OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

Advice on Taxonomy-related sustainability disclosures

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INTRODUCTION

The OPSG supports the ESAs' proposed approach to amend the existing SFDR RTS as this will achieve consistency across legislation and help avoid overlaps. In this respect, there are some challenges that the ESAs should consider in their draft RTS:

1. Timing:
   Since the Taxonomy-related product disclosures come with amendments to the regulatory technical standards (RTS) of the Sustainable Finance Disclosure Regulation (SFDR), this risks delaying the finalisation of the product disclosures, which are due for application on 1 January 2022. Therefore, the TR RTS should make only essential changes to the SFDR RTS and consider potential safeguards – similar to what the ESAs already suggested in their supervisory statement on the SFDR - in case the final RTS are not adopted sufficiently early to enable FMP to implement the RTS.

   As companies begin to report their Taxonomy alignment only in 2022, the periodic disclosures level 2 requirements should enter into application in 2023. Investors do not have the data available for periodic disclosures yet in 2022.

   If a postponement of the entry into force and application of the RTS is not plausible/possible, there should at least a flexible and more principle-based approach in the early stage.

2. Content:

   a. While an alignment of Taxonomy-related disclosures with those under the SFDR is appreciated, the final templates risk being very long and overly detailed for customers. Therefore, care should be taken to only introduce essential changes in the RTS, while allowing for a broad use of references in the mandatory templates.

   b. The ESAs could provide examples of how to apply the disclosures to real products, as there is need for guidance on the specific Taxonomy indicators (i.e. for using Turnover, Capex, Opex) and the link with the ESAs work on Article 8 of the Taxonomy.

   c. Only eligible total investments should be considered as not all investments are in scope of the Taxonomy. Not doing so comes with a risk of confusing customers with respect to product types and related risks (for example, equity funds versus guaranteed products).

3. ESG data/information: it is key that new product-level disclosures are realistic and adequately consider existing issues with providing meaningful Taxonomy-related disclosures. This is key especially because the final Taxonomy screening criteria are not available yet, in turn making the collection of required ESG data even more challenging.

   In the absence of mandatory reporting financial market participants need to request from investee companies that they disclose on relevant KPIs, for instance through existing mechanisms such as CDP. In recent years US companies have acquired ESG rating agencies. There is a risk that European financial market players will have a competitive disadvantage due to the costs involved in applying the Taxonomy. The creation of a European non-financial data repository could help but an international cooperation would be more efficient in the long term.

Question 1: 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?

The OPSG supports the approach to amend the existing SFRD RTS to minimize duplication and complexity in this area, to define a single rulebook on sustainability disclosures and clarify certain aspects of the first ESAs proposal as well.

As much convergence as possible is needed in the methods, definitions, and the use of the "green asset ratio" under Article 8 of the Taxonomy Regulation and SFDR RTS.

However, more attention should be paid to the timeline and coordination of work between the ESAs and the Commission.

We are concerned that ESA´s report under Taxonomy-related product disclosure, amending the existing SFDR RTS, will be finalised only after the Commission´s endorsement of SFDR RTS submitted by ESAs in February. Therefore, the ESAs should work with the Commission in ensuring that the technical standards are endorsed as a single rulebook instead of producing two separate sets of rules.

The choice of the ESAs has an impact on the overall timetable expected for the finalization of the delegated acts envisaged by Regulation (EU) 2019/2088. As the ESAs themselves recognize, they were not able to start the work on the amendments to the RTS until beginning 2021 and the delay will impact the release of the RTS. Financial entities would not have sufficient time to comply with the new requirements, given that the ESAs expect to issue a final report with the amended RTS at the latest by early July 2021, the revised RTS will then be subjected to the scrutiny of the EU institutions and the delegated regulation is planned to apply form 1 January 2022. The concerns raised by the compressed timetable match with those triggered by the lack of information to feed the disclosure as the work on Taxonomy is still under way and when finalized it will take some time for companies to comply with

A compressed timetable and lack of reliable information, at least in the first stage, are problematic for all financial entities, especially for IORPs. Occupational pension schemes are usually small entities which rely on a very restricted staff and small budgets: the compliance to the RTS in a squeezed time would be too burdensome. The new ESG product templates are likely going to be available only shortly before their date of application and they are not need-based, nor easy to understand for customers. The data quality and availability are also particularly challenging for the Taxonomy-related disclosures.

