Frankfurt am Main,
12 May 2021

BVI[1] response to the ESAs Joint Consultation Paper concerning Taxonomy-related sustainability disclosures (ESMA34-45-1218)

Please make your introductory comments below, if any

We are grateful for the opportunity to comment on the joint ESA's consultation concerning Taxonomy-related sustainability disclosures at the product level. The German fund management industry is committed to working towards the objectives of the EU Action Plan for financing sustainable growth and to supporting transition of Europe's economy. In order to effectively contribute to these goals, the industry needs clear and consistent regulatory conditions and reliable timelines for implementation.

Against this background, we fully support the approach proposed by the ESAs to implement the reporting requirements under Art. 5 and 6 of Taxonomy Regulation by amending the draft RTS under SFDR. In our view, this approach will help to create a coherent and comprehensive set of rules for ESG-related product disclosures. From the viewpoint of investors, it is also strongly preferable to be provided with only one piece of information covering all ESG-relevant aspects of their investments.

In terms of timing, however, this integrated approach further adds to the implementing burden for financial market participants. Hence, it is important to stress the following:

- **The final integrated RTS comprising disclosure details in relation to both SFDR and EU Taxonomy must be published and adopted as soon as possible.** This pertains in particular to the final standardised templates for pre-contractual and periodic disclosures that require sufficient time for technical implementation. In this regard, we urge the ESAs to do their best to meet the deadline of 1 June 2021 for submitting the final draft RTS to the EU Commission.
- **The bar for political and public expectations in terms of reporting on the EU Taxonomy by the beginning of 2022 should be set very low.** Even though there is a clear interest among asset managers and investors to invest in line with the EU Taxonomy criteria, investment strategies based on the EU Taxonomy are still not operational on a broader scale. This is mainly due to the early stage of the development of technical criteria that cover only a few sectors and are not relevant to the broader economy. Moreover, given the late publication of the delegated acts with technical criteria for environmentally sustainable economic activities contributing to either climate change mitigation or adaptation, it should be clear that even those companies covered by technical criteria will not be able to report reliable data on Taxonomy-alignment of their activities until end 2021 or shortly afterwards. This means that **by 1 January 2022 asset managers and other financial market participants will lack the necessary data basis for assessing their holdings against the EU Taxonomy, yet alone to commit to certain minimum shares of Taxonomy-aligned investments as part of their investment strategy**.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets more than EUR 3.8 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

The draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021 accounts for this challenge by requiring only generic disclosures in relation to the EU Taxonomy by 1 January 2022 for both non-financial and financial undertakings. If adopted accordingly, specific KPIs on the proportion of Taxonomy-aligned activities in companies would be available even later, i.e. only from the beginning of 2023. **It should be clear that before that date no product will be able to assess the likely share of Taxonomy-aligned investments that are in line with its investment strategy in order to make firm commitments as regards their minimum proportion to investors. This also means that by the expected time of entry into force of the new provisions on sustainability preferences under MiFID II and IDD there will be no products that offer investors a minimum proportion of investments in line with the EU Taxonomy according to Art. 2 (7)(a) of MiFID II Delegated Regulation and Art. 2 (4)(a) of IDD Delegated Regulation to be amended in line with the Commission's proposal from 21 April 2021.**

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 fully support the proposed approach to implement the reporting requirements under Art. 5 and 6 of Taxonomy Regulation by amending the draft RTS under SFDR. In our view, this approach is fully consistent with the ESAs' empowerments under Art. 25 of Taxonomy Regulation and helps to create a coherent and comprehensive set of rules for ESG-related product disclosures. From the viewpoint of investors, it is also strongly preferable to be provided with only one piece of information covering all ESG-relevant aspects of their investments.

In terms of timing, however, this integrated approach further adds to the implementing burden for financial market participants. Hence, it is important to stress the following:

- **The final integrated RTS comprising disclosure details in relation to both SFDR and EU Taxonomy must be published and adopted as soon as possible.** This pertains in particular to the final standardised templates for pre-contractual and periodic disclosures that require sufficient time for technical implementation. In this regard, we urge the ESAs to do their best to meet the deadline of 1 June 2021 for submitting the final draft RTS to the EU Commission.
- **The bar for political and public expectations in terms of reporting on the EU Taxonomy by the beginning of 2022 should be set very low.** Even though there is a clear interest among asset managers and investors to invest in line with the EU Taxonomy criteria, investment strategies based on the EU Taxonomy are still not operational on a broader scale. This is mainly due to the early stage of the development of technical criteria that cover only a few sectors and are not relevant to the broader economy. Moreover, given the late publication of the delegated acts with technical criteria for environmentally sustainable economic activities contributing to either climate change mitigation or adaptation, it should be clear that even those companies covered by technical criteria will not be able to report reliable data on Taxonomy-alignment of their activities until end 2021 or shortly afterwards. This means that **by 1 January 2022 asset managers and other financial market participants will lack the necessary data basis for assessing their holdings against the EU Taxonomy, yet alone to commit to certain minimum shares of Taxonomy-aligned investments as part of their investment strategy**.

