



ADVICE TO ESMA

SMSG Response to ESMA's Consultation on the Draft Advice to the European Commission under Article 8 of the Taxonomy Regulation

I. Background

1. On 15 September 2020, ESMA received a call for advice from the Commission, requesting input on how the three KPIs to be disclosed by non-financial undertakings should be further specified and what information asset managers subject to the Non-Financial Reporting Directive should disclose on how their activities are directed at funding environmentally sustainable economic activities.
2. On 5 November 2020, ESMA launched a consultation on its draft advice to the European Commission under article 8 of the Taxonomy Regulation. This report presents the SMSG's advice to ESMA in view of this consultation.
3. The SMSG largely supports ESMA's draft advice to the European Commission. Nevertheless, the SMSG makes a number of general comments and advises ESMA to change or refine its approach in respect of specific aspects of the draft.

II. General comments

4. The SMSG is aware that neither the decision on timing, nor on the scope, nor on the size of non-financial undertakings falling under the scope of the NFRD fall within ESMA's remit. Some members, however, deemed it important to point to certain observations in that regard.

The timing of alignment of the different pieces of legislation and phasing of disclosure obligations

5. The SMSG would like to begin with reiterating its previous advice (see SMSG advice on ESG disclosure¹) to consider carefully the timing issue and phasing of disclosure obligations and the relation between the timings of various consultations.
6. The timeline for the application of the new reporting requirements is very challenging for companies, in particular in the aftermath of the COVID pandemic. EU corporates are in need of their Working Capital and liquidity to support their operations in the face of a dual supply and demand shock that has produced a very deep recession in the EU and globally. Moreover, the required adjustments necessitate a reorganisation of corporations' business models and strategies as well as the adaptation of their resources and education of their teams. In a nutshell, compliance with the new reporting requirements will take

¹ See SMSG, 'Advice to the ESA's - Joint Consultation Paper on ESG Disclosures' (ESMA22-106-2858, 14 September 2020) at II.12.b, https://www.esma.europa.eu/sites/default/files/library/esma22-106-2858_smsg_advice_on_esg_disclosure.pdf.

time and will also generate considerable additional costs. In addition, asset managers will need to report in percentages the “green” proportion of their investment portfolios and these will depend on the time non-financial undertakings will disclose and make available information from the KPIs.

7. As non-financial undertakings are in need of flexibility to adapt and asset managers rely on the disclosure provided by non-financial undertakings, the SMSG recommends a phasing in of the new disclosure requirements or an extension of the deadline for implementation and/or a pilot phase. The SMSG understands that the new disclosure requirements will apply in 2022 regarding FY 2021 (e.g. publication in 2022 of revenue, CapEx and if relevant OpEx related to financial year 2021). Since the delegated act (DA) is to be adopted by 1 June 2021, at the latest, and the Parliament and Council benefit from a three-month objection period, the DA is unlikely to be published in the Official Journal before Q4 2021. As already explained, companies will not have sufficient time to prepare their accounting and reporting to comply with the new requirements.
8. The SMSG is mindful of the continuous work of the Platform on Sustainable Finance, as well as continuous legislative efforts in areas closely related to the subject of this Consultation, such as the pending review of the Non-Financial Reporting Directive. This Advice is not meant to interfere with these processes or pre-empt in any way their findings.

Geographical Scope

9. The SMSG recommends further clarification regarding how the proportion of revenue, Capex and if relevant OpEx realised outside the EU – in third countries – should be assessed and accounted for against the Taxonomy Regulation criteria. This proportion can be significant for non-financial undertakings operating worldwide. The SMSG advises ESMA to provide guidance regarding how to account for activities carried out in third countries, e.g. by providing a standardised table.
10. Asset managers invest in assets of issuers outside the EU, which do not provide Taxonomy-related disclosures. The SMSG advises ESMA to provide guidance to asset managers how to deal with such situations, e.g. (i) by providing that asset managers should engage with such companies to encourage them to produce Taxonomy-related disclosures on a voluntary basis; and (ii) by providing examples of disclosures of the proportion of assets on which asset managers could not obtain the necessary data.

Consistency of approach between supervisory bodies

11. EBA and EIOPA are also invited to provide similar advice on the delegated act, to be adopted within their respective remits. The SMSG advises that ESMA, EBA and EIOPA take a consistent approach when coordinating the three pieces of advice which will be delivered to the Commission.

