Memo for information

To: Long Term Investments & Sustainable Finance PG, Distribution PG, PRIIPs Project Group
From: Secretariat
cc: Financial Reporting Working Group, Public Affairs & Communications Committee, Sustainability WG
Date: 18 May 2021
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Subject: ESAs hearing on Taxonomy-related product disclosures

Summary

On 29 April, the European Supervisory Authorities (ESAs) held an o**pen hearing on Taxonomy-related product disclosures**, the structure of the amending Regulatory Technical Standards (RTS), the product categories established by the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation (TR), graphical representation, KPI and statement of alignment of disclosures (see agenda). Recording and slides are available here.

This memo contains a summary with key take-aways, as well as a detailed overview of the hearing.

The secretariat reminds members that the information provided is only indicative and should therefore not be used as a reference for compliance with the RTS.

Key take-aways:

- **The need to avoid double implementation:** following a question from the secretariat, the ESAs agreed that continuous, fragmented regulatory changes to the templates should be avoided. So, the ESAs intend to develop one single template, applicable from 1 January 2022, to comply with SFDR and all taxonomy environmental objectives disclosures. However, as only 2 taxonomy environmental objectives will be defined by 1 January 2022, insurers will need to update the contents of the templates once the other environmental objectives will be finalised (and potentially again for social objectives).
- **Timing**: the secretariat also raised a question on the challenging timing for implementation. The ESAs admit it is challenging, but it is up to the EC to take the final decisions on whether to deal with this issue.
- **Difficult definitions and methodologies**: out of the 300 questions raised during the hearing, many concerned product classification and the calculation of the taxonomy-related key performance indicators (KPIs). Following the discussions in the joint call with the LTSI and PRIIPs PGs, also the secretariat raised a question about the link between product disclosures and entity-level disclosures. While pointing out that Article 8 disclosures are required for product level disclosures, the ESAs provided no definite answer and point out that the work at product level is coordinated with all three ESAs, while each ESAs worked separately for the entity-level disclosures, meaning that it will be up to the EC to decide how to proceed and whether to achieve consistency in these areas.
- **Complex disclosures:** the consumer testing of the part of the draft SFDR template related to the taxonomy-related disclosures (performed in two small focus groups in NL and PL) showed consumers' concerns on length, complexity, unclear language and repetitions. The ESAs admitted that the testing involved educated consumers and that it was limited only to the part of the templates on taxonomy disclosures. Despite the outcome, the ESAs appeared generally satisfied with its results. The secretariat and a number of other participants raised concerns during the hearing about the risk of information overload and consumers' confusion. The ESAs repeatedly highlighted that they are working under the constraints of the Level 1 Regulations, which limit their flexibility to proceed in a different direction or to tailor disclosures for different products in scope of the SFDR.

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Detailed comments:

- **Outline of CP and context of hearing – Gráinne McEvoy, Central Bank of Ireland (Chair of the Joint Committee Sub-Committee on Consumer Protection and Financial Innovation)**

  - The Taxonomy Regulation (TR) places new disclosure obligations on financial market participants making available financial products making sustainable investments with environmental objectives.
  - Product level disclosures are intended to make use of the entity-level taxonomy disclosures under Article 8 of the Taxonomy Regulation.
  - Financial products making sustainable investments in taxonomy-aligned activities will have additional disclosures apply to them, replacing some of the previous obligations under the original SFDR RTS.

- **Structure of amending RTS and product categories - Lievijne Neuteboom (EBA)**

  - The ESAs decided to create a single rulebook for SFDR and TR disclosures in order to minimise duplication and complexity. To achieve this, the draft RTS in the ESAs consultation paper makes specific disclosure requirements for the subset of products that make sustainable investments with environmental objectives according to the EU Taxonomy within the broader set of SFDR RTS sustainability disclosures.
  - SFDR refers to article 8 products (light green) that promote environmental or social characteristic or a combination of both, and article 9 products (dark green) that are more ambitious and have a sustainable investment as their objective.
  - Article 25 of the TR amends article 8, 9 and 11 of SFDR. In a nutshell, the TR builds in further distinctions within article 8 and article 9 SFDR products by providing two new categories of products which can be seen as being a subset of the larger SFDR article 8 and article 9 product categories. Article 5 TR products are a subset of article 9 SFDR products by being article 9 SFDR products with environmental objectives and then article 6 TR products are a subset of article 8 SFDR products by being article 8 SFDR products with environmental characteristics and making sustainable investments with environmental objectives. What is common for all article 5 and 6 taxonomy regulation products is that they only concern environmental sustainability.

- **Q&As with Patrik Karlsson (ESMA), Ursula Bordas (EIOPA) and Lievijne Neuteboom (EBA)**

  - Q: Should we expect that the article 9 product will be reserved only for Taxonomy fully compliant products, ie that the definition of sustainable investment will be amended to refer to taxonomy only once the work on taxonomy is completed? If not, should the social environmental objectives be those included in the EU taxonomy?
    - A: It is possible to make sustainable investments according to article 2.17 without using the taxonomy. For example, they can invest in activities that contribute to social objectives that are not yet covered by the TR.

