

Response form for the Joint Consultation Paper concerning Taxonomy-related sustainability disclo- sures





Responding to this paper

The European Supervisory Authorities (ESAs) welcome comments on this consultation paper setting out the proposed Regulatory Technical Standards (hereinafter “RTS”) on content and presentation of disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088 (hereinafter Sustainable Finance Disclosure Regulation “SFDR”) and in particular on the specific questions summarised in Section 3 of the consultation paper under “Questions to stakeholders”.

Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives the ESAs should consider.

When describing alternative approaches the ESAs encourage stakeholders to consider how the approach would achieve the aims of SFDR.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in the present response form.
- Please do not remove tags of the type <ESA_QUESTION_ESG_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- When you have drafted your response, name your response form according to the following convention: ESA_ESG_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESA_ESG_ABCD_RESPONSEFORM.
- The consultation paper is available on the websites of the three ESAs and the Joint Committee. Comments on this consultation paper can be sent using the response form, via the [ESMA website](#) under the heading ‘Your input - Consultations’ by 12 May 2021.
- Contributions not provided in the template for comments, or after the deadline will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESAs rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESAs Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the ESAs is based on Regulation (EU) 2018/1725¹. Further information on data protection can be found under the [Legal notice](#) section of the EBA website and under the [Legal notice](#) section of the EIOPA website and under the [Legal notice](#) section of the ESMA website.

¹ Regulation (EU) 2018/1725 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC, OJ L 295, 21.11.2018, p. 39.

General information about respondent

Name of the company / organisation	The international business of Federated Hermes and EOS at Federated Hermes
Activity	Investment Services
Are you representing an association?	<input type="checkbox"/>
Country/Region	United Kingdom

Introduction

Please make your introductory comments below, if any:

<ESA_COMMENT_ESG_1>

The international business of Federated Hermes ('Federated Hermes') includes Hermes Investment Management Limited (HIML) and EOS at Federated Hermes ('EOS'). HIML is authorised and regulated and carries out regulated activities referred to. EOS is a stewardship services provider and does not carry out regulated activity.

The international business of Federated Hermes is a global leader in active, responsible investment. We are guided by the conviction that responsible investing is the best way to create long-term wealth. We provide specialised capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and proven liquidity-management solutions. Through our world-leading stewardship services, we engage companies on strategic and sustainability concerns to promote investors long-term performance and fiduciary interests. Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns, and, where possible, to contribute to positive outcomes in the wider world. As of 31 December 2020, the international business of Federated Hermes had £39.5bn assets under management. EOS is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society. EOS represents £938.5bn of assets under advice as of 31 December 2020. EOS conducts proactive and reactive engagement with the companies in which its clients invest on a regular basis on environmental, social, governance and strategy, risk and communications concerns. Our team engages in active stewardship on behalf of clients, voting at AGMs and other shareholder gatherings to achieve our clients' responsible ownership aims and fulfil their fiduciary duty to be active owners. EOS is a stewardship services provider and does not carry out regulated activity.

We strongly support the aims of the Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation (TR), including the amendments to SFDR include taxonomy-related sustainability disclosures. In particular, we welcome the increased transparency for end investors.

Our views on the current proposals are set out in more detail below, with our suggestions as to how the European Supervisory Authorities (ESAs) can more closely align the final Regulatory Technical Standards (RTS) with the aims of the SFDR and TR. Please do not hesitate to contact us if we can be of use discussing any of the below further.

Feedback

In addition to our responses to the consultation questions below, we have the following comments in relation to the timings of taxonomy-related sustainability disclosures:

- We would advise that the ESAs permit disclosure in the first year of taxonomy-related sustainability disclosures on a best-efforts basis, particularly in relation to KPIs. Financial market participants

(FMPs) rely heavily on investee company disclosures. In addition to the large part of the investment universe – including non-EU and smaller companies – that are not subject to taxonomy reporting requirements, taxonomy reporting by companies in scope will not be made in advance of FMPs' own disclosures. Given that the Delegated Acts for Taxonomy technical screening criteria have only just been published, we would not expect to see early reporting on Taxonomy alignment from companies. Allowing FMPs the option in the first year to disclose either partial or modelled data with an accompanying explanation would offer a more manageable lead-in time. This would reflect the approach taken to the principal adverse impact indicator template in the SFDR Regulatory Technical Standards (RTS). Regardless of whether the ESAs and the Commission decide to permit a more phased implementation, clarification on how FMPs should approach the issue of timing would be appreciated.