Size of Non-Financial Undertakings under the scope of the Non-Financial Reporting Directive

12. Article 8 of the Regulation applies to non-financial undertakings falling under the present scope of the Non-Financial Reporting Directive. Some members of the SMSG suggest that the proposed KPIs should be broadened in view of the expected enlargement of the NFRD’s scope, so that it is feasible to include companies that are currently not under the scope today but which might be under the scope of the Directive in the future.
13. Moreover, some members of the SMSG note that in the ESMA questionnaire there is no question as regards the distinction between small and medium size companies that already fall under the scope of the Taxonomy Regulation and might face increased difficulty to comply with complex reporting methodologies. The SMSG believes that this is in contradiction with the Commission’s policy to think small first.

Methodology and data reporting

14. The SMSG deems it important to clarify who should be in charge of using the proposed methodology described by ESMA in “Annex V: Estimates for the three KPIs for the EU economy as a whole and by

NACE macro sector". This is an important clarification since it would shed light on whether it is ESMA's intention that non-financial undertakings should do this by themselves or rating agencies should make use of it.

15. The methodology proposed by ESMA seems practicable. Nevertheless, the SMSG believes that the methodology generalizes companies' sales too much (e.g. 20% of Production of electricity sales are green/sustainable) without considering the individual characteristics of each company, the "do no significant harm" (DNSH)-approach or minimum safeguards. The use of industry averages is quite common, but it should be reconsidered with regard to the calculation of coefficients for the EU taxonomy.
16. The SMSG believes that it is important to encourage companies to provide data instead of using an industry average. Companies who provide data should not be placed in a less favourable situation than companies who do not deliver any data. It is unclear how the investor can distinguish between "good/investable" companies and "bad" ones (with regard to ESG) if the information of any company can be expressed on the basis of industry average.
17. Therefore, the SMSG advises to use a methodology based on existing company-specific and common ESG data (e.g. CO2 intensity) instead of using only industry averages. The process can be implemented on the basis of a multi-step approach: if there is a lack of data then the use of industry averages apply; if there is sufficient data, existing ESG data applies.
18. Taxonomy data needs to be reliable for financial data analysts, not everyone should be permitted to calculate or estimate this data. The SMSG advises that ESG rating agencies provide taxonomy data, if the company itself cannot provide it.
19. The SMSG observes that the definition of some activities is missing, as pointed out in the Final report of the Technical Expert Group on Sustainable Finance. The activities as defined by the NACE codes framework capture all economic sectors and hence almost all economic activities. However, there are economic activities that are not directly covered by the NACE classification. Some of these activities are important for climate change mitigation and adaptation. When activities of companies are defined and assessed, two situations may occur. In some cases, the activity of a site, factory or unit of the company falls under NACE codes, whilst in other cases, there are several activities on one plant. There is no guidance on how to assess what percentage of those activities is taxonomy aligned, does significantly contribute or does not significantly harm the different environmental objectives. Neither the assessment of the percentage of activities that are taxonomy aligned, nor their level of contribution are explained.
20. The SMSG advises ESMA to develop a methodology to calculate the information from those units or plants or sites on a more consolidated level.
21. For the reporting, you need the delegated act to article 8 which is the right place to define what activity is met in the taxonomy regulation.

Compliance facilitated by sound corporate governance

22. The SMSG observes that for some asset managers the new regulation will not provide more transparency when undertakings are below the reporting threshold of 500 employees. The 500+ employee rule excludes firms which are, nevertheless, large in terms of assets under management. Moreover, in some markets, annual reports on the largest domestic asset management firms are available via the company filings from the commercial register at a cost. In the present scheme, some affluent markets would not require any asset manager to report on its own company-specific criteria like diversity of decision-making bodies which are considered as risk-relevant. All this means that investors will not have easy access to information on the cognitive diversity of investment decision making, even though it is a crucial element of the overall investment process.

III. Advice relating to non-financial undertakings

23. *Definitions – questions related to the KPI ‘proportion of turnover derived from products / services associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of the Taxonomy Regulation’*

Question 1: For this KPI, do you agree with the proposed approach to defining turnover (bullet a in the draft advice)?

24. The SMSG agrees, subject to the following reservation and advice.

25. The SMSG notes that it will be very challenging for companies to produce this KPI considering the deadline and the fact that internal reporting processes are not based on NACE classification. The SMSG advises ESMA to provide explanatory examples.