  - Q: A fund that has both an environmental and a social objective is both an article 5 and article 9 product?
    - A: Yes.

  - Q: The pre-contractual disclosure template under consultation requires that green products investing in social and non-taxonomy aligned environmentally sustainable investments disclose what is the minimum share of sustainable investments that are not aligned with the EU taxonomy. Why are these products required to make taxonomy related disclosures in the templates when not required to do so under the taxonomy?

- A: The ESAs wanted to ensure transparency on the share of investments that are actually taxonomy aligned and by contrast those that are not taxonomy aligned.

- Q: What information should be included in the template on the minimum share of sustainable investments that are not aligned with the EU taxonomy?
  - A: The ESAs have included an option in the templates: investments that are not taxonomy aligned but are still environmentally sustainable investments can be disclosed. In the case of a product that has no EU taxonomy alignment, but still has environmental investments within the product, then it would disclose in the first part that the share of the investments that are taxonomy aligned is a zero percent of alignment.

- Q: Due to the new proposals on the RTS changing the previous proposal on the RTS published in February this year, should the supervisory statement be applied to the new proposal if at all?
  - A: The supervisory statement only refers to the SFDR, it does not refer to the TR yet.

- Q: What is the relationship of the TR RTS to the draft EU taxonomy climate delegated act that the EC published on 21 of April?
  - A: There is there's almost no relation relationship at all, except for the compliance with the taxonomy for those investments that are taxonomy aligned. If your financial product is an article 5 or 6 financial product, then it must make disclosures according to RTS and one of the significant items is a statement that the financial product is taxonomy compliant and that includes compliance with the technical screening criteria for environmentally sustainable activities. It's those technical screening criteria that are in the draft EU taxonomy climate delegated act of 21 April.

- Q: What if the product mixes environmental social objectives or characteristics?
  - A: It is an article 8 product. The templates allow to switch on and off different sections depending on whether the product has sustainable investment objectives and then disclose whether these investments are taxonomy aligned or not.

- Q: Do-not-significant-harm principle.
  - A: For the investments that are taxonomy aligned, the do-not-significant-harm requirements that were included in the RTS that the ESAs published in February this year are not required. This is because the taxonomy has within the screening criteria already a do not significant harm for each economic activity. So, such investments do not have to comply with these requirements. Only those that are not taxonomy aligned have to comply.

- Q: Article 14.1 RTS relates to article 8 SFDR products which promote among other characteristics environmental social characteristics. On the other hand, article 14.2 applies only to article 6 taxonomy regulation products. It is not clear whether article 14.2 RTS applies only to isolate products that contribute to sustainable investment of the economy under the taxonomy.
  - A: That's correct. Amended article 14.2 in our proposal is indeed the section that we require to identify the environmental objectives (in article 9 of the TR). So if it's an article 6 product, it must make sustainable investments with environmental objectives and then it should identify which objectives the activities contribute to and it should be one you know of the six objectives of the taxonomy regulation. That is indeed intended only for the article 6 products

- Q: Many questions on the possibility of making environmental sustainable investments that are not taxonomy aligned.
  - A: The sustainable investment definition under the SFDR is very broad. The approach taken is that an article 9 product with climate objectives does not have to use the taxonomy. However,

article 5 of the TR asks to disclose to what extent the investments are aligned with taxonomy referring to article 3 of the TR and therefore it could be interpreted that a positive alignment is required for products article 9 products with the climate objectives.

- Q: Under a quantitative point of view, when is a product article 8? Is a product investing 30% in promoting ESG features article 8? When it's a product article 9? Is it a product having 50% ESG?
  - A: Article 8 and article 9 of the disclosure regulation are agnostic about the product strategy. They have to promote environmental or social characteristics, or they have to have sustainable investment as an objective. The ESAs have asked the EC to clarify this issue in a letter published on 7 January but the EC has not been able to respond yet.

- Q: Question on the timing for implementation.
  - A: From 1 January 2022, the TR will only apply to climate change mitigation and climate change adaptation. The other environmental objectives are not yet covered.

- Q: Could you provide an example of a financial product that promotes environmental characteristics but does not make sustainable investments with environmental objectives?
  - A: Article 8 products are for example products that screen on certain environmental characteristics or criteria (e.g. a certain level of CO_2 emissions). Whereas article 9 products make investments into environmentally sustainable activities as outlined in article 2 of SFDR (e.g. a product that specifically invests in renewable energy projects).

- Q: What considerations drove the ESAs view that article 6 only covers article 8 SFDR products with a partial sustainable investment objective? Paragraph 1 of that provision might also be read in a way that TR disclosure should be due for all article 8 products that promote environmental characteristics.
  - A: The words *mutatis mutandis* in article 6 drove the ESAs' view that this product disclosure should be applied to article 6 products as a subset of article 8 SFDR products.