- We also have concerns regarding the timings of changes to pre-contractual documentation. If the amendments to the SFDR RTS are not confirmed until late 2021 and the deadline for compliance is January 2022, this will not leave sufficient time for FMPs to make the necessary changes to the documentation and have these approved by the relevant regulator. We are aware that some regulators which offered a fast track process for Level 1 SFDR are not planning to do the same for the January compliance date. We would urge the ESAs to engage with member state regulators to find a workable solution. There will likely be a greater amount of Article 8 and 9 fund documentation than the March 2021 compliance procedures – due to both new funds and existing funds being reclassified from Article 6 to Articles 8 or 9 – and Article 6 product documentation will also need to be updated to state that they do not take the Taxonomy into account. If it is not possible to fast-track all of the Level 2 SFDR changes, we would strongly advise that at least the Taxonomy-related amendments are fast tracked, even if the rest of the pre-contractual documentation relating to SFDR must be approved through the usual process. Given that all firms will be using the same template, there should still be a reasonable amount of consistency between FMPs. Documents could then be reviewed by the regulators in more detail in the following year.

We agree with the scope of products that are required to make such taxonomy-related disclosures, to ensure consistency in approach across Article 8 and 9 products. However, we would like to emphasise the importance of recognising that there are sustainable investments beyond those that are taxonomy-aligned, especially given the current scope of the taxonomy on only two environmental objectives. We believe the templates could more strongly reflect the broader definition of sustainable investment that is set out in the SFDR Level 1 text.

<ESA_COMMENT_ESG_1>

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?

<ESA_QUESTION_ESG_1>

We fully agree with this approach, as it will ensure that the disclosure obligations are aligned. Having two separate Regulatory Technical Standards (RTS) risks contradictory requirements and may create a confusing landscape for firms in scope of the requirements. All opportunities for further harmonisation between the Taxonomy Regulation (TR) and Sustainable Finance Disclosure Regulation (SFDR) are welcomed.

We do note the risk that delays in finalisation of the taxonomy-related sustainability disclosure requirements could delay the overall finalisation of the SFDR RTS and advise that the adoption of the SFDR RTS by the Commission proceeds in the coming months with the taxonomy-related disclosures included at a later date. This allows financial market participants (FMPs) as much time as possible to prepare for regulatory deadlines. We would however encourage finalisation of the Taxonomy-related disclosure requirements as soon as possible to allow FMPs sufficient time to implement the requirements. We would also advise the European Supervisory Authorities (ESAs) to provide guidance on the likely timings of finalisation of the RTS and application deadlines. Please also note our comments in the introductory section regarding timelines.

<ESA_QUESTION_ESG_1>

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?

<ESA_QUESTION_ESG_2>

Yes, we agree that the same approach should apply to all investments made by a given financial product. Whilst the decision-usefulness for investors of these three KPIs, particularly capital expenditure (CapEx) and revenue, varies by sector it is important to streamline the reporting regime where possible. Combining different methodologies for the same product could provide a misleading metric and make it more challenging for clients to compare products. Requiring the same measure across the investments within a product would also bring the RTS more closely in line with the Article 8 TR requirements, which require asset managers to disclose the weighted average of taxonomy-aligned activities of investee companies measured by turnover, with the option to provide additional calculations for CapEx and OpEx.

Whilst ultimately it may be preferable for all three metrics to be reported by FMPs (turnover/CapEx/OpEx), the current approach is pragmatic given the limitations in data as FMPs may have to conduct significant work to fill in the gaps, which could be unfeasible if reporting across all three metrics were required.

