Executive summary of FESE response to ESAs consultation on the SFDR RTS review

Brussels 4th July 2023

FESE appreciates the ESAs taking a step forward and including derivatives in the PAI indicators as well as in the Taxonomy-alignment and share of sustainable investment ratios, reflecting derivatives in both the numerators and denominators. However, clarity is still lacking on how to include them.

Our response reflects our key observations and recommendations to ensure a fair approach which is aligned with the potential role of derivatives in contributing to sustainability:

- Derivatives should be looked at comprehensively, i.e. also with respect to their positive contributions. This is not reflected in the ESAs’ current approach, which mainly focuses on the negative contribution of derivatives due to greenwashing concerns. Derivatives also contribute to and facilitate the sustainability and green transition. This misleading bias towards derivatives is still present vis-à-vis addressing PAI ratios versus Taxonomy-alignment and sustainable investment ratios.
- The final decision on the netting approach should be carefully scrutinised with the market before its adoption. In relation to PAI, the provisionally excluded short positions under the numerator of PAI indicators can still contribute to sustainability even if the underlying does not. Similarly, on the other side, the exclusion of long net exposures in the Taxonomy-alignment and sustainable investment ratios would also be unfair, as if derivatives in these ratios can only ever have negative ESG impacts. Until a decision is taken following the needed scrutiny with market players, we see merit in a flexible approach. The same netting approach should ideally be reflected on all the above ratios for harmonisation and equal treatment.
- It is misleading to include derivatives with ‘any’ kind of underlying into PAI calculations, as some are Taxonomy-neutral (e.g. interest rates, commodities, Forex) and they are not considered in any other sustainability ratio. However, the exclusion from the numerator of the PAI ratio of those exposures that do not ultimately result in physical investment in the underlying security could be limiting. Physical ownership does not necessarily demonstrate sustainable impacts and should not be considered as the criterion for inclusion/exclusion. We also believe it would be reasonable to include underlyings in companies’ “equity” and “debt” asset classes of the derivatives proportionately in all PAI, taxonomy-alignment and sustainable investment ratios.
- We welcome the proposed calculation methodologies to convert derivative positions into equivalent underlying positions in PAI calculations to reflect derivatives’ exposures in portfolios. These could also serve as an adequate starting point for Taxonomy-alignment and sustainable investment ratios. Alignment among all ratios is desirable. We would also encourage the inclusion of risk-based methodologies with respect to bond futures and interest rates futures, and would appreciate more clarity on the notion of ‘plain vanilla’ derivatives in the methodology. Before the proposed conversion methodologies are taken on board, the netting methodology must be decided.