- **Q: Subsequent amendments of templates should be avoided. Are the ESAs planning to modify again the RTS and the templates with respect to the non-climate objectives of the taxonomy?**
  - A: No, the ESAs have taken a joint decision not to issue a new RTS for the other objectives. After all, the template has to be one for all objectives and has to be easy to be understood by consumers. With regards to the implementation of the RTS, the SFDR RTS is not yet adopted. In the supervisory statement, the ESAs have recommended an application date in the RTS of January 2022, so that these templates are applicable together with the new template. Basically, the old SFDR templates included in the RTS would not be used at all by market participants. These new RTS are amending those templates with the same date of application (1 January 2022), so they should be used from the beginning and there will be no double implementation either in this respect.

- Q: Can you explain why the templates then make consistent reference to minimum share? There is no concept of minimum threshold in the taxonomy or SFDR.
  - A: What the ESAs require is a kind of commitment to a minimum of taxonomy aligned investments at least (an indication of the minimum percentage) in the pre-contractual disclosures. Then, in the periodic disclosures, the full actual investments throughout the reference period should be disclosed.

- Q: Delegated acts will be complete by January 2022 only in relation to the first two environmental goals. Can taxonomy compliance be assessed against Level 1 of the taxonomy?

- A: The do-no-significant-harm is only for the first two objectives from 1 January 2022 to 1 January 2023 and then to all objectives from 1 January 2023.

- Q: Is the alignment with the taxonomy required to call article 5 and 6 TR products?
  - A: Yes, so products will have to indicate whether they have any taxonomy investments. It's not possible just to remove this section. Nonetheless, some specifics can be turned off. For example, the details on taxonomy alignment on the use of the methodology will not be required, but the information on whether the taxonomy is being used or not and what is the alignment is compulsory for all products with the environmental investment objectives.

- Q: Timing.
  - A: The ESAs expect to publish the draft RTS final report by the end of June/early July, with the intention of having taxonomy disclosures applied to the first two environmental objectives from the 1 January 22. ESAs realize that this is challenging but are bound by the level 1 deadlines.

- Q: Is the correct understanding that an article 8 product with environmental characteristics that does not make any environmentally sustainable investment as per the taxonomy does not need to report the taxonomy alignment?
  - A: This is an article 8 SFDR financial product and not an article 6 TR product, so it would not need to abide by the draft RTS in the consultation paper.

- Q: How to reconcile the requirements to explain non-sustainable investments for an article 9 product under SFDR and whether a company has to have a 100% in sustainable economic activity? Do you see minimum percentage threshold for article 9 products in sustainable investments?
  - A: The ESAs have addressed a letter to the EC in January. It's not a role for the ESAs to define this percentage. Nonetheless, it is worth pointing at the Delegate Acts that were published last week on MiFID and IDD where there is a minimum threshold. **That clearly indicates that in the sales process there is a minimum threshold and that is the threshold that the customer expresses in the process of purchasing a financial product.** It is as such not embedded in the legislation at the moment.

- Q: The segmentation of investments and activities under a product has a very high degree of complexity that can be hard to cope even for trained legal and asset management professionals. Do you consider simplifying this in order to ensure end investors understand and value the disclosure?
  - A: No, the ESAs can only develop technical standards under the Level 1 indications.

- Q: Could you comment on the application of SFDR to portfolios?
  - A: A portfolio is a financial product according to the disclosure regulation article 2. If a portfolio is managed with environmental or social characteristics it's an article 8 portfolio; if a portfolio is managed with environmentally sustainable economic activities then it's an article 9 product. The same article 5 and 6 sub-categorization applies to them just like any other products. The ESAs asked the EC a specific question in the January letter and hopefully the response will help.

- Q: Lack of methodological consistency.
  - A: The ESAs are concerned but it is a legal challenge that doesn't really depend on ESAs, it is a Level 1 issue.

- Q: If taxonomy alignment must be disclosed from January 2022, it is not possible to calculate alignment for the 4 objectives that we don't have screening criteria for. Does that mean that products with those objectives have to disclose 0 alignment in 2022?
  - A: The ESAs could not provide an answer.

- Q: An article 9 product could have an environmental objective under article 2.17 which is not a taxonomy objective and hence would not be an article 5 product?
  - A: Yes, it's possible that an article 9 product could have an environmental objective under article 2.17 which is not a taxonomy product. So, the ESAs require also for those products to make a substantial contribution and do-not-significant-harm disclosures, but according to SFDR RTS that came out in February, which include consideration of PAI indicators to prove do-not-significant-harm for non-taxonomy investment. It is correct that an article 9 product can have an environmental objective under article 2.17 which is not a taxonomy objective, but in that case it should still be considered an article 5 TR product and it should make disclosures accordingly including do-not-significant-harm and substantial contribution but according to the ESAs old standards.

