

ICI's proposed responses

To

Joint Consultation Paper (CP) by the European Supervisory Authorities (ESAs) regarding Taxonomy-related sustainability disclosures Draft regulatory technical standards (RTS) with regard to the content and presentation of sustainability disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088 (Taxonomy Regulation or TR)

(submitted on 12 May 2021)

Introductory statement

ICI Global is pleased to submit its input to the European Supervisory Authorities (ESAs) on the Joint Consultation Paper (CP) regarding draft regulatory technical standards (RTS) for Taxonomy-related sustainability disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088 (Taxonomy Regulation or TR).

ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally, with offices in London, Brussels, Hong Kong, and Washington, DC. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$39.4 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. For the purpose of this response, our references to "products" mean "undertakings for collective investment in transferrable securities" or UCITS.

Brief overview of our comments

Clearly communicating the limited scope of the Taxonomy Regulation. It is essential for the TR's success and its long-term credibility with investors that the templates inform investors of the TR's current limited scope. Thus, the templates must include, at the outset, a clear explanation that the taxonomy alignment disclosure would cover only 2 out of TR's 6 environmental objectives in 2022 and only environmental objectives in 2023 and beyond. The templates must be clear that the TR does not include social objectives.

The Taxonomy Regulation's timing and sequencing provisions. The TR is a cornerstone of the EU's sustainable finance agenda, and the disclosures should be sequenced appropriately. For the financial product taxonomy-alignment reporting, the products will base their pre-contractual and periodic disclosures on the information from the investee companies (the methodology for investee companies' reporting is yet to be adopted by the European Commission). In this regard, on 7 May 2021, the European Commission published for consultation a delegated act that relates to the corporate issuer taxonomy-alignment disclosures (under Article 8 of the Taxonomy Regulation), in which it proposed a simplified corporate issuer reporting for 2022, with the full reporting beginning in 2023. The taxonomy-alignment disclosure rules for products should follow a similar approach.

Single rulebook approach and the consolidated SFDR/TR templates. We agree with the single rulebook approach for the SFDR and TR disclosures and the use of consolidated templates, where the taxonomy

sections will be added only for products that are subject to the TR's requirements. Alternatively, the ESAs can consider the use of separate templates for SFDR-only products vs. SFDR products that plan to have taxonomy-aligned investments.

Clarifying the products to which taxonomy-alignment disclosure applies. The ESAs should clarify that the RTS for the taxonomy-alignment disclosure will apply only to products that target or intend to invest in companies that are taxonomy-aligned, and that they will not apply to products that happen to have taxonomy-aligned investments in their portfolios.

Making the RTS disclosure consistent with the TR's mandate. The TR requires products to disclose "proportions" of taxonomy-aligned investments and the information on the environmental objectives to which the products' underlying investments contribute. The draft RTS, however, would require products to show "the minimum" taxonomy-alignment and non-alignment and a "clear explanation of the reasons" for investing in "economic activities that are not environmentally sustainable economic activities." These requirements go well beyond the TR's mandate and should be deleted from the RTS and the corresponding templates. Introducing new concepts further complicates disclosures and introduces negative inferences that were not intended by the TR. For example, the question about "not investing in the environmental objectives" would force products investing in social objectives for which there currently is no taxonomy to rebut the negative impression about its investment objectives.

For the pre-contractual disclosures, the ESAs should clarify the nature of the graphical illustration of the "taxonomy alignment." For example, it appears that the representation can be a "snapshot" of the product's holdings at the time of the pre-contractual document's preparation. For some products (e.g., new products or products that newly intend to have taxonomy-aligned investments), it may be an anticipated taxonomy alignment. For both cases, the RTS should make it clear that the actual alignment may vary from the prospectus disclosure throughout the life of the product, and investors will be able to see the products' actual taxonomy alignment percentages in the periodic statements for the relevant reporting period.

Choice of a single KPI (turnover, capital expenditure, or operating expenditure). We agree that the same KPI should be used for all investments by a given product, but the ESAs should confirm that asset managers will have the discretion to select the KPI for each product, based on their needs for the products.