Where the proportion of enabling/transitional activities is reported, we would advise that this uses the same metric as the overall Taxonomy-alignment metric.

Further clarification should be provided on how the metrics for financial and non-financial undertakings should be combined, as this methodology is currently unclear in the RTS.

Beyond our requested one-year delay to the implementation of the taxonomy-related disclosures, we believe that continuing challenges in data availability are not a reason to delay reporting. However, it is important that the KPIs can be contextualised to avoid being misleading. We strongly advise that the templates include an **optional** narrative section to accompany the taxonomy-alignment KPI so that FMPs can provide contextual information if desired, for example on the proportion which are not assessable due to the asset class, the proportion which are not covered by the Taxonomy and the proportion where the economic activity is covered by the Taxonomy but is not taxonomy-aligned.

Guiding definitions of turnover, capital expenditure and operational expenditure should be included in the RTS, aligned with methodologies for Article 8 TR disclosures. Whilst there might be some variation in exact methodologies for non-EU assets, a standard understanding of what is meant by these terms will aid comparability.

<ESA_QUESTION_ESG_2>

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?

<ESA_QUESTION_ESG_3>

We believe that turnover and CapEx are far more decision-useful metrics than OpEx. OpEx includes costs that are less relevant for assessing taxonomy-alignment. It could also be more challenging for investors to model this data for assets not in scope of Taxonomy reporting requirements.

<ESA_QUESTION_ESG_3>

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?

<ESA_QUESTION_ESG_4>

In the longer term, we believe that taxonomy assessment should be possible for as wide a range of assets as possible, including money market securities and derivatives. In the short term, it will be challenging to assess alignment for derivatives such as contracts for differences where there is no physical delivery of goods or services and which do not involve the ownership of particular assets. They are often used for risk management and hedging purposes rather than taking an exposure to an asset. Therefore, detailed guidance would be required on particular types of derivatives and the purposes that they are used for if they are to be included in the KPI in order to ensure consistency between FMPs.

Given that it is not feasible to have such guidance in place with sufficient lead-in time for the initial compliance deadline, we advise that such instruments are not included in the first instance, but that the ESAs work with industry to develop guidance so that the scope of assessable instruments increases over time. In most cases, improving data coverage or guidance on modelling data would also be necessary if such instruments are included as coverage is often very low.

<ESA_QUESTION_ESG_4>

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?

<ESA_QUESTION_ESG_5>

It would be useful to have confirmation in the RTS of how hybrid instruments such as contingent convertibles (CoCos) should be treated. It would also be helpful for the ESAs to specify how investors should incorporate short positions, as the date on which the calculation is made could impact overall alignment. The solution could be for such positions to be included as of the date on which the data is captured for KPI calculation, with FMPs given the option to explain in the narrative disclosure the impact this has had on the overall KPIs (though this should not be mandatory). Otherwise, we consider the terms sufficiently clear.

<ESA_QUESTION_ESG_5>

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 denominator for the KPI?

<ESA_QUESTION_ESG_6>

Articles 8 and 9 SFDR products are not necessarily targeting taxonomy-alignment and so FMPs may make investments in assets they deem to be contributing to the product's characteristics or objectives but for which it is not possible to confirm Taxonomy-alignment. We believe it is important not to penalise FMPs for such investment decisions which may support the achievement of the product's characteristics or objectives.

Regardless of which solution is pursued, the Commission should specify the list of asset classes that are currently excepted on the advice of the ESAs. This should not be left to the discretion of individual FMPs as this would result in inconsistencies and make it difficult for clients to make comparisons.

We see two possible solutions to this challenge. The first, and preferred, option is to exclude investments in asset classes for which it is not possible to estimate significant contribution for Taxonomy purposes. There could be contextualising disclosure to explain the proportion of assets that were included in the KPI calculation. So, for example, if 5% of product's investments were in an asset class that the Commission has specified should not be included in the calculation, it should be disclosed that the KPI for Taxonomy-alignment covers 95% of that product's investments.