- **How and to what extent – graphical representation, KPI and statement - Patrick Karlsson (ESMA)**

  - The consultation paper proposes a graphical representation of the taxonomy-aligned investments of the product, calculated based on a key performance indicator (KPI). **The KPI is aligned with the ESAs technical advice on Article 8 TR disclosures** – the share of the product's investments that are directed at funding economic activities that qualify as environmentally sustainable, in relation to the total investments of the product
  - Numerator:
    - Green bonds issued under the EU GBS
    - Green bonds issued under non-EU standards can count up to their taxonomy contribution
    - Debt and equity instruments of investee undertakings weighted by the taxonomy aligned activity contribution of underlying undertakings
    - Non-financial investee undertaking taxonomy-alignment to be measured by one of turnover, capital expenditure or operational expenditure

> You have both non-financial and financial undertakings there. For non-financial undertakings, you actually have to use one of 3 KPIs (turnover, capex or opex). Here, the ESAs propose that the calculation for non-financial undertakings in the numerator should be measured by one of turnover capex and opex.
>
> It's important to clarify that you can't use different KPIs for each company. That choice has to be made ex ante and it has to be disclosed in the pre-contractual disclosures - you have to explain the choice of which of the three KPI you use for the non-financial undertakings and then also a short justification of why that choice is appropriate.

  - Denominator: all investments of the financial product
  - The disclosures include a requirement to self-certify through a statement that the activities funded by the product are aligned with the criteria of Article 3 of the TR:
    - Significant contribution to an environmental objective
    - Not significantly harming any environmental objectives
    - Respecting Article 18 TR social safeguards
    - Complying with technical screening criteria of TR Delegated Acts
  - Disclosure of whether statement has been reviewed by third party

- The statement would replace the broader Article 2(17) SFDR DNSH in the SFDR RTS by way of derogation. But: only available for the sustainable investments of Article 5-6 TR products that are EU taxonomy-aligned
- For sustainable investments that are not EU taxonomy-aligned, disclosures should follow the broader Article 2(17) SFDR DNSH requirements in the SFDR RTS (i.e. take account of PAI indicators).

- **Q&As with Patrik Karlsson (ESMA), Ursula Bordas (EIOPA) and Lievijne Neuteboom (EBA)**

  - Q: Contributing enabling and transitioning activities have to be split out in the product level taxonomy disclosures or just report on a degree of taxonomy alignment in one figure?
    - A: In the templates, both are required: the total share and the split as this is as well required in the Level 1.

  - Q: Companies will not start reporting on taxonomy until 2022 and therefore how our product provider is expected to complete these templates by first of January 2022? In the absence of any reliable data, won't our product providers therefore have to disclose zero percent alignment?
    - A: The ESAs hope that companies can already disclose on the taxonomy before and heard from data providers that they're already screening a company's taxonomy alignment based on the climate change technical screening criteria. Therefore, the ESAs would expect that in the market there will be already data available before 2022 for those that can already disclose the taxonomy alignment. Of course, where the data is not available then they will have to do so after and not be able to disclose that the product is taxonomy aligned before.

  - Q: What happens if you have 20% as a minimum share in your pre-contractual information and then when you report you have solely invested in 10% taxonomy activities?
    - A: It's not a scenario that the ESAs have considered. For the ESAs, you should at least abide by the minimum commitment you made in the pre-contractual stage. If you had a minimum share of taxonomy line investment of 20% in your pre-contractual stage, then it should at least be 20% in the periodic report in the periodic disclosures. There is no sanction currently in the text about what happens. Hopefully the embarrassment of having made less than what you promised would be a disincentive.

  - Q: Will the Commission be able to adopt these RTS before the first January 2022 application date?
    - A: The ESAs hope to deliver the RTS by the summer to the Commission and it will depend then on the Commission, Parliament and Council how quick the adoption will be.

  - Q: Regarding the consideration of all investments in the denominator: knowing that not only investments are eligible, some products by nature will be perceived as greener than others, for instance an equity fund with available data versus funds containing sovereign investments.
    - A: That's potentially a risk, but it would be more misleading the other way around, having a selection of investments in a product that has very significant investments in instruments that aren't eligible that is simply outside the calculation. The ESAs feel quite strongly that it's better to have an all-encompassing denominator to show that the extent of taxonomy aligned investments. So, it's better that way than the other way around of having very significant investments in sovereigns that may be green at all and that's simply being excluded from the disclosures.

  - **Q: How do the taxonomy disclosures for products and associated indicators relate to those under the ESAs proposals on entity level?**

- A: The way to calculate your taxonomy alignment is derived from the article 8 disclosures. Those disclosures show the taxonomy alignment of the activities of those entities so for the financial product to calculate the extent of its taxonomy alignment, it needs to take those article eight disclosures of financial and non-financial undertakings. Using them, the product will determine the extent to which those undertakings activities are taxonomy aligned - that's the essential key.

- Q: If one product uses turnover and another product uses capex as the KPI doesn't that make the product impossible to compare with each other?
  - A: There are limits to comparability and this is one of the trade-offs that the ESAs have taken.