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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?

We suggest that **disclosure of Taxonomy-aligned proportion of investments in a portfolio should be based on one common, turnover-related KPI, with further indicators based especially on CapEx being provided as supplementary information on an optional basis**. In particular, while appreciating the choice between different indicators as proposed by the ESAs from the portfolio construction perspective, we fear that the **differences between disclosures based on e.g. turnover and CapEx will not be properly understood by the vast majority of especially retail investors**. Generally, investors will tend to pay little attention to the accompanying explanations and compare the disclosed ratios, even more if such ratios are visualised by a pie chart in a uniform manner. However, the Taxonomy-aligned ratios will convey totally different information depending on their reference base. Given that turnover-based ratios cannot be compared, or even related to, calculations based on CapEx or OpEx, we see the clear need to provide for one common Taxonomy-related KPI to investors. Such KPI should be based on the turnover, firstly in view of the current data environment (most ESG data providers focus on turnover-related data offerings), but secondly given the fact that proportion of Taxonomy-related turnover provides the most relevant indication about the extent of green activities in a company.

On the other hand, we definitely see **added value in providing investors with additional information especially on Taxonomy-related CapEx** in certain circumstances. CapEx-based indicators will be particularly relevant for funds and other products that invest in transition with the objective of improving the environmental performance of companies and guiding them towards expanding environmentally sustainable business activities. In such products, the turnover-based Taxonomy ratio will be typically rather low and the sustainability performance should be measured with a particular focus on CapEx figures. Therefore, it is important that such products are allowed to disclose additional KPI(s) in order to provide investors with a full picture as regards the attainment of their sustainability-related investment strategy.

Another option would be to use an indicator integrating both turnover and CapEx elements in one integrated calculation approach as proposed by the JRC for calculating the Taxonomy-relevant portfolio shares under the EU Ecolabel. The calculation formula is included in the fourth proposal of criterion 1 that has been tabled by the JRC in the Technical Report 4.0 on Development of EU Ecolabel criteria for retail financial products in March 2021 and allows for a comprehensive picture of alignment with the EU Taxonomy that comprises both turnover and CapEx dimensions.

What remains as a **challenge**, however, is to **report one single integrated KPI for investments in both financial and non-financial undertakings**. The draft Delegated Regulation under Art. 8 of Taxonomy-Regulation published on 7 May 2021 provides for numerous singular indicators to be disclosed by asset managers with regard to their investments in financial and non-financial companies. So far, however, it is still unclear how these KPIs relate to each other and in particular, how they can be taken into account in order to calculate a Taxonomy-aligned quota for a diversified fund portfolio comprising investments in both financial and non-financial companies. Therefore, we deem it **necessary that the ESAs provide further guidance** as to **which KPIs for financial undertaking should be treated as equivalent to the KPIs for turnover, CapEx and OpEx respectively** or otherwise taken into account in the calculation of one integrated ratio of Taxonomy-aligned investments at the portfolio level.

Lastly, the consultation document **does not provide any indication as regards the appropriate data base** that could be used for the purpose of calculating the Taxonomy quota. This is in contrast to the final advice on reporting by asset managers under Article 8 of Taxonomy Regulation where ESMA proposes a decision tree hierarchy with regard to prioritisation of different types of data. We would welcome a similar clarification for the purpose of calculations at the product level. In particular, **it should be clear that product providers must not rely solely on data that is directly reported by companies, but can use other sources of information, including the services by ESG data vendors**, in order to obtain the data necessary to reasonably establish the proportion of Taxonomy-aligned investments.

In this context, we have fully supported ESMA's suggestion in the final report under Article 8 of Taxonomy Regulation for considering the development of a common methodology for estimating the share of Taxonomy-aligned activities in different economic sectors. We note, however, that the Commission did not follow this suggestion in the draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021. On the contrary, it seems that the proposal currently on the table allows only calculation of Taxonomy quota on the basis of information reported directly by EU companies and that voluntary disclosures by non-EU undertakings could be taken into account from 2025 on at the earliest. The use of estimated figures appears to be generally not admitted. This approach will obviously further narrow down the proportion of portfolio assets that could be disclosed as Taxonomy-aligned due to the lack of reported data and impossibility to account for Taxonomy-aligned activities in investments outside the EU. In a global ESG portfolio the share of Taxonomy-aligned assets will thus remain negligible in the next years.

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?

In our view, **operational expenditure with regard to Taxonomy-aligned economic activities should not be treated as a basis for assessing the overall taxonomy alignment of investments**. If at all, it can only provide supplementary information on the extent of the running expenses spent in the context of environmentally sustainable activities that could be disclosed as an additional KPI on a voluntary basis.

