in the numerator to those subject to NFRD, product manufacturers would be incentivised towards European large-cap company exposures to achieve a higher percentage of taxonomy alignment. Therefore, voluntary company disclosures should be possible at the same time as disclosures by NFRD companies. Such disclosures should be consistent with the requirements of the forthcoming mandatory European sustainability reporting standards and made available under the expected European Single Access Point.

In general, KPIs should be defined consistently so that exposures in the denominator have a chance of being taxonomy aligned. Exclusion of these exposures from the numerator would assume that none of these companies is taxonomy aligned, which is inaccurate. Therefore, if these companies cannot be assessed or estimated against the taxonomy, they should be excluded from the denominator (in a similar manner as derivatives or sovereign bonds), until voluntary disclosures are admitted.

5. Screening of all assets under management against the taxonomy at the entity and SFDR Article 6 product level should be optional

We believe that a mandatory requirement for asset managers subject to NFRD/CSRD to screen all assets under management against the taxonomy would be disproportionate, as taxonomy aligned activities are expected to show higher concentration in Article 8 and 9 SFDR products. Therefore, we recommend that asset managers are required to provide taxonomy alignment disclosures for article 8 and 9 funds and have the possibility to conduct taxonomy screening of Article 6 SFDR fund portfolios on an optional basis. For entity-level disclosures, it would be more proportionate to allow for the possibility of either assuming 0% alignment for parts of the AuM falling under Article 6 products, or screening also these assets.

[1] https://www.esma.europa.eu/sites/default/files/library/esma30-379-471_final_report_-_advice_on_article_8_of_the_taxonomy_regulation.pdf

About EFAMA

EFAMA, the voice of the European investment management industry, represents 28 member associations, 58 corporate members and 24 Associate Members. At the end of 2020, total net assets of European investment funds reached EUR 19.6 trillion. These assets were managed by 34,615 UCITS (Undertakings for Collective Investments in Transferable Securities) and 29,608 AIFs (Alternative Investment Funds). At the end of 2020, asset managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 27 trillion.

More information is available at www.efama.org.

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