- Q: Is there a problem of having a level playing field on sovereign bonds issues? If insurance have to invest in a large share of sovereign bonds they will necessarily have a very low ratio compared to a dedicated fund.
  A: The ESAs are very well aware of this issue, nonetheless the requirement under article 5 and 6 is to disclose the extent of taxonomy alignment and that includes all investments, so within this the ESAs cannot exclude from the denominator sovereign bonds. The ESAs are aware that it is difficult to screen sovereign bonds against the taxonomy and hope that there will be a methodology developed for them so that in the future they can be more easily included in the numerator. It would be misleading for a financial product to promise to target taxonomy aligned investments and then not disclose compared to the to the whole product.

- Q: Is there a specific date the taxonomy calculation should be performed for the purpose of the pre-contractual disclosures?
- A: This is a minimum share, not the actual extent of the taxonomy aligned. Therefore, this doesn't require a specific date for that calculation. It has to be done whenever the product is launched and the pre-contractual disclosures are developed.

- Q: Which KPI should be used for financial undertakings that have several activities asset management insurance and banking activities so essentially conglomerates?
  - A: The ESAs have been trying to deal with that and realized that it’s not easy. The EBA had some very good advice in its technical advice to the Commission on how banks should treat other financial institutions (around page 34 of the technical advice) but there is no final solution yet.

- Q: There’s a statement that was included in the TR article 6 for the light green products and that is not covered by the amendments to the RTS.
  - A: That was a non-intended consequence of the last drafting changes. Somehow this sentence was deleted. The ESAs will re-include this as this statement is very important for article 6 products of the taxonomy regulation.

- Q: How to deal when we don't have data, for example a **non-EU company** that doesn't publish information about its taxonomy alignment measured by turnover capex or opex? Is it a 0% alignment, do we use a proxy or do we exclude it from the calculation? It is necessary to provide rules because this methodological choice will significantly impact the ratio.
  - A: In the RTS the ESAs have adopted a relatively strict approach that the estimation of taxonomy alignment, which should as far as possible be based on publicly disclosed data by the entities. The ESAs understand that this is limited to EU companies reporting under the NFRD and that for example many smaller companies don't report. The ESAs have not provided for a kind of proxy or estimation possibility for the financial product. The primary consideration is transparency, avoiding green washing and overly optimistic estimations. The ESAs want to

base this on disclosed data as much as possible. Article 16a paragraph 2b includes a description of what happens where information to the taxonomy alignment of investment is not readily available from public disclosures: details of how equivalent information was obtained directly from the investing companies or from third-party providers are required. The ESAs imagine a role for aggregators of information. So, there are ways to obtain equivalent information to the article 8 disclosures but they should be obtained ideally directly from the from investing companies or they can also be provided from third-party providers.

- Q: Question on the possibility to have turnover capex or opex and whether this will not create some risks of green washing.
  - A: Turnover is simply more available, but capex and opex can also be very useful to provide information. Therefore, the ESAs allow to use one of the 3, but it has to be the same for the whole financial product.

- Q: If you must choose only one KPI then you automatically exclude all investments in companies that do not report on that KPI.
  - A: No, that still tracks with article 8 because this is for non-financial companies and for those non-financial companies they are required to publish turnover capex and opex. So, it should not necessarily exclude a sector of non-financial undertakings necessarily.

- Q: Did I understand correctly that eg for an investment fund we must choose for all invested companies if we use revenue capex or opex for the calculation of taxonomy alignment? To calculate the overall figure of a fund, we can't use opex for company A and revenue for company B.
  - A: That's correct.

- Q: Question on the minimum share of investment aligned with the EU taxonomy in the pre-contractual information and whether each breach of this limit would need to be reported to the regulator. Would it make more sense to disclose a target ratio instead of a minimum? The actual number would still be available in the financial report.
- A: The ESAs have discussed this thing thoroughly. The target is important information, but it doesn't create a requirement to commit to this target. The ESAs want to make the financial market participants accountable for their commitments.

- Q: Do you foresee smaller asset managers having to turn to third-party providers in order to map investments to all the taxonomy activities therefore imposing larger costs on these smaller less resource heavy managers?
  - A: That may be, however the ESAs have not found alternatives so far. If you can't collect the data, and if you can't be sure of how taxonomy aligned your underlying investing companies are, then obviously that's something you should consider when marketing a taxonomy aligned product

- Q: What happens with an article 9 product that are 10% aligned with taxonomy do they have to include a disclaimer for the 90% that is not aligned with the taxonomy, as it should be required for article 8 products according to article 6 in TR?
  - A: This is indeed an issue that has not been yet tackled in the RTS and relates to the requirement in the Level 1 for article 6 products to include a disclaimer. However, there is no disclaimer for article 5 products being required in the Level 1. In case the ESAs would keep the current thinking, they would add a disclaimer because otherwise article 5 products would provide less consumer protection.

- Q: If a product tracks an index, for example composed of equities, and the index providers gives a taxonomy alignment percentage for the index, can the product rely on the index?
  - A: The responsibility for providing this information will be with the financial market participant and therefore the financial market participant should be accountable for this declaration.

