

CONSULTATION RESPONSE

PRI RESPONSE TO THE ESA CONSULTATION ON TAXONOMY RELATED PRODUCT DISCLOSURES

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PRI Association

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United Nations
Global Compact

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is a not-for-profit company with over 3,800 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US \$100 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the European Supervisory Authorities (ESAs) consultation on Taxonomy-related product disclosures.

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members. More information: www.unpri.org

ABOUT THIS CONSULTATION

As of 2022, investors that offer funds in the EU that have sustainable investment as their objective or which promote environmental characteristics, will need to explain how, and to what extent, they have used the Taxonomy in determining the sustainability of the underlying investments under the Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation. They will also have to disclose the proportion of underlying investments that are Taxonomy-aligned as a percentage of the investment product. The consultation document published by the ESAs in March 2021 proposes a methodology and template for investors to do this.

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KEY RECOMMENDATIONS

The PRI believes the Taxonomy is a generational shift for responsible investment. Investor disclosures against the Taxonomy will bring much needed clarity to investment products' alignment with environmental objectives, and together with the SFDR, will provide an important level-playing field among financial market participants. Beyond the mandatory disclosures, the Taxonomy provides a practical tool for investors' engagement and stewardship activities with companies by providing a common language to assess companies' transition plans and track environmental performance progress.

Starting in late 2019, over 40 investment managers and asset owners ([PRI Taxonomy Practitioner's Group](#)) worked with the PRI to implement the Taxonomy on a voluntary basis in anticipation of the upcoming regulation. The final report shares insights from the first comprehensive set of case studies around how to use the EU Taxonomy. The investors assessed Taxonomy alignment before many details of the final regulation were in place, and before widespread corporate reporting against the Taxonomy is available. The results highlighted some important implementation challenges, and the need for more guidance from policymakers and supervisors on how the Taxonomy should be implemented for different asset classes. Yet, the case studies demonstrate that the Taxonomy framework can be operationalised today, despite the challenges due to data availability and limited specific asset class guidance. The recommendations in this consultation response draw from these experiences and insights.

The PRI welcomes the draft Regulatory Technical Standards (RTS), as they provided much needed clarity to investors preparing for their disclosures against the Taxonomy under the SFDR. Below are our main recommendations relating to the draft RTS:

- **Alignment of technical standards.** We support the ESAs' approach of amending the existing SFDR RTS instead of drafting a new set of standalone RTS for Taxonomy disclosure. It is essential to ensure alignment between the SFDR and Taxonomy RTS. We welcome, for example, the fact that the Do No Significant Harm (DNSH) statement¹ in the ESAs' proposed Taxonomy related RTS will supersede the broader provision in Article 2(17) of SFDR (relating to the broader definition of a "sustainable investment"²).
- **Broader policy coherence.** Beyond this consultation, we encourage EU institutions to continue existing efforts to explain how SFDR, the Taxonomy and current and future related RTSs, as well as the new Corporate Sustainability Reporting Directive (CSRD), will work together as a coherent framework for disclosure of sustainability risks and impact by investors

¹ The ESAs propose that the disclosure of "how" investments are taxonomy-aligned should come in the form of a statement that the activities invested in by the financial product comply with the four criteria of Article 3 TR : substantial contribution to at least one environmental objective, DNSH any other environmental objectives, complies with minimum social safeguards, and complies with the technical screening criteria established by the European Commission.

² Article 2(17) SFDR contains a definition of sustainable investments: 'sustainable investment' means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

and companies. Coherence between these different pieces of legislation will be crucial to ensuring that the Taxonomy disclosures are consistent and useful for end-investors. Of particular importance for investors will be the disclosure standards for financial and non-financial companies under Article 8 of the Taxonomy Regulation³ and ensuring that these are clear, comparable, and aligned with the RTS for investment product disclosures. Consistent treatment of asset classes in taxonomy-alignment calculations will be essential to ensure a workable framework for both investors and corporates.