Third party assurance statement. We strongly disagree with the proposed requirement for pre-contractual documents that a TR-compliant narrative must be accompanied by a statement "whether the statement has been subject to an assurance provided by an auditor or a review by a third party."

With respect to UCITS, the pre-contractual disclosure (prospectus) is subject to extensive legal requirements, including a stringent regulatory pre-approval process by national competent authorities (NCAs). There is no reason for the statement of taxonomy compliance to be the only item that states whether it was confirmed by a third party. The ESAs should avoid creating the appearance that this piece of information is more valuable than other information in the Sustainable Finance Disclosure Regulation (SFDR)/TR templates and other information in the prospectus.

Question 1: Do you have any views regarding the ESAs' proposed approach to amend the existing

Sustainable Finance Disclosure Regulation (SFDR) RTS instead of drafting a new set of draft RTS?

We agree with the single rulebook approach for the SFDR and the TR disclosures, but we note that further delay in finalizing draft SFDR RTS significantly shortens the period for preparing the 2022 SFDR pre-contractual disclosures. The ESAs have been well aware of the timing challenges for the SFDR. By deciding to amend a not-yet final draft RTS to add the taxonomy-alignment disclosures, the publication of the final SFDR RTS has been delayed to at least late summer. The ESAs already indicated that they will be targeting “late June or early July” (CP at 7) for delivering their report to the European Commission. The lack of the final RTS creates uncertainty, confusion, and data challenges in preparing pre-contractual documents for 2022.

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?

We agree that the same KPI should be used for all investments for a given product, but the ESAs should confirm that each financial product should be able to choose the KPI that is most relevant to its type of investments. For example, it may be more appropriate for funds investing in real estate and infrastructure assets to adopt either the capital expenditure (CapEx) or operational expenditure (OpEx).

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?

The option to use OpEx as one of the KPIs should be retained. This is because operational expenditure is particularly relevant to some asset classes. For example, for real estate investments, carrying out maintenance that contributes to a building’s sustainability is relevant to the calculation of the KPI. Also see response to Question 2.

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

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?

In general, the use of “equities” and “debt instruments” is sufficiently clear to capture relevant instruments issued by investee companies, and no special valuation criteria is necessary for these instruments.

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?

This approach, in combination with the TR's limited scope and the insufficient data sets from the investee companies, will lead to the low percentage of taxonomy-alignment at the outset. To help investors of financial products understand the context of these percentages, it is critical to ensure a clear explanation of the TR's limited scope and the inability of certain assets to be assessed for taxonomy-alignment. We continue to believe that proper sequencing for the taxonomy-alignment reporting is necessary for more robust and meaningful reporting to investors of financial products.

By the ESMA's own calculation, only 1.4% of EU fund equity and corporate bond holdings are likely to be taxonomy-aligned and less than 3% of EU fund portfolios have an estimated taxonomy-alignment of 5% or higher. This stems from the fact many funds have the high share of non-EU holdings and that the TR covers only a very limited number of activities/sectors. (See ESMA's Final Report, Advice on Article 8 of the Taxonomy Regulation, at 100-102).

The low taxonomy-alignment percentages are likely to be confusing to investors and it might undermine the long-term success of the Taxonomy Regulation. That is why it is critical to have a proper sequencing for the taxonomy-alignment reporting, with proper disclosure of the TR's limited scope.

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?

We strongly disagree with the proposed requirement for pre-contractual documents that have a narrative regarding the TR compliance to be accompanied by a statement "whether the statement has been subject to an assurance provided by an auditor or a review by a third party."

With respect to UCITS, the pre-contractual disclosure (prospectus) is subject to extensive legal requirements, including a stringent regulatory pre-approval process by national competent authorities (NCAs). Also, asset managers have internal processes and controls to help assure compliance with the prospectus disclosure requirements. There is no reason for the statement of taxonomy compliance to be the only item that requires a statement whether this information was checked by a third party. The ESAs could create the appearance that this piece of information is more valuable than other information in the SFDR/Taxonomy templates and other items in the prospectus.

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

Our comments on the pre-contractual disclosures also apply to corresponding periodic disclosures.