- Q: How about a sustainable investment that is not taxonomy aligned and for which no principal adverse impact indicators are available in the annex? The example given is infrastructure investments.
  - A: The requirements is quite generally worded as it says "take into account the principal adverse impact indicators". It's not correct that you can simply ignore the 50-plus indicators given for infrastructure investments in that case. The financial market participant should make best efforts from the 50-plus indicators available to scrutinize and check whether for example greenhouse gas emissions are caused by the infrastructure investments.

- Q: Many comments on whether the KPI for periodic disclosures should not be limited to one KPI, but the three KPIs should be required (turnover capex and opex) as the taxonomy is a pre-contractual promise but periodic reporting is already reporting on what happened.
  - A: The ESAs want to limit over information to consumers and it's quite complex to understand three figures for retail investors. That is why the ESAs propose just to have one KPI and report on the same KPI that was used pre-contractually.

- Q: SFDR requires to report taxonomy data split out into substantial contributing, enabling and transitional activities. That is correct or not?
  - A: We have substantial contribution disclosures as part of the taxonomy aligned investments disclosures but then there's a separate division between enabling and transitioning activities in the Level 1 text already.

- Q: We are really worried with the consistency of calculating numerator and denominator. That is utmost important that both are calculated in the same way otherwise it would be clearly misleading for retail investors.
  - A: The ESAs share this concern and that's why they have provided for a comprehensive approach to the denominator.

- Q: Any thoughts yet on how you might treat derivatives in the numerator?
  - A: The ESAs have mixed thoughts about this. The ESAs are worried about certain gaming of the system that could be allowed by the use of derivatives.

- Q: Question on whether the ESAs will publish Q&As.
  - A: The ESAs will consider the questions and those that that need convergence at the EU level. The ESAs could publish Q&As, but only on implementation and not on the Level 1.

- Q: It's important that the methodology for investment for the KPI to be published by insurers at the entity level under article 8 is the same one that has to be disclosed at the product level. Is the Commission working on the delegated act on article 8 TR and how consistency will be ensured?
  - A: The difference is that on article 5 and 6 the ESAs are working through the joint committee, so they're having one consultation paper, while the advice on article 8 was delivered separately by each ESA. It will be up to the Commission to decide whether to follow the advice of each supervisory authority or whether to bring consistency within article 8 already in the delegate acts. If that's not possible, then our KPI within the RTS is quite close to ESMA and also EIOPA's advice, with some differences, and it will be the one that will be mandatory at the product level.

- Q: What is the need of the compliance statement if taxonomy alignment is described in legal documents eg fund perspectives periodic report?
  A: The idea is to have transparency at both the pre-contractual stage and then also in the periodic stage. There might be duplications, but how else do you convince the investor that the activities you proclaim are taxonomy aligned and you've included your graphical representation of taxonomy alignment, are truly sustainable?

- Q: Portfolios change on a daily basis. Do firms have to report taxonomy alignment as at a particular date or over a particular period?
  - A: This relates to the Level 1 text, particularly how periodic disclosures work. There is no reference period in the Level 1 text of SFDR for periodic disclosures. Those reference periods are set by the sectorial legislation. The main difference between products is that MiFID products have quarterly periodic reporting and every other product has annual periodic reporting.

- Q: Regarding the calculation of taxonomy alignment of investments in article 16 from 1 January. Should investments relating to the two climate screening criteria be included in the numerator and all other taxonomy aligned investments be included in the denominator?
  A: Everything relating to the first two objectives is applied from 1 January 2022. Then all other objective will apply from January 2023.

- Q: If a financial market participant is allowed to choose a different KPI for different products offered wouldn't that provide a big gaming opportunity by launching three products with different KPIs, then stop marketing the ones that look less sustainable? Why not requiring the same KPI for all portfolio instead of discussing using different KPIs for different products?
  - A: It is the product level that is compulsory. Some products might focus more on one KPI, while others might focus more on another KPI, eg capex for infrastructure.

- Q: Did you consider requiring a quantitative disclosure of the extent to which taxonomy alignment is based on data as reported by companies versus as estimated by database providers? This information might be interesting especially when comparing product that invest into EU and third country to a different extent.
  - A: The ESAs considered this but did not include it in the consultation paper. It would have complicated the disclosure as the templates are quite complicated already.

- Q: When it is stated that sovereign exposure is not eligible, does that also mean that green bonds issued by sovereigns cannot be eligible?
  - A: No, that is not the case. The ESAs didn't have time to provide clarity of that in the consultation paper. Green bonds issued by sovereigns are not sovereign bonds and they can count as green bonds in the numerator.

- Q: Do proposals related to the approach to the KPI take into account the recent recommendations from the platform of sustainable finance report on transition finance? They are saying that to provide companies that perform activities that do not yet meet taxonomic criteria with access to transition finance, it would be allowed to consider as taxonomy aligned also companies investments towards meeting the technical screening criteria in the future. These investments should cover capex objects and related finance.
  - A: At the moment, the ESAs don't allow for some kind of intermediate taxonomy alignment based on the future.