Alternatively, all investments could be included in the denominator with a dedicated section of the template to disclose the proportion of non-assessable assets. In particular, we strongly advise that the pie chart indicates the proportion of non-assessable assets.

As per our response to Q2, the template should allow FMPs the flexibility to distinguish in narrative disclosure between those economic activities which are misaligned to the Taxonomy on the basis of its specified thresholds and those for which thresholds have not been set and which may or may not be captured by the Taxonomy when its scope is expanded in future. The latter may potentially be classed as Taxonomy-aligned once the Taxonomy is expanded and so should not be considered in the same light as those which do not meet existing screening criteria requirements or are in breach of minimum safeguards. This will also help focus investor engagement on those companies whose economic activities are covered by the Taxonomy, but which are not Taxonomy-aligned. To avoid creating additional reporting burdens on smaller FMPs, such a disclosure should be optional.

We agree that all investments that can be assessed for Taxonomy-alignment (based on their asset class) within a product should be assessed, regardless of whether they are intended to contribute to a product's environmental or social characteristics or to its sustainable investment objective. This ensures better comparability between Article 8 and 9 products across the market.

For those asset classes for which it is not yet possible to calculate Taxonomy-alignment, immediate focus should be given to development of methodologies. To reach the EU's environmental goals it is key that focus is not limited to equities and certain debt instruments. The EU Green Bond standard will help but will not be appropriate for all bonds, particularly non-EU bonds. Equivalents may be needed for other instruments. In particular we see value in developing a methodology for including sovereign bonds (aside from those already meeting EU Green Bond Standard). The TEG Final Report suggests some high-level methodologies. Whilst a more blunt instrument than the technical thresholds for economic activities, alignment of national climate change mitigation targets with net zero by 2050 and Nationally Defined Contributions (NDCs) that align with the Paris Agreement target of well below 2°C could act as a reasonable proxy for significant contribution to climate change mitigation. The other methodologies proposed – sectoral contribution of Taxonomy-aligned economic activities to national GDP and sectoral contribution of Taxonomy-aligned economic activities in the form of tax receipts – could be more difficult to calculate, particularly for non-EU countries, and would likely need to be based on estimates of sectoral contribution where issuer-level disclosures are not available. Alignment should be sought in developing such guidance with other

regulatory disclosure requirements where applicable, including the Corporate Sustainability Reporting Directive (CSRD) and Article 8 TR.

<ESA_QUESTION_ESG_6>

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?

<ESA_QUESTION_ESG_7>

We believe it is sufficient that a statement is made that the activities that are included as taxonomy-compliant comply with the four criteria of Article 3 TR.

Requiring assurance could result in additional costs which could then be passed on to the end investor and would be particularly burdensome for smaller FMPs. This is particularly important in the early stages when there is already a significant burden on firms to set up the assessment and reporting processes. We would advise instead relying on existing regulatory requirements to ensure businesses – both investees and FMPs – have appropriate controls in place. Much of the information from EU investees which feeds into FMPs own disclosures will be subject to its own assurance process. Furthermore, particularly in the early years of reporting, there may be a significant reliance on modelled data which would be difficult to assure. The focus instead should be on disclosure of methodologies for calculating Taxonomy alignment where this is not based on investees' own disclosure of Taxonomy alignment, as is already reflected in the pre-contractual disclosure and periodic reporting templates.

<ESA_QUESTION_ESG_7>

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

<ESA_QUESTION_ESG_8>

We agree that the periodic disclosures should mirror the pre-contractual disclosures. We believe that these reporting requirements should apply to reports made in 2023, as FMPs will not have sufficient data to report in 2022 due to the lack of investee disclosures.

In addition to the comments we have on both the pre-contractual and period templates, it would be useful to have further guidance on how firms should approach investments where there is insufficient data to assess Taxonomy alignment despite best efforts to obtain it. For example, there could be a qualitative disclosure accompanying the graphic breakdown which states that for x% of the 'other investments' category, there was insufficient data to assess alignment. As mentioned in our response to Q2 and Q6, there could be optional qualitative disclosure on the breakdown between those economic activities which are simply not in scope of the current Taxonomy (for example where they may substantially contribute to other objectives for which technical screening criteria is not yet available) versus those which are included but are in breach of Taxonomy criteria, such as the requirement to do no significant harm.