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 agree with including contracts for difference in the scope of assets eligible for assessment against the EU Taxonomy. In addition, we would deem it **reasonable to include in the calculation the so-called participation certificates, i.e. derivatives or structured notes that strictly track the performance of their respective underlying asset**. Such underlying assets can be indexes or baskets, but also shares of individual companies. In some emerging markets without sufficient liquidity, such participation certificates are the primary way of investing for European asset managers.

Of course, eligibility of participation certificates should depend on the underlying assets and should be considered only for derivatives that track the performance of equity (or debt) instruments issued by financial or non-financial undertakings or real estate assets.

Moreover, for the avoidance of doubt, it should be clarified that investments in real estate assets comprise both direct holdings and indirect investments, especially by holding companies, special purpose vehicles or real estate investment trusts.

The draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021 explicitly excludes derivatives from the numerator of any KPI that shall be reported by financial undertakings under the EU Taxonomy. While not supporting this sweeping exclusion, we believe that the calculation methodology for the proportion of Taxonomy-aligned investments must be fully consistent at both product and entity levels. In the end, therefore, a uniform approach to the treatment of derivatives should be adopted under both Level 2 measures.

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?

In our view, the use of the terms "equities" and "debt instruments" is sufficiently clear per se. What remains to be clarified, however, is the question of whether the calculations under Art. 16b (1) of the draft RTS shall comprise all direct and indirect investments in equity or debt instruments issued by investee companies. In our view, **consideration of indirect investments would be appropriate in order to provide for a complete picture of environmentally sustainable activities** to which financing a product is contributing. Such indirect investments should comprise target funds and participation derivatives that strictly track the performance of the underlying assets (for further details on the latter, cf. our reply to Q4 above). Also here, consistency with the treatment of indirect investments in the draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021 should be sought.

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 de-nominator for the KPI?

We consider the approach chosen by the ESAs appropriate to the information needs and capacities of especially retail investors. A possible alternative approach whereby the denominator would be limited to the eligible assets only would run the risk of being misunderstood by investors in the sense of overstating the proportion of Taxonomy-aligned investments in a product. We note, however, that the draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021 explicitly excludes any exposures to central governments and central banks from both the numerator and the denominator of Taxonomy-related KPIs. For the sake of consistency as regards disclosures of Taxonomy-aligned proportions of investments at both company and product levels, treatment of sovereign bonds for the purpose of KPI calculations should be fully aligned under both Level 2 measures.

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 disagree with the assumption underlying the respective proposals in the draft RTS **that an external review of the Taxonomy compliance statement by a third party should be considered an additional quality feature**. The EU Taxonomy framework is a very complex piece of regulation that will require substantial research and/or purchase of data from commercial vendors in order to become applicable to an investment portfolio. It is questionable whether external verifiers such as auditors are better placed for assessing or reviewing the Taxonomy-based calculations than the product provider itself who needs to work with the Taxonomy criteria on the daily basis in order to meet and monitor the respective commitments in terms of share of Taxonomy-aligned investments. The regular auditing firms have so far no practical experience with application of the EU Taxonomy. Therefore, the added value of an external verification would be rather limited and would only produce additional costs that would be ultimately borne by the end-investors. In addition, in-depth verification of the underlying calculation would require access to the same data sources that would raise significant licencing issues and render external verification hardly practicable.

Against this background, the **prominent statement suggested by the ESAs as to whether or not an external review has taken place should be deleted from the standardised templates for pre-contractual information**.

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

In our view, it makes a lot of sense to report on the share of Taxonomy-aligned investments in periodic reports in a manner that mirrors the disclosures in pre-contractual documents. We also believe that the requirement for periodic reporting against the Taxonomy criteria should apply only to products that make dedicated commitments for minimum sustainable investments in line with the Taxonomy.

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

Given that the amended templates are at least in parts relevant for all Art. 8 and 9 products according to SFDR, the timing issue is becoming critical. It is crucial that the **final standardised templates for**

pre-contractual and periodic information comprising disclosure details in relation to both SFDR and EU Taxonomy must be published as soon as possible. It should be clear that without final specifications, technical implementation of the annexes is not possible. Fund managers face an additional challenge in terms of timing given that funds are often used as investment options for mulit-option products such as unit-linked insurance products or personal pensions. Insurers and pension providers will thus likely require provision of ESG annexes for investment funds in good time before 1 January 2022 in order to integrate them in the pre-contractual information at the level of the multi-option product.