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

The ESAs' hearing of 29 April 2021 on the CP, which drew more than 500 participants who posed 300 questions, illustrates the complexity of these RTS and the corresponding disclosures. At the hearing, the ESAs reported that the consumer testing raised concerns about the length, complexity and density of text on the templates (see p. 16 of the ESAs' presentation deck at the hearing, available at https://www.esma.europa.eu/sites/default/files/library/open_hearing_on_taxonomy-related_product_disclosures_cp.pdf).

One of our key concerns is that the proposed templates lack any explanation of the TR's limited scope, which is the critical information investors will need to understand the meaning of the taxonomy-alignment disclosures. We strongly recommend amending the templates to include a clear explanation of the limited scope of TR, which would cover only 2 out of TR's 6 environmental objectives in 2022 and only environmental objectives in 2023 and beyond. The templates must be clear at the outset that the TR does not include social objectives.

We also make a number of other suggestions to make the templates more understandable to retail investors.

- As an alternative to the approach used in the templates (requiring taxonomy disclosures only if the products are subject to the TR), the ESAs could consider separating the TR content from the SFDR templates (see response to Question 10).
- As we state in the introduction, the TR requires product disclosures only to illustrate "proportions" of taxonomy-aligned investments and only the information on the environmental objectives to which the products' underlying investments contribute. The draft RTS requires to show "minimum" taxonomy-alignment and "minimum" non-alignment, and a "clear explanation of the reasons" for investing in "economic activities that are not environmentally sustainable economic activities." These requirements should be removed.

Introducing the new concepts crowds the already complicated disclosures and introduces its own challenges. For example, the question about "not investing in the environmental objectives" creates a negative inference towards investing in social objectives. Thus, the question "What is the minimum share of sustainable investments that are not aligned with the EU Taxonomy?" (and the sub-questions) should be deleted. The templates should allow, but not require, an explanation regarding the nature of investments that are not taxonomy-aligned.

- For the pre-contractual disclosures, the ESAs should clarify the illustrative nature of the "taxonomy alignment" pie-chart. For example, it can be a "snapshot" of the product's holdings at the time of the pre-contractual document's preparation. For some products (e.g., new products, products that newly intend to have taxonomy-alignment investments), it may be an anticipated taxonomy alignment. In both cases, it must be clear that the actual alignment may vary from the prospectus disclosure throughout the life of the product, and investors will be able to see the products' actual taxonomy alignment percentages in the periodic statements for the relevant reporting period.
- The new icons for the taxonomy disclosure are not meaningful and should be eliminated: an open book symbol by the taxonomy-alignment question does not lead to any obvious conclusion that the section or the graphic illustration is about an alignment to an important law. Similarly, a symbol crossing out a book does not lead to a conclusion that there is no alignment with a law. These icons also take attention away from the pie chart.

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?

As evident by the ESAs' consumer testing, the proposed consolidated templates for all products are too complex and overly confusing to the end investor. The ESAs can retain the consolidated template approach, but they must make it clear that any taxonomy content should only be used for the TR products. In this regard, we ask the ESAs to make it clear that the SFDR Article 9 products with purely social objectives do not need to make any taxonomy-aligned disclosures. The ESAs can also consider separating the templates.

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?

The consolidated templates require an answer regarding taxonomy-alignment from *all* products with sustainable investments, including those that do not target taxonomy-alignment and are not subject to the TR disclosure requirement.

We disagree with this approach, which will be confusing to end investor. Further, this opening section on the templates may even signal to the investor that a financial product may be sub-par if the taxonomy box is not checked, even though the answer may simply be reflecting the fact that social objectives are not yet part of the EU taxonomy. Limiting the inclusion of the taxonomy sections only to the TR products or separating the SFDR-only templates would eliminate this issue.

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?

Complying with the new requirements of the SFDR and the TR will involve significant new costs. We advise against adding any new requirements that will increase the costs without significant corresponding benefits to end investors. In this regard, any requirement or a suggestion of a third-party assurance for a statement in a regulatory document will increase the compliance costs without the obvious corresponding benefit to the investors. (See our response to Question 7).