<ESA_QUESTION_ESG_8>

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

<ESA_QUESTION_ESG_9>

We have some comments in relation to pre-contractual and periodic disclosures. In particular, as noted in our introduction, we would like to emphasise the importance of recognising that there are sustainable investments beyond those that are taxonomy-aligned. This is partly due to the currently narrow scope of the Taxonomy. We feel that it is important to reflect in the templates that taxonomy-aligned investments are not the only sustainable investments, in line with the broader definition contained in the SFDR itself.

- The tick boxes at the start of the template may be confusing for users of these disclosures who are not familiar with the regulatory framework underlying them. For example, a retail investor could be presented with a product which i) promotes ESG characteristics but does not have as its objective a sustainable investment, which ii) invests partially in sustainable investments but iii) with activities that are not Taxonomy aligned. We would suggest instead that FMPs are required to include a short paragraph that explains how this product relates to SFDR and Taxonomy categorisations.
- The requirement to disclose a minimum share of investments in pre-contractual disclosures that are aligned or not aligned with the Taxonomy – and that are transitional and enabling activities – poses a particular challenge. The proportion of Taxonomy-aligned investments for many products will increase over time as data availability and the proportion of the investable universe that is aligned with the Taxonomy increase. Similarly, as the Taxonomy expands, more economic activities will come into scope. To be meaningful, this metric would require regular updates of the pre-contractual documentation, which can require significant resource for both FMPs and regulators depending on the materiality of the changes. Otherwise, firms may need to set low thresholds in order to avoid potentially breaching them, which therefore removes the value of this metric for clients. We do see clear value in reporting on % alignment in periodic disclosures but would recommend removing this metric from the pre-contractual disclosures. If it is not possible to remove this metric from pre-contractual disclosures – in particular if it has been introduced in order to correspond with change to regulation on product suitability assessments – as we described earlier in our response, we would advise an option to add narrative context to this section so that FMPs can explain the threshold that has been set and how it may change over time.
- For Article 8 and 9 SFDR products, the sections requiring information on the environmental/social characteristics or sustainability objectives promoted by the product and the extent to which they were met request that in respect of sustainable investments with environmental objectives, relevant environmental objectives referenced in Article 9 TR should be disclosed. To avoid confusion, it would be worthwhile clarifying that other characteristics and objectives – including other environmental objectives – can be included here.
- Likewise for Article 8 and 9 SFDR products, the questions ‘to which objectives do/did the sustainable investments contribute to and how do/did they not cause significant harm?’ could be accompanied by a clarification that ‘sustainable’ refers to the broader definition in SFDR, and so the objectives they contributed to can be broader than only those specified in the Taxonomy. This could be done by an overall clarification that throughout the templates, unless otherwise specified, ‘sustainable’ refers to the definition in SFDR, rather than being limited to investments in Taxonomy-compliant activities.
- Some of the questions – in particular what objectives sustainable investments contribute to and why the product invests in activities that are not environmentally sustainable – are difficult to answer on a pre-contractual basis. This is particularly true for Article 8 SFDR products, which do not have a sustainable investment objective and so may not target particular sustainable objectives. We would advise removing this from the Article 8 product pre-contractual disclosures.
- The phrasing of ‘what is/was the minimum share of sustainable investments that are not aligned with the EU Taxonomy?’ has negative connotations and could undermine the legitimacy of sustainable investments beyond those that are taxonomy-aligned. We would suggest rephrasing as ‘What is/was the minimum share of sustainable investments, excluding taxonomy-aligned investments?’ (or alternatively, including taxonomy-aligned investments). Again, we would like to share our concerns relating to the pre-contractual disclosure of such indicators for the reasons outlined above. Furthermore, the guidance for this section suggests that this section is applicable where the product invests in economic activities that are not environmentally sustainable economic activities. This would seem to imply that it covers all non-Taxonomy-aligned investments rather than just *sustainable* investments that are not Taxonomy-aligned. We suggest rewording this guidance so that it focuses on sustainable investments only rather than all investments.