- Q: The taxonomy assesses substantial contributions and DNSH at the activity level, not the entity level. To the extent that a product makes sustainable investments that are not within the scope of

the taxonomy, are the criteria of article 2.17 SFDR to be evaluated also at the activity level or the level of investing companies?
    - A: Article 2.17 simply says such investments do not significantly harm any of those objectives, so that includes both environmental or social objectives; it doesn't limit the DNSH per se to the activity. It is not inconsistent to require non-taxonomy sustainable investments to use DNSH to be evaluated by using the principal adverse impact indicators (even if they are not activity based per se but they are entity based).

- Q: Can you disclose a 0% minimum taxonomy alignment regardless of environmental objectives?
    - A: Yes, under the current CP proposal. This is something the ESAs are still analysing as it depends slightly on the analysis of article 5 of the TR and the interaction with the article 2.17, bearing in mind also recital 19 of the TR. This is a very important legal question regarding the interpretation of the Level 1 and the approach taken in the CP is that in that case the pie chart would show 0 for example.

- Q: If a fund is article 8 SFDR and it's invested in green bonds as constituents, is it obliged to make the disclosure of TR? Or does it have the right to choose?
    - A: Since it invests in green bonds then it may have environmental characteristic or it may promote environmental characteristic, so it should follow taxonomy disclosures.

- Q: Does article 8 product make sustainable investments with an environmental objective?
    - A: It could be that it does because it has chosen to invest in green bonds and in that case it does become an article 6 of the TR. Therefore, it would have to disclose according to the to the disclosures in the RTS.

- Q: On the delegate acts of 21 April, if a product is categorized as article 8 but does not show a minimum share of sustainable investments, it's not an article 6 for the TR. Can it still be offered to a client having sustainability preferences or are article 8 products not suitable for clients that have sustainability preferences?
    - A: Not our competence, but we can comment because it is strictly linked with the RTS. **An article 8 product that does not make sustainable investments will not be suitable for client's sustainability preferences unless it also includes information on principal adverse impact consideration which is a requirement under article 7 of the SFDR.** This is also covered in the templates so it should be rather easy for advisors to identify which article 8 products can match sustainability preferences of the clients.

- **Amended templates – Ursula Bordas (EIOPA)**

    - The draft RTS in the consultation paper:
        - Amends the mandatory templates from SFDR RTS (4.02.2021) adding new sections for art 5 TR and art 6 TR products
        - Adds a new section on sustainable investments:
            - share of EU taxonomy aligned investments and
            - share of sustainable investments that are not aligned with the Taxonomy
        - Amends table on 1st page to specify inclusion of Taxonomy-aligned investments
    - Consumer testing conducted in April in cooperation with the Netherlands Authority for the Financial Markets (AFM), with its Consumer Panel, and the Warsaw School of Economics (Szkoła Główna Handlowa w Warszawie – SGH) in Poland.
    - Two different groups: age, country, professional experience.
    - Positive aspects: the pie-chart tested very well
    - Concerns were raised by respondents over:

- Length, complexity and density of text
- Use of jargon such as term "taxonomy", alternatives suggested such as "classification", Principal Adverse Impact
- Possible repetitions across sections
- Layout and attractiveness of the template, choice of colours and complexity of introductory table in Page 1

- **Q&As – Ursula Bordas (EIOPA)**

  - Q: Most article 9 products with environmental objectives will comprise both taxonomy compliant and other sustainable investments at least until the taxonomy is fully operational. Would you say that for such products both boxes of activities aligned and not aligned with the taxonomy need to be ticked, and both respective sections included in the standardized disclosures?
    - A: Yes. The graphical representation and the KPI only applies to the taxonomy aligned investments.

  - Q: On the frequency of updating the pre-contractual report: is it required only if we bring substantial changes to the fund structure or objectives or is it an annual review?
    - A: It is only when there are changes introduced to the product that an update is necessary. It's not required to be updated annually. We can't create new rules that would undercut the sector legislation for the financial products. For article 11, we have to follow the underlying sectoral rules, whereas for article 4 which are principal adverse impacted disclosures at entity level there was no reference period in the Level 1 but we had a methodological empowerment to define RTS.

  - Q: Is it correct that by completing the template, a FMP can be sure to have met all pre-contractual requirements for article 8 and 9 and SFDR and taxonomy, except for SFDR article 6 requirements?
    - A: Yes, that is the way the legislation is intended to function.

  - Q: On third party assessment: is it to assess internal processes or data?
    - A: Both.

  - Q: How should the PAI be taken into account: solely by methodology or also by some sort of measurement/results of the analysis of PAI?
    - A: Both.

  - Q: How should investments that are not taxonomy aligned be reported when there is no full taxonomy alignment? Whether they should be both boxes of article 9 included and ticked or not?
    - A: It depends if the product includes sustainable investments that are not taxonomy aligned or not. If it doesn't, then it does not include this second tick the box. If it includes taxonomy aligned investments and also sustainable investments that are not aligned, then it ticks both boxes.