In terms of content of the amended pre-contractual and periodic templates, we would like to point out the following:

- **Disclosure of Taxonomy-aligned proportion of investments in a portfolio should be based on one common, turnover-related KPI, with further indicators based especially on CapEx being provided as supplementary information on an optional basis**. Otherwise, we fear that the differences between disclosures based on e.g. turnover and CapEx will not be properly understood by the vast majority of especially retail investors. Generally, investors will tend to pay little attention to the accompanying explanations and compare the disclosed ratios, even more if such ratios are visualised by a pie chart in a uniform manner. However, the Taxonomy-aligned ratios will convey totally different information depending on their reference base. Given that turnover-based ratios cannot be compared, or even related to, calculations based on CapEx or OpEx, we see the clear need to provide for one common Taxonomy-related KPI to investors. Such KPI should be based on the turnover, firstly in view of the current data environment (most ESG data providers focus on turnover-related data offerings), but secondly given the fact that proportion of Taxonomy-related turnover provides the most relevant indication about the extent of green activities in a company.

- On the other hand, we definitely see **added value in providing investors with additional information especially on Taxonomy-related CapEx** in certain circumstances. CapEx-based indicators will be particularly relevant for funds and other products that invest in transition with the objective of improving the environmental performance of companies and guiding them towards expanding environmentally sustainable business activities. In such products, the turnover-based Taxonomy ratio will be typically rather low and the sustainability performance should be measured with a particular focus on CapEx figures. Therefore, it is important that such products are allowed to disclose additional KPI(s) in order to provide investors with a full picture as regards the attainment of their sustainability-related investment strategy.

- An alternative option would be to use an **indicator integrating both turnover and CapEx elements in one integrated calculation approach** as proposed by the JRC for calculating the Taxonomy-relevant portfolio shares under the EU Ecolabel. The calculation formula is included in the fourth proposal of criterion 1 that has been tabled by the JRC in the Technical Report 4.0 on Development of EU Ecolabel criteria for retail financial products in March 2021 and allows for a **comprehensive picture of alignment with the EU Taxonomy that comprises both turnover and CapEx dimensions**.

- **We doubt that it will be practicable** for products committing to a certain share of sustainable investments in line with the Taxonomy **to specify minimum proportions of transitional and enabling activities in the pre-contractual documents**. Commitment to a minimum share of Taxonomy-aligned investments that will need to be met and monitored on a continuous basis is a challenge in itself and the fewest products will be able to make commitments on a more granular level. Therefore, we would expect that it is **possible to disclose a zero minimum share of transitional and enabling activities in the pre-contractual documents and to explain** to investors that this is simply due to the lack of feasibility to make binding commitments, but **that the actual share of investments in transitional and enabling activities will be disclosed in the periodic report**. It would be very helpful if the ESAs confirmed the possibility of such approach, e.g. in the feedback statement to the consultation.

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 support the ESAs' approach to develop unified pre-contractual and periodic templates for all products falling under Art. 8 and 9 SFDR. As suggested in the consultation paper, the section specifying the share of sustainable investments aligned/not aligned with the EU Taxonomy should be included only if relevant for the specific product.

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?

Yes, we agree with including a specific section on the share of sustainable investments that are not aligned with the EU-Taxonomy. In fact, in the current early stage of the EU Taxonomy development this section will be relevant also for most Article 8 or 9 products with environmental objectives, given the limited possibility to identify Taxonomy-aligned investment opportunities. The likely scenario will be therefore that products committing to invest in environmentally sustainable activities will do this only in part on the basis of the Taxonomy criteria and in part based on other metrics and thus, will need to include both sections on the minimum share of investments (aligned/not-aligned with the EU Taxonomy) in the pre-contractual and periodic disclosures.

It should be clear that the draft Delegated Regulation under Art. 8 of Taxonomy Regulation published on 7 May 2021 further aggravates this situation, firstly by delaying reporting of specific Taxonomy-related KPIs that could be used for identification of Taxonomy-aligned investments to 2023, secondly by not admitting consideration of Taxonomy-aligned investments in non-EU companies or effectively any companies not subject to NFRD reporting until 2025. In the meantime, the share of Taxonomy-aligned assets that could be identified in a global ESG portfolio will remain negligible. **Moreover, before 2023 no product will be able to assess the likely share of Taxonomy-aligned investments that are in line with its investment strategy in order to make firm commitments as regards their minimum proportion to investors. This also means that by the expected time of entry into force of the new provisions on sustainability preferences under MiFID II and IDD, there will be no products that offer investors a minimum proportion of investments in line with the EU Taxonomy according to**

Art. 2 (7)(a) of MiFID II Delegated Regulation and Art. 2 (4)(a) of IDD Delegated Regulation to be amended in line with the Commission's proposal from 21 April 2021.

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

Assessment of investments against the EU Taxonomy will inevitably require purchase of the relevant data from commercial data vendors at least in the first years of application, i.e. until the European Single Access Point becomes operational. Given that Taxonomy-related company data is scarce and will entail bilateral requests for information or substantial research, ESG data providers demand considerable surcharges for their Taxonomy-related data services.