- For both Article 8 and Article 9 SFDR products, we strongly believe that the question ‘why does/did the financial product invest in economic activities that are not environmentally sustainable?’ also needs to be rephrased to avoid negative implications. It currently implies there is something wrong with making non-taxonomy aligned investments, which risks undermining the legitimacy of Article 8 products as a whole as well as Article 9 products making non-Taxonomy-aligned investments. Article 8 products have an extremely important role in facilitating the transition to a more sustainable economy, as investors can steward assets to support them in transitioning to a more sustainable business model. Article 9 products may be making sustainable investments that are not taxonomy-aligned due to their broader sustainable investment objectives, investment in companies with multiple business lines or because investee companies are outside the EU. This question therefore needs to be reframed to avoid the implication that there is something wrong with investing in companies that are not Taxonomy-aligned. We would suggest something along the lines of ‘Explanation of the financial product’s level of alignment with economic activities that are environmentally sustainable in accordance with the EU Taxonomy and the product’s proportion of sustainable investments.’

<ESA_QUESTION_ESG_9>

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?

<ESA_QUESTION_ESG_10>

We agree that unified templates would be far more preferable. This maintains comparability without adding unnecessary additional documents. It also improves harmonisation between the disclosures and will provide a more complete picture for clients.

<ESA_QUESTION_ESG_10>

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?

<ESA_QUESTION_ESG_11>

Please see our response to Q9 for more detail. Where possible, ‘sustainable’ should be used in the broader SFDR definition rather than to mean only taxonomy-compliant activities. Where taxonomy alignment is to be disclosed, there should be capacity to contextualise the KPI, for example to explain that as the product has a social objective this is not yet captured by the taxonomy. The language used around Taxonomy-alignment should be less negative, as investments that are not Taxonomy-aligned can still be sustainable investments as defined by SFDR.

We agree that it is too complicated to apply the Taxonomy disclosure requirements to only some Article 8 and 9 SFDR products, especially as some may have both social and environmental characteristics/objectives. The most appropriate solution would be the flexibility to include explanatory text, as mentioned earlier in our response. This will be very important for FMPs to contextualise the taxonomy alignment KPI for their clients, for example where the product invests in non-EU assets which have low disclosure or where investments are focused on a social objective.

Further clarification on when to use the 'do not significantly harm' (DNSH) concepts in the TR and when to use the DNSH concepts from SFDR would be useful. Paragraph 38 of the consultation paper states that for taxonomy-aligned investments, the DNSH criteria from the taxonomy should be used. So, for all Taxonomy-aligned investments, the technical screening criteria should be applied to determine whether the investment is 'sustainable' or not. Paragraph 39 states that for products pursuing social objectives or environmental objectives that are not covered by the Taxonomy, the SFDR DNSH definition should continue to apply. However, it is possible that there are products with more than one objective, or an environmental objective that is aligned with the Taxonomy overall but makes sustainable investments that are not within scope of the Taxonomy. To cover these instances, we would suggest clarification that for any sustainable investments that are not Taxonomy-compliant, compliance with the SFDR DNSH definition should be assessed (that is, reframing so the focus is on whether individual investments are taxonomy-compliant rather than the objective).

<ESA_QUESTION_ESG_11>

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

<ESA_QUESTION_ESG_12>

We do not have more granular examples of costs, but the proposed requirements will require significant resource – particularly in setting up operational procedures in the first year to assess and report on taxonomy-alignment – and potentially costs to obtain the necessary data, particularly for assets that are not within scope of the new Corporate Sustainability Reporting Directive/before this Directive comes into force. Data may be obtained directly from assets or from third party data providers, both of which require resources and/or costs.

<ESA_QUESTION_ESG_12>