In context of the operational implementation challenges relating to the Taxonomy green asset ratio disclosures by financial undertakings, the OPSG therefore would recommend a transitional, best-effort approach in the first year of the application of the Taxonomy Regulation.

Such a transitional period would also help investors address the uncertainties related to the calculation of green asset ratios caused by the lacking availability of ESG company disclosures, non-availability of data against the Taxonomy DNSH and overreliance on sector-based coefficient methodology developed by the JRC.

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?

OPSG agrees that a share of investments as a ratio of eligible assets that are Taxonomy aligned is an appropriate indicator. The choice of indicators should be aligned with the forthcoming Delegated Act under Article 8 of the Taxonomy Regulation, which will determine the calculation methods, eligible assets in the denominators, and the role of Capex in deriving the green asset ratio of financial undertakings.

While the same approach would help comparisons, it does not account for differences in data availability and type of economic activities. Depending on the type of investment, Taxonomy-aligned Turnover, capital expenditure or operational expenditure might be more suitable. A unique method should not be imposed, and each financial market participant should be able to consider the most suitable KPI for each activity/investment in a non-financial undertaking investee company.

Focusing on the application to all investments, it is also key to ensure consistency with the Level 2 legislation related to Article 8 of the TR. The ESAs should focus on investments which are in the scope of the Taxonomy and exclude those which are strictly non-eligible under the Taxonomy. This is key to avoid putting some products at a competitive disadvantage with respect to others and avoiding confusion to customers, who will have disclosures on 1) sustainable investments, 2) a share of environmentally sustainable investments and 3) a sub-share of Taxonomy-environmental investments. Given this complexity, the graphical representation in the SFDR templates also creates significant issue in terms of comparability between different types of characteristics or objectives, as previously acknowledged by the ESAs themselves in their Final Report on draft RTS (page 144).

At the same time, it is crucial to ensure consistency in the disclosures among different Taxonomy-related initiatives, including the EU Ecolabel for financial products. The proposed calculation method is not consistent with the latest proposal method in relation to the EU Ecolabel for financial products. It is essential for both calculations to be consistent to not create an additional administrative burden producing different %'s – one for SFDR Taxonomy product disclosures and one for the EU Ecolabel.

Therefore, one indicator to be applied to all investments should not be imposed. Financial undertakings should have the possibility to use the indicator (Turnover vs. Capex), which seems most relevant. In an ideal situation, Capex would be used for companies in transition and Turnover for companies achieving higher revenue alignment.

In the current data environment, the Turnover is probably the most relevant indicator. However, subject to the Article 8 DA and its possible provisions on the standardisation of company decarbonisation plans making the activities in question Taxonomy aligned within a given timeframe, Capex could become a metric with an equal footing as the Turnover indicator.

Capex is a crucial metric because it reflects new, incremental green investments in the economy, filling the existing investment gap, which is especially relevant to companies in transition. In this context, the Consultation Paper should take into account the recent recommendations of the Platform on Sustainable Finance on forward-looking metrics to be published by companies. I agree with the papers´ recommendation that product developers can choose whether to weigh a company in a fund portfolio based on the share of Taxonomy-aligned Turnover, or the Taxonomy-aligned Capex.

Choosing the Turnover as the only relevant indicator would also run contrary to the TEG Final Report, which stated that revenue cannot be counted towards climate adaptation, as this is a continuing process, and is not consistent with the latest proposal method in relation to the EU Ecolabel for financial products.

We would also like to highlight a major challenge regarding ex-ante pre-contractual disclosure if Turnover is to be used. Turnover is a past indicator, not a forward-looking one. A portfolio manager will not be able to take a decision to invest/reinforce/divest from a company, thanks to the Turnover that will be communicated by companies. Our main fear is to write a minimum threshold of indicator in the pre-contractual documentation, i.e. to commit to a minimum threshold, which could hardly be controlled.

Nonetheless, use of Capex might introduce heterogeneity issues to the data summed in the numerator of the ratio. To avoid the risk of greenwashing, the use of forward-looking Capex should be encouraged only if the Article 8 DA introduces measures enhancing the reliability and comparability of company decarbonisation plans.