- **Need for further implementation guidance.** In the proposed RTS, the KPI for Taxonomy alignment includes equity and debt instruments issued by financial and non-financial undertakings and real estate assets. We recommend that the ESAs provide more guidance for how investors should apply the Taxonomy-related disclosure requirements to the specificities of each financial instrument, and how certain asset classes, such as sovereign or sub-sovereign bonds, could be integrated into Taxonomy calculations in the future. Further guidance is also needed on how taxonomy-related data can be obtained or estimated for companies that are not in scope of CSRD. The PRI's [Testing the Taxonomy](#) report identified other areas where investors may need more guidance, such as a structured approach for demonstrating compliance with minimum safeguards and qualitative DNSH criteria, tools to support the application of the taxonomy in non-EU markets, further development of the adaptation criteria, and further specificity of expenditure metrics⁴
- **Legibility of disclosure templates.** PRI is concerned that the disclosure templates will be difficult to read and understand for end-users that are not familiar with the specific definitions contained in the SFDR and Taxonomy Regulations. A particular source of confusion will be the subtle differences between investments categorised as “sustainable investments” according to SFDR and those that are aligned with the Taxonomy. We recommend that such categories be clarified in the templates in simple terms, and if possible, with examples. This should be done in a way that is easy to read, as there is also a need to reduce some of the complexity and density of the information contained in the templates (as shown in the ESAs’ consumer testing).

³ PRI will respond to the European Commission’s ongoing consultation on the Article 8 Taxonomy Regulation disclosure standards.

⁴ [“Testing the Taxonomy: Insights from the PRI’s Practitioner’s Group”](#) (PRI, 2020), p21

DETAILED RESPONSE

Q1: 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 agree with the ESAs' aim to have the RTS on disclosures rules function as a "single rulebook" for sustainability disclosures at Level 2 for both the original standards in SFDR and the additional ones added by TR.

We particularly welcome the fact that the DNSH statement in the ESAs' proposed RTS will supersede the broader provision in Article 2(17) of SFDR (relating to the broader definition of a "sustainable investment"). Investors should not have to report on Principle Adverse Indicators (PAI) for investments that are Taxonomy-aligned, as these already undertake a DNSH and minimum social safeguards analysis. Investors should however be able to include these Taxonomy-aligned investments as part of their PAI product-level disclosures if they wish to – for simplicity or operational reasons.

Further work should be undertaken to align the SFDR and Taxonomy RTS in the future, as and when new taxonomies and standards are developed (e.g. social Taxonomy, significant harm Taxonomy, etc), subject to the review of the Taxonomy Regulation.

Q2 : 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?

Overall, we support the ESAs' proposed approach for calculating the extent to which investments are aligned with the Taxonomy.

- We support using a weighted average of all investments to show Taxonomy alignment and recommend alignment with indicators of the forthcoming Art 8 DA of the Taxonomy Regulation.
- We agree that the extent of Taxonomy alignment of investments is the only comparable element that should be allowed for the graphical representation of Article 8 and Article 9 product disclosures. Attempts to compare other indicators and sustainability classifications could mislead users and lead to greenwashing.
- We believe that all investments should be included in the denominator, even those that cannot be judged against the Taxonomy (such as sovereign bonds). Otherwise, there is a risk that the calculations for products containing a substantial proportion of such instruments become skewed. We encourage work and guidance to clarify how these investments could be judged against the Taxonomy in the future (see response to Q6). We recommend that KPI calculation methodologies in the Article 8 Delegated Acts are aligned with the methodologies for investment product disclosures (for example, ensuring all assets are included in the denominator calculations for financial entities).

- We agree that the reporting requirements should focus on turnover or expenditure (CapEx or OpEx). Investors should choose one single KPI for all companies in a specific financial product for the purposes of disclosure, as mixing different KPIs could be misleading for end-investors and could lead to gaming opportunities. They should explain clearly in the disclosures why they decided to choose a particular KPI over another. CapEx and OpEx company disclosures should be encouraged, due to their relative lack of availability, and their importance to ensuring robust transition financing⁵.

Q3: 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?

OpEx should be included as an option where relevant, without being a mandatory requirement.

Expenditure information may be more difficult to obtain for companies that are not in scope of the CSRD (particularly those located outside the EU). They are also not applicable or possible for non-use of proceeds for sovereign and sub-sovereign bonds and may be even difficult for use of proceeds. CapEx and OpEx should therefore be used to disclose alignment only when this information has been made available by the investee companies.

Q4: 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?

We believe that derivatives should be excluded from calculations until there is further evidence on how they could be judged against the Taxonomy. Without specific guidance on how these financial instruments can be Taxonomy aligned, such disclosures would be too complex and could potentially be misleading to end-investors. We encourage an examination as to how derivative instruments could make a substantial contribution to environmental objectives, as defined by the Taxonomy.

We do however recommend the inclusion of other asset classes beyond equity, debt and real estate instruments – notably infrastructure and private equity.