Question 2: For this KPI, do you agree with the proposed approach to when turnover can be counted (bullet b in the draft advice)?

26. The SMSG agrees, subject to the following reservations and advice.

27. On the proposed approach to when Turnover can be counted, ESMA's approach seems very restrictive. As a matter of fact, if paragraph (b) of article 11 can be understood as enabling other activities to undergo climate change adaptation, paragraph (a) clearly refers to the adaptation of the activity (company) itself. Therefore, the SMSG is of the opinion that for the environmental objective climate change adaptation, turnover can be counted where the activity enables other activities to undergo climate change adaptation as put forward by ESMA, but also where the activity includes adaptation solutions that substantially reduce the risk of an adverse impact on the current climate or the expected future climate of that economic activity.

28. The DNSH principles are mainly based on EU rules and, as such, applying them outside the EU in the absence of equivalence regimes is a complex exercise. It is also unclear whether the assessment of a company endorsement of the minimum social safeguards should be done at the global entity level, whether this entity performs activities outside of the EU or not.

29. The SMSG therefore advises (i) to clarify the reporting on the Do Not Significantly Harm (DNSH) principles on an activity by activity basis, as well as for activities or parts of the value chain exercised outside of the EU, needs clarification or (ii) to develop a step by step approach in this respect.

30. *Definitions – questions related to the KPI ‘proportion of capital expenditure related to assets / processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of the Taxonomy Regulation’*

Question 3: For this KPI, do you agree with the proposed approach to defining CapEx (bullet a in the draft advice)?

31. The SMSG agrees with the proposed definition of CapEx. As expressed for the Turnover KPI, it considers however that it will be very challenging for companies to produce this KPI considering the deadline and the fact that internal reporting processes are not based on NACE classification.

Question 4: For this KPI, do you agree with the proposed approach to when CapEx can be counted, including the definition of ‘plan’ (bullet b in the draft advice)?

32. The SMSG has a number of reservations.

33. On the approach of counting CapEx, Article 8 of the Taxonomy Regulation requires companies to disclose the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable. The SMSG notes that adding a requirement that CapEx should be part of a plan in order for the activity

to be counted as sustainable, results in adding a condition not laid down in level 1. Setting a uniform time horizon (5 years) may not be suitable for all companies which plan in very different time horizons. The SMSG recommends that the time horizon of the investment plan, whether short, medium or long term is defined by companies. This approach would be aligned with TCFD Recommendations and Commission Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01) that require companies to disclose climate-related risks in short-, mid- and long term and leave the definition of these horizons to the company. That solution would be inclusive of investments for projects that run over 6, 10 or even 15 years in the different sectors. The procedure for approval of investments by the board varies according from company to company and it is not possible to determine a common threshold. Finally, disclosing the plan should be sufficiently high-level

34. The SMSG therefore advises to delete the condition that the Capex should be part of a plan. If ESMA would not agree to do so, it should at least delete the 5-year period and allow projects running over longer periods to be counted. Moreover, ESMA should allow that disclosure of the plan should be sufficiently high-level.

35. The SMSG also advises to clarify whether the variation of intangible and tangible assets accounted for on the balance sheet should be considered gross or net of disposals.

36. As for the first KPI, the SMSG advise ESMA to provide examples on the calculation of this KPI based on different business cases.

37. Definitions – questions related to the KPI ‘proportion of operating expenditure related to assets / processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of the Taxonomy Regulation’

Question 5: For this KPI, do you agree with the proposed approach to defining OpEx (bullet a in the draft advice)?

38. As of today, the IASB’s Primary Financial Statements project has not yet resulted in any amendment to IAS1 endorsed by the EU and therefore companies remain free to determine the relevant operational indicator to measure their performance. Therefore, the SMSG advises that the definition remains general, allowing flexibility for companies. This will ensure alignment and consistency of this KPI with alternative performance measures used by companies to measure their operational performance.

39. The SMSG agrees with the definition put forward by ESMA that « non-financial undertakings should include in the amount of OpEx all items of expense that arise from the undertaking’s main business activities, which are generally identified as the principal revenue-producing activities of the entity. »

40. In this regard, determining the proportion of OpEx associated with sustainable activities will be very complex and burdensome for companies with limited added value, if the purpose is to show the transition path/demonstrate the trajectory of the company.

41. The SMSG observes that the disclosure of this KPI could be redundant with the proportion of revenue associated with sustainable activities.