For IORPs with a relevant share of investments in mutual funds, following a proportionality approach, some minimum thresholds could be useful under which this kind of investments should not be considered in the computation of the KPI. In any case, it should be up to the fund manager to provide the IORP with the KPI of the fund in which the IORP would invest.

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?

Even if its usage might be less frequent than Turnover and capital expenditure (Capex), it should be possible to use operational expenditure (Opex) as an additional indicator, as this is envisaged in the work taken so far on the Taxonomy screening criteria. Its inclusion will allow to consider all economic activities whose contribution is measured through the Opex indicator.

The disclosure and availability of the Opex indicator by economic activities is not uniform and comes with several accounting challenges for non-financial undertakings. The inclusion of mandatory Opex disclosure would be disproportionate also to the original Taxonomy regulatory text, which rightly considered “Capex and, if relevant, Opex”. The rationale behind “if relevant” was to allow for including operational expenditures inherently linked to a project. In this context, a general requirement to report on all Opex, albeit well intentioned, would constitute an insurmountable barrier for companies given the extremely high accounting difficulties to allocate operational expenditures to NACE codes and to adjust internal accounts to such a classification. Therefore reverting to the original text: “Capex and, if/when relevant Opex” is recommended, which will ensure its inclusion at the project financing level where and when it is appropriate and meaningful.

Question 4: 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?

Ideally all asset categories should if possible be included in a comprehensive KPI. While derivatives are also a type of investment carrying their benefits and risks, and thus should be included, this would increase the already high level of complexity of the KPI formula. Given the current challenges, it is premature to include derivatives in the scope of the indicators. There is no significant added value for customers, while strong guidance and methodology on how to consider them are lacking. Therefore, it would be better to exclude derivatives for the time being.

Considering the large scope of derivatives (future, forwards, options, Total Return Swaps, convertible bonds etc.), the nature of their underlying (indices, interest rates, securities, currencies, cash etc.), purpose (strategic vs. tactical) and their potential usage (exposure, hedging, arbitrage), answering this question is not straightforward. The market would need guidance on how to treat derivatives before including it in the KPIs.

Given the complexity of derivative financial instruments, their potential inclusion in the green asset ratio could raise several technical questions and lead to disproportionate reporting requirements (leverage or short positions, full exposure or residual exposure or delta equivalent exposure, collateral received or posted, etc.). The relevance of derivatives in KPI calculation must be assessed instrument by instrument. For example, for futures, calculation of the MSCI ACWI would require decomposing it into 3,000 constituents, measuring each one at the respective weighting, and building it back up again. Logistically, this would be very difficult for market participants and overly complicated, especially with regards to estimating the underlying data.

If derivatives are to be excluded, the definition should also include CFDs. In many geographies, notably the UK, investors commonly use CFDs to simply avoid stamp duty.

Moreover, for IORP’s the use of derivatives is limited; derivatives are mainly used for hedging purposes and not to get a return. For these reasons, the KPI should only be limited to equity and debt instruments, though which IORPs take a direct exposure on the financial and non-financial undertakings.

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?

The use of "equities" and "debt instruments" seems sufficiently clear to capture relevant instruments issued, as even more complex investment products (Alternative Investments, Loan portfolios, Infrastructure) could be split up into these two categories.

In terms of valuation, a market value approach is probably the most suitable and efficient in terms of implementation by financial market participants.

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?

The disclosures should exclude from the denominator all assets that cannot be assessed for Taxonomy-alignment. These disclosures will provide a better comparability across products in line with the Taxonomy objectives. In fact, as per Recital 13 of the Taxonomy Regulation (TR), the disclosures aim to provide a clear understanding of the extent to which the financial products invest in activities that meet the criteria for environmentally sustainable economic activities under the TR, so that investors can compare investment opportunities across borders and make their business models more environmentally sustainable.

Considering the inclusion of the Taxonomy disclosures in the SFDR templates, as a subset of sustainable investments that are Taxonomy-related, it would be more logical to focus only on those investments - underlying the financial product - that take into account the EU criteria for environmentally sustainable economic activities.

