Schroders

# JOINT CONSULTATION ON TAXONOMY-RELATED SUSTAINABILITY DISCLOSURES

## Response by Schroders Investment Management (Europe) SA

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**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 ?**

We welcome the approach taken by the ESAs to consolidate the previously published draft SFDR RTS and the draft RTS on taxonomy-related disclosures. Producing one set of requirements appears reasonable and will facilitate implementation.

However, we note that there are still areas where the RTS based on SFDR and those based on the Taxonomy Regulation lack consistency, in particular as regards DNSH, although it doesn't make sense (and is certainly not understandable by clients) to differentiate or to draw up different templates for funds focusing on environmental or social objectives.

We appreciate that the ESAs acknowledge the staggered timelines as regards the different sets of taxonomy screening criteria for environmental objectives. However, we understand from the recent public hearing by the ESAs that this doesn't solve the issue of what to disclose for those objectives without screening criteria, possibly having to disclose 0% taxonomy alignment. We are concerned that this would mislead investors as well as heavily discriminate against certain sustainable funds qualifying under Art. 8/9 SFDR (and also meeting the recently published definition of "sustainability preference").

Finally, it is yet unclear whether the European Commission will follow the approach of a "single rulebook" proposed by the ESAs. We would therefore urge the ESAs to advocate for a similar approach at the Commission and, in case the European Commission decides for a staggered approach, to coordinate a "no enforcement"/transition period until all technical standards are available.

**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?**

The KPI definition to measure the extent of taxonomy alignment is sensible in our view.

We note that turnover is the only practical indicator currently possible in most situations, given limited data disclosure at other financial line items. (Indeed, more progress will be needed to allow robust turnover analysis). We also note that capex provides a more forward looking view of companies' intentions and direction of travel, which will be appropriate in cases where companies are undergoing business transitions to realign their product portfolios toward greener activities.

However, requiring that all instruments in a given product apply the same approach is unhelpful in our view; the decision to use capex or turnover can be determined on a company by company basis (in most cases, where companies' exposures are not changing materially, the figures should be similar), which would alleviate challenges of data availability, where capex data might be available for some companies in transition but not others. Financial institutions should have the ability to select the most appropriate approach for each company, potentially varying within a portfolio.

**3. Do you have any views on the benefits and drawbacks of including specifically operational expenditure of underlying non-financial investee companies as one of the possible ways to calculate the KPI referred to in question 2?**

The use of operating expenditure (OpEx) will be useful in a small number of cases where companies have low turnover or CapEx (for example start up technology-based companies or in the cases of projects for which revenues are not attributable) and where neither turnover nor capex will be possible measures.

However, that situation is rare and OpEx is challenging to dissect along product category lines; where companies do so, disclosure is often inconsistent. While the flexibility to apply the OpEx approach on a case-by-case basis may be useful, its use is likely to be rare and its interpretation inconsistent across companies.

As a result, while we consider that the option to apply OpEx measures will be useful in some cases, it should be presented as an option for securities where other options are not possible.

**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 ?**

Including derivatives in the KPI would create significant practical challenges in their incorporation and likely inconsistencies in their treatment. For example, derivatives can provide significant economic exposure in excess of the amount invested, which challenge can be overcome through clearer guidance on their treatment.

Beyond those practical challenges, we note that derivatives are often based on broad indices (such as the S&P 500 or global benchmarks). Examining the exposures of all constituents of those indices in order to calculate the exposure of the associated derivative would be very onerous.

As a result, we consider it appropriate to exclude derivatives from the scope of KPI calculations at this point.

**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?**

We consider the use of those terms – equity and debt instruments – to be sufficiently clear. Some securities could be interpreted to span those categories (for example convertible bonds) but this ought not affect their treatment in calculations in any case.

**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 ?**

We do not consider that investments such as sovereign bonds that cannot be assessed for taxonomy alignment should be included in the denominator of the KPI. While there are data and methodological challenges to their analysis, those instruments can provide capital to support environmental or social goals and their inclusion with effectively zero contribution is likely to be misleading in our view. As a result we consider that those securities should be excluded from denominator calculations.

We recognize that a portfolio comprising largely sovereign bonds and a small exposure to eligible securities risks becoming misleading (for example a fund assessment could be based on a small proportion of that portfolio comprising eligible securities). As a result, we propose that a fund assessment should only be produced where a minimum proportion (for example 70%) of the portfolio comprises eligible securities.

**7. Do you have any views on the statement of taxonomy compliance of the activities the financial product invests in and whether those statements should be subject to assessment by external or third parties ?**

We strongly believe that there is no need for third party input to establish compliance and this would create an overly burdensome additional layer of administration as well as unnecessary costs. It is not clear to us why compliance with this particular obligation requires third party assessment while the vast amount of other obligations (be it in the context of SFDR or other requirements not related to ESG) can do without external assurance. Also, the proposal on a Corporate Sustainability Reporting Directive by the European Commission foresees third party assurance at company level. An assessment by a third party at the investment level would therefore duplicate the assurance of practically the same content.

We understand that the ESAs base their proposal on the obligation to disclose “how” investments are made so that they qualify as environmentally sustainable. However, we don’t believe that third party assessment is a logical answer to this requirement and why this would be preferable to a e.g. qualitative explanatory statement.

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

While we can generally agree with an approach that works hand in hand with pre-contractual disclosures, we are concerned that certain elements risk duplication and don’t add value, in particular sections on “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?” and “How does the reference benchmark differ from a broad market index?”. We would therefore suggest to delete the latter categories.

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

We welcome the introduction of standardised templates as this will both improve transparency and allow for comparability between different providers. We are, however, concerned by the length of the disclosures and some of the detail required, especially when compared to existing documents such as the KIID.

One challenge relates to the availability of data to disclose the proportion of Taxonomy aligned investments. This lack of data means less meaningful comparison and may also be misinterpreted by end investors for both funds with environmental objectives but also those with e.g. social objectives which would possibly need to disclose 0% taxonomy alignment until a social taxonomy is adopted. This would mislead investors and heavily discriminate against funds with social objectives. managers not taking the Taxonomy objectives into account.

We would therefore prefer a more qualitative approach to the disclosures. A more quantitative approach could be adopted over time.

**10. The draft RTS propose unified pre-contractual and periodic templates applicable to all Article 8and 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 ?**

For the sake of clarity/easier reading for investors (particularly retail investors) we believe it would be better to provide one single template but with an extra section dedicated to taxonomy disclosures in case a product qualifies under Art. 5/6 TR.

**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 envir onmental 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?**

It is unclear why such additional disclosure is necessary given the strict criteria in SFDR for social funds: Products with social objectives need to meet the test outlined in Art. 2(17) SFDR (and meet the definition of "sustainability preferences" as recently published). Also, lacking any social taxonomy screening criteria, such funds would possibly need to disclose 0% taxonomy alignment. This would mislead investors and heavily discriminate against funds with social objectives. Finally, it appears that a requirement as proposed in the question would go beyond the level 1 text of SFDR and TR.

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

We highlight that the new requirements under both SFDR and the Taxonomy Regulation considerably increase the burden on asset managers. In certain areas this will lead to considerable cost, for example, we have invested heavily in data and building proprietary tools to assess sustainability risks. These significant investments should not be done in vain by imposing an overly rigid, "monochrome" methodology through regulation, not in the least because integration of sustainability is still a developing area and there's currently not one "silver bullet" approach.

Existing data will in most cases will not suffice to e.g. support the calculation of taxonomy alignment. Data will therefore need to be purchased from external vendors.

Any additional costs by e.g. third party assessments should therefore be avoided.