  - Q: 1. Does a product have to disclose the share of sustainable investments in the general section on what was the asset allocation in all cases? Or only if it makes sustainable investments other than taxonomy aligned investments? 2. Doesn't this section also require a graphical representation albeit not in the form of a colored pie chart?
    - A: 1. Yes, the general section should include that where it doesn't make taxology aligned sustainable investments. 2. No, the only comparable graphical representation is taxonomy aligned investments. The others aren't necessarily comparable because they may be completely different frameworks, different standardization, different quality levels etc.

- Q: The consumer testing showed many concerns and very limited positive impact. What will you do with this feedback since the template is developed to inform the consumer?
  - A: We take the consumer testing seriously. We already knew that the templates were complicated. We knew as part of the consumer testing we did last year in September on the SFDR RTS templates. These add an extra element of complexity too, so it's not surprising that the same two consumer groups we tested actually found these more complicated this time. We've had to introduce more complexity since we are amending the old templates with new disclosures for certain types of products. This issue is linked to the Level 1 text: we have this legacy problem that the pre-contractual documents for article 8 and 9 - which are listed in article 6.3 - are of very different length and complexity. For UCITS you have this as part of the prospectus which can be a 300 page legal document. For PEPP, at the other end of the extreme, you have a 5-page KID and then you add an annex to that which is almost the same length and very complex. You have this difference between 300 and 5 pages and yet they have to be the same for both.

- Q: Was the consumer testing conducted on the entire template, including the SFDR provisions or just the taxonomy section?
  - A: The full document was given to the respondents. However, the questions were focusing only on the first graph, so the tick the box table at the beginning and the new section with taxonomy and non-taxonomy sustainable investments.

- Q: Can an article 8 product that is not an article 6 TR product may still have some investments that are taxonomy aligned even if these are neither disclosed nor the objective of the product?
  - A: There is an idea of intentionality in the SFDR RTS, that you have to intend to make sustainable investments for the disclosures to apply. The response is the same for the TR: if the product intends to make sustainable investments with the environmental objective of the taxonomy, it should disclose according to this. The question is then, can it consider itself not to be an article 6 product just because it happened to make some sustainable investments even if it did not intend to do? Based on our SFDR RTS the answer yes, but the ESAs are still discussing this.

- Q: On multi-option products, the annex templates are not yet finalized. Operational implementation on the financial market participants side will therefore be rather late during 2021 and this becomes an even bigger issue for those participants that offer MOPs for pre-contractual disclosures. They need to collect at least hyperlinks for periodic reporting, even the templates themselves. Without the time lag for application there is no way they can comply in time by 1 January 2022.
  - A: There is clearly an issue of timing. There is not much time left until 1 January 2022. With this consultation and especially with the final report there will already be an indication of how the templates will look like. We hear as well from quite a lot of stakeholders that they are already preparing the implementation of the templates. In that way, an insurer should be able to request the templates from the asset manager before the application date. It is a cross-sectoral regulation and so the application date is the same for all products irrespective of whether they depend on the provision of information from another FMP, as it's the case for MOPs.

- Q: Is there a position on publishing the templates as a standalone document like a PRIIPs KID?
  - A: This has to be part of the underlying sectoral documents listed in article 6 paragraph 3 of the SFDR. There's no choice there: the article 8 and 9 disclosures (the pre-contractual disclosures) have to be made according to that, so they cannot be standalone documents. They have to be part of those. We have provided in the old SFDR RTS that they should be provided

as an annex to that document. It could be possible to separate an annex from the underlying document: you could at least consider the annex somewhat separately. By the way, all the templates have been tested on their own. They weren't tested as part of another document even though they have to be published as part of another document. We haven't tested the templates together with the prospectus of the fund, but we have just tested the templates. That is because it will be too many pages to present to the respondents in the reality: that's how they will see it, so it's not completely a real experiment.

- Q: Would it be possible to allow to use hyperlinks with pre-contractual disclosures and periodic reporting of investment options?
  - A: The ESAs have established a differentiation in the rules for multi-option products in the RTS published in February, where at the pre-contractual level it is possible to include hyperlinks. That is only possible when the amount of underlying options is big enough not to make the provision of the annexed templates for each option possible or for the customer to go through that. Then cross-referencing is allowed. That is not the case nevertheless for periodic reporting and that is because these documents - so here it is the case of Solvency II disclosures - are for the underlying options chosen, so this amount of options will be limited. We do not see the problem of information overload which was the case for pre-contractual disclosures.

- Q: A question on the translation of the templates and also the use of the images, so whether they can be adapted in the templates.
  - A: The images in the templates, the icons, cannot be adapted nor removed. They have to be included. What is not mandated in the templates is the size and font style, as well as the colours used the templates. That can be adjusted to fit as best as possible the rest of the documents. With regards the translation, once adopted, the RTS it will be translated by the Commission and all the translations will be available in the publication in the Official Journal of the EU.

- Q: Question about MiFID quick fix rules on electronic communication exemptions and opt-out eligible counterparties professional clients.
  - A: The ESAs could not provide an answer.