From a logical perspective the ratio should be computed only between fully comparable sets of data, to have a clear measure of the share of Taxonomy-aligned investments held by the financial product. Additionally, for financial products largely invested in sovereign bonds, as is the case of IORPs, the criterion proposed in the draft RTS seems penalizing, as they would appear not very much Taxonomy-aligned financial products. This is far from reality, which see IORPs, as main characters of the ESG market. Considering the government bonds for the purpose of the KPI would reflect a misleading picture of the portfolios of financial products issued by IORPs as a poor pro-environment investor. It could cause pressure on the board of the occupational pension schemes to change the asset allocation of their investments in a direction not fully aligned to the interests of members/beneficiaries, while the IORP2 directive requests the occupational pension schemes to invest their assets on a prudent basis, taking into account the interests of the members/beneficiaries.

While there are good reasons to include sovereign bonds and investments that cannot be assessed for Taxonomy-alignment in the denominator, it would be wise to exclude them and disclose the total investment figure and the percentage of assets that are not eligible for Taxonomy assessment separately.

This would provide sufficient transparency about the overall product composition and avoid that the proposed ratio:

- misleads customers about the comparability of different products in scope of the SFDR (for example, in terms of risk level) and
- penalises products with better diversification (which are likely to invest in assets outside the Taxonomy scope, such as sovereign bonds) as it will highly dilute the percentage of alignment with the Taxonomy.

Nonetheless, should the EU Green Bond Standard develop an objective and science proven methodology for sovereign bond compliance with EU GBS, then these bonds should be calculated towards the numerators and denominator of the green asset ratio for the share of their earmarked, Taxonomy-aligned projects. Sovereign green bond issues for earmarked projects aligned with the Taxonomy should also apply, even if not compliant with the EU GBS. This would also encourage the participation of sovereigns in green bond issuance.

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?

The proposal on a statement of Taxonomy compliance is understandable in terms of transparency and makes sense, but an external or third-party assessment should not be mandatory, because this would be costly requirement. A self-certification disclosure mechanism is appropriate at this stage.

There is a risk that customers proxy the assessment by an external provider as a guarantee of better disclosures, which is not necessarily the case for such high-level statement.

It is not clear exactly what is understood with an external or third-party assessment and what level of assurance this could provide to the consumer on Taxonomy compliance. It will most likely have to be carried out by a consultancy or a rating agency and will add extra costs to the relevant products, which in case of an IORP must be borne by the beneficiaries and/or the sponsor companies – both being counterproductive to strengthening the occupational pensions. Such extra costs could discourage IORPs from promoting article 8 or 9 products.

In many cases the assets of a financial product issued by an IORP are invested through an asset manager, an insurance company, an investment company etc based on an agreement in which the investment policy that has to be followed is clearly defined. In these cases, a declaration provided by the subject in charge of the investment should be accepted as a third-party declaration.

Moreover, this question relates also to the upcoming revision of the Non-Financial Reporting Directive (NFRD). According to the 2020 public consultation on the matter, the EU could impose stronger audit requirements for non-financial information in the revised NFRD. If the revised NFRD were to introduce stronger audit requirements, and financial market participants use the data published by non-financial investee companies in their non-financial reporting under Art. 8 of the Taxonomy Regulation, the information collected will benefit from better assurance, resulting in increased data quality and more trustworthy disclosures by financial undertakings as users of this information.

In the long run, with the revised NFRD in place, and with a maturing market for Taxonomy aligned investments, methodologies for such verifications will probably be developed to support the credibility of green products.

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

It makes sense to mirror the pre-contractual disclosures as laid down in the proposed RTS for the periodic disclosures, as it is important to ensure coherence with the structure of the SFDR RTS. The mirroring will simplify requirements for financial entities and will make it easier for consumers to understand their chosen product in terms of sustainability.

However, certain sections of the reporting documents are not necessary, mainly because they are merely a duplication of the content of the pre-contractual document. For ease of reading and for keeping the spirit of a reporting document, it would be better not to add too much information and not include the following headings:

- “Environmental and/or social characteristics.”
- “What methodology was used for the calculation of the alignment with the EU Taxonomy and why?”
- “Why did the financial product invest in economic activities that are not environmentally sustainable?”

- “How does the reference benchmark differ from a broad market index?”

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

Pre-contractual and periodic templates should be as simple as possible to give members/beneficiaries of financial products issued by IORPs the opportunity to access a fair and truly understandable information. The templates provided to the EU Commission on February 4th were already complex and too long. Jargon, definitions and abbreviations were especially singled out in a recent survey performed by AFM in September 2020 “Consumer testing pre-contractual and periodic ESG financial product information” and many respondents also doubted whether they as consumers were the target audience.

The information disclosure for individual investors must be at all times clear (in the MiFID sense, i.e. intelligible), simple, short and concise, avoiding jargon and comparable, especially as they are only a small part of customers’ disclosures. The current proposals might be overwhelming for retail customers and not help them compare products. Unfortunately, the SFDR does not consider a proportionality approach for different financial entities. Changes to the RTS following this consultation phase, should be as limited as possible and not to further complicate the templates. This would be useful both in terms of clear and adequate disclosure to members/beneficiaries of IORP’s and to ease the compliance by IORPs and other financial entities.

A better consultation process and earlier consumer testing could have helped the ESAs to propose more advanced draft RTS with clearer options and methodologies (e.g., on the KPIs, the scope of disclosures, etc). Unfortunately, due to the timing constraints, the ESAs will have only limited time to account for the input from the public consultation and the findings of the consumer testing, which means suboptimal proposals to be sent to the EC likely for implementation.

Preliminary voluntary implementation of the currently available templates by some financial market participants already shows that a pre-contractual document for a single product results in several pages of disclosures. This excessive length also makes the digital accessibility of the templates problematic and ends up overwhelming consumers who are looking for key non-financial information. It is therefore key that only minimal essential changes are introduced, while allowing the use of references and considering simplification of proposals.

The inclusion of the graphical representation is welcome since it could help individual investors to easily understand the sustainable features of the product as long as the same format of graphical representation is used for the same product category.

The main unclarities are linked to interpretations of how to disclose the underlying information. In relation to the disclosed proportion of Taxonomy aligned investments, it is still unclear whether it shall be seen as a minimum proportion of the underlying investment or an expected average. There is also a challenge of how to disclose the underlying data from the investors if the Taxonomy alignment is based on Turnover, Opex or Capex.

As specific issues, the ESAs could consider the opportunity to provide more clarity on the annex for pre-contractual and periodic reporting for the case in which a product has two or more sustainable investment options qualifying as a financial product referred to Art. 8 and Art. 9 of Regulation 2019/2088. It is not clear if there should be an annex for any investment option qualifying for Art. 8 and Art. 9 or a single annex for all the investment options qualifying for Art. 8 and Art.9. Moreover, as regards art. 63 and 69 of the RTS further clarification could be provided on how to compare the performance of the product with the other indexes requested.

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?

The option to use unified templates appears to be the most logical way forward as a separation of pre-contractual and periodic templates for Article 5-6 TR products would be confusing for customers and not efficient in the long run. Using the same template would maximise the comparability of the information provided, and therefore usefulness of the documents for the investors.

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?

Sustainable development is not possible without achieving both social and environmental goals. To give the consumer a holistic view of how sustainable a product is, it makes sense to include green Taxonomy disclosure for a product with social objectives and vice versa. This will facilitate the evaluation and comparison of investments.

However, it will also increase the complexity of the disclosure and the reporting burden. Furthermore, an objective and science-based “social Taxonomy” has yet to be developed. In the meantime, a simple reference to the social objectives of the investments could be useful.

While waiting for such potential Social Taxonomy, a product should be able to claim a social objective in a positive way, and not only in opposition to an Environmental Taxonomy. A product that does not comply with the EU Taxonomy alignment should be able to explain it fully and extensively in these templates.

For a product that has a social (not environmental) objective, it could be misleading to include in the pre-contractual information the percentage of assets that will be aligned with the green Taxonomy, as the product does not have a defined environmental objective.

To simplify information provided to customers, products making sustainable investments with social objectives/characteristics could be exempted from indicating the share of Taxonomy-eligible investments in the templates.

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?

In order to better assess the impact of their proposal while providing implementation guidance, it would be useful that the ESAs make use of examples of real products in the application of their disclosure proposals. This would provide a good indication of the effort required to provide the disclosures, for example how to disclose about eligible total investments in scope of the Taxonomy, as well as the feasibility and meaning about proposed KPIs.

Finally, it appears that the new product-level disclosures do not sufficiently factor in the current situation in terms of existing issues with ESG data and very much rely on expectations about such information. In this respect, it is key that proposals remain realistic and adequately consider the timing of related Taxonomy-related developments, such as for the final Taxonomy screening criteria.