Q5: 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?

N/A

Q6: 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?

We agree with the ESAs’ approach to use all investments (or the AUM of the product) as the denominator, even if it is not yet technically possible to evaluate Taxonomy alignment for some asset classes. This is essential for comparability between products, and to paint an accurate picture of the

⁵ Note that this is not applicable or possible for non-use of proceeds for sovereign and sub-sovereign bonds.

percentage of a product that is aligned with Taxonomy. It would also avoid a situation whereby a product may have a higher Taxonomy alignment ratio due to investing in assets that are not measurable against the Taxonomy.

More guidance is needed on how sovereign, sub-sovereign, supranational and government agency bonds, linked to specific projects, can be Taxonomy aligned. This could be developed in the context of a sovereign green bond methodology for the EU Green Bond Standard, but clarification is also needed for the non-use of proceeds bonds.

Q7: 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 welcome the fact that the DNSH statement in the ESAs' proposed Taxonomy related RTS will supersede the broader provision in Article 2(17) of SFDR (relating to the broader definition of a "sustainable investment").

Internal validation of Taxonomy related information at board or senior management level should be mandatory, and external assessments or third-party verification should be encouraged as best practice, especially for larger FMPs. We do not see the need, for now, for mandatory external assessments of Taxonomy disclosures, particularly if external assessment in corporate disclosures against the Taxonomy is required.

We agree with the ESAs' recommendation that FMPs should have to clarify whether or not the disclosures and underlying calculations have been audited by a third party. Mandatory external assessments could be introduced in the future once there is wider data availability in the market.

Investors should be able to distinguish between data provided directly by the company and data where the investor or a third party has had to estimate the alignment using other data sources. This would be helpful due to the lack of available taxonomy-related data for companies not in-scope of CSRD (particularly non-EU companies and non-listed SMEs), recognising the fact that these companies can often have taxonomy-aligned activities. To avoid differences of interpretation, FMPs should disclose details of the methodologies and sources used for estimated data. We also encourage the European Commission and/or the ESAs to develop a set of criteria and guidelines for the use of proxies or estimates to calculate taxonomy-alignment for non-CSRD companies, to ensure that such estimations do not lead to greenwashing.

Q8: Do you have any views on the proposed periodic disclosures which mirror the proposals for pre-contractual amendments?

We agree with the approach to mirror pre-contractual and periodic disclosures and encourage alignment with the SFDR RTS on product disclosure.

We recommend including, for the time being at least, only product-level (as opposed to company-level) disclosure to ensure the legibility and usability of the templates (see response to Q9 below).

Q9: Do you have any views on the amended pre-contractual and periodic templates?

We are concerned that the pre-contractual and periodic templates will be difficult for users (both retail and institutional) to understand, particularly if they do not have a pre-existing understanding of the specific product categories laid out in SFDR and the Taxonomy Regulation. This is particularly the case for subtle distinctions between “sustainable investments” (under the SFDR definition) and investments that are Taxonomy-aligned. Many users unfamiliar with the legislation may assume these to be equivalent.

We recommend that such categories be clarified in the templates in simple terms, and if possible, with examples. This should be done in a way that is easy to read, as there is also a need to reduce some of the complexity and density of the information contained in the templates (as shown in the ESAs’ consumer testing). A user-friendly guidance document could also be developed to help end-users make sense of the Taxonomy-related pre-contractual and periodic disclosures.

In both the pre-contractual and periodic disclosures, the quantitative Taxonomy-alignment ratio (pie chart) should be accompanied by a qualitative segment explaining how the FMP plans to increase its share of Taxonomy-aligned investments.

Q10: 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?

We encourage harmonising disclosure templates, as much as possible. End-investors should be able to easily access the Taxonomy alignment percentage of a given product that claims to have environmental characteristics (Article 8 SFDR) or that promotes or directly pursues an environmental objective (Article 9 SFDR).

Q11: 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?

We recommend that products pursuing social objectives should not have to disclose on Taxonomy alignment until work to develop a social Taxonomy has been finalised. In the meantime, we encourage disclosure for such products on how they meet the minimum social safeguards (as defined in TR), report against the social Principal Adverse Indicators (as defined in SFDR) and any other relevant indicators linked to the specific social objectives.

Q12: Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?

N/A

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of European supervisory authorities (ESAs) in developing effective technical standards for sustainable finance disclosures.

Any question or comments can be sent to policy@unpri.org.