Question 6: For this KPI, do you agree with the proposed approach to when OpEx can be counted, including the definition of ‘plan’ (bullet b in the draft advice)? With reference to the TEG’s inclusion of the words “if relevant” in relation to OpEx, in which situations should it be possible to count OpEx as Taxonomy-aligned?

42. The same comment applies – see answer to Question 4.

Definitions – questions related to all three KPIs

Question 8: Do you agree that sectoral specificities should not be addressed in the advice, as proposed in Section 3.2.3?

43. The SMSG agrees with this approach. Companies with sectoral specificities will disclose information in order for the KPIs to be similar and comparable regardless of the particular sector. Asset managers will publish KPIs at portfolio level. Furthermore, it is of utmost importance to get harmonised KPIs without sectoral differentiation, in order to consolidate the data.

Accompanying information – questions related to all three KPIs

Question 9: Do you agree with the requirements for accompanying information which ESMA has proposed for the three KPIs?

44. The SMSG agrees, subject to the following observations.

45. The SMSG believes that accompanying information is potentially useful for the interpretation of the KPIs and to make them more comprehensive and accessible. Quantitative indicators seldom tell the whole story and we can imagine that there are users of data who want to be able to look behind the figures. Specifying the content of the accompanying information (i) could be cost-effective for the reporting companies (depending on how it is done) as it would indicate the information which is to be provided, and (ii) increase understandability for the users.

46. On the other hand, the SMSG is concerned that this could impact on the downstream use of the data and the ability to present clear information to investors. Financial undertakings will be relying on the KPIs to assess and report on the alignment of their investments and financing activities with the taxonomy and will not be in a capacity to incorporate all the accompanying qualitative information for each single issuer or borrower. For the financial reporting on taxonomy-alignment to be efficient, digitalisation and automation will be critical given the multitude of different issuers and borrowers on which taxonomy-alignment will have to be assessed. Care should be exercised to avoid any shift in the focus of the accompanying information away from the primacy of the KPIs; for investors and other users of this information, having to interpret accompanying information that is long and non-standardised or comparable could ultimately lead to confusion and undermine comparability between non-financial undertakings.

47. Finally, depending on how this information is presented, it could be subject to very different interpretations from non-financial undertakings. Establishing additional requirements on the content of this accompanying information in its delegated act to ensure comparability across the information provided by different non-financial undertakings is necessary, but should be done in such a way that it does not bring further operational complexities for companies in addition to the reporting information for the three KPIs.

Question 11: Do you agree with ESMA's suggestion to permit compliance by reference, so that non-financial undertakings may present the accompanying information elsewhere in the non-financial statement than in the immediate vicinity of the KPIs, as long as they provide a hyperlink to the location of the accompanying information?

48. The SMSG agrees with ESMA's suggestion to permit compliance by reference, but has a preference for providing the information in the immediate vicinity of KPIs is possible.

Question 12: Do you consider there are additional topics that should be considered by ESMA in order to specify the content of the three KPIs? If yes, please elaborate and explain the relevance of these topics.

49. First, for the non-financial reporting on taxonomy-alignment to be efficient, digitalization and automation will be critical given the multitude of different issuers and borrowers on which taxonomy-alignment will have to be assessed.

50. Secondly, depending on how this qualitative information is presented, it could be subject to very different interpretations from non-financial undertakings. Establishing additional requirements on the content of this accompanying information in its delegated act to ensure comparability across the information provided by different non-financial undertakings would bring further operational complexities for companies.

51. The SMSG therefore considers that additional topics to specify the content of the three KPIs should not be considered by ESMA as publishing the three KPIs will already be a great challenge for companies.

Questions relating to the methodology of preparing KPIs

Question 14: Do you agree that non-financial undertakings should provide the three KPIs per economic activity and also provide a total of the three KPIs at the level of the undertaking / group? If not, please provide your reasons and address the impact of your proposal to financial market participants along the investment chain.

52. The SMSG agrees with ESMA's proposal that both levels of information, per economic activity and at entity level, should be requested. Non-financial undertakings should provide the three KPIs per economic activity, provided that the economic activity is defined as the activity used to determine the environmental objective to which it makes a substantial contribution. As such, non-financial issuers should possess this level of information. The provision of this information is important for asset managers as certain companies have very different activities.

Question 15: Do you agree that where an economic activity contributes to more than one environmental objective, non-financial undertakings should explain how they allocated the turnover / CapEx / OpEx of that activity across environmental objectives and where relevant the reasons for choosing one objective over another?

53. The SMSG agrees with ESMA's proposal, notwithstanding our reservations about disclosing the proportion of OpEx associated with sustainable activities. Furthermore, transparency is of the utmost importance in order for asset managers to process this information at portfolio level. However, it should be a brief explanation, in order to avoid that the message would be blurred.

Question 16: Do you agree that non-financial undertakings should provide information on enabling and transitional activities?

54. Most SMSG members agree, given that enabling and transitional activities are central to the Taxonomy and as banks will be required to publish a green asset ratio for each type of activities. One member indicated that transitional activities are only mentioned in article 10 paragraph 2 of the Taxonomy Regulation. Therefore, transitional activities are by definition activities that substantially contribute to the first objective of climate change mitigation.

Question 17: Do you agree that the three KPIs should be provided per environmental objective as well as a total at undertaking or group level across all objectives? If not, please provide your reasons and address the impact of your proposal to financial market participants along the investment chain.

55. The SMSG agrees with ESMA's proposal that the three KPIs should be provided per environmental objective as well as a total at undertaking or group level across all objectives, notwithstanding our reservations about disclosing the proportion of OpEx associated with sustainable activities.

Question 18: Do you agree that non-financial undertakings should be required to provide the three KPIs for economic activities which are covered by the Taxonomy, economic activities which are covered by the Taxonomy but for which the relevant criteria are not met and therefore are not Taxonomy-aligned as well as for economic activities which are not covered by the Taxonomy?

56. The SMSG agrees, subject to the following changes.

57. First, the SMSG advises ESMA to provide for a phasing approach in the disclosure obligations. Non-financial undertakings should first be required to disclose the three KPIs for economic activities which are covered by the Taxonomy and the technical screening criteria. Then, they would be required to disclose the requirements on economic activities which are covered by the Taxonomy but for which the relevant criteria are not met and therefore are not Taxonomy-aligned as well as for economic activities which are not covered by the Taxonomy. This phased approach would allow them to adapt to these new requirements and publish reliable KPIs.

58. Second, the delegated act (DA) should clarify the obligations of companies whose activities are not yet covered by the taxonomy and technical screening criteria. Since the delegated act is to be adopted by 1 June 2021 and the Parliament and Council benefit from a three-month objection period, the DA is unlikely to be posted on the official journal before Q4 2021. As a consequence, companies and financial institutions having to collect the data from issuers and borrowers will have too little time to prepare their accountancy systems to comply with the new requirements. Moreover, as already expressed it will be even more challenging to apply them retroactively to the first months of the reporting period. The SMSG therefore recommends that the DA takes 2022 as the reference period instead of 2021 for the first two climate objectives and 2023 as the reference period for the four other environmental objectives for both non-financial and financial undertakings.

Question 19: Do you agree with the proposal not to require retroactive disclosure concerning the four environmental objectives relating to the financial year 2021?

59. We agree with ESMA's proposal not to require retroactive disclosure concerning the four environmental objectives relating to the financial year 2021. If the DA would lead to the implementation of new methodologies by companies, it would indeed be challenging to apply them retroactively to the first months of the reporting period.

Question 21: Are there points that should be addressed in ESMA's advice in order to facilitate compliance of financial market participants across the investment chain? If yes, please specify.

60. In addition to the elements referred to above, the SMSG raises to the following issues.

61. The compliance of financial market participants across the investment chain relies on reliable data being provided by investee companies. As such, the information on KPI's data reported by non-financial undertakings should be reliable. Therefore, to ensure compliance of financial market participants across the investment chain, the SMSG recommends a formal verification process to review the reliability of disclosed information.

62. As expressed in the general comments, the entirety of concepts introduced by the sustainability legislation, is new and also requires that sufficient attention is given to competence development of staff. Nevertheless, as long as the different sets of legislation are in different stages of development and not yet fully aligned with one another, full compliance across the investment chain will be very difficult.

Questions relating to the presentation of KPIs

Question 24: Do you agree that in order to ensure the comparability of the information disclosed under Article 8(2) of the Taxonomy Regulation and as such facilitate its usage, ESMA should propose the use of a standardised table?

63. The SMSG recognises that the advice is very detailed and precise in explaining to non-financial companies how they should determine CapEx, OpEx, turnover and how the decision to determine which activities are aligned or not with the taxonomy will be taken. The proportion of revenue associated with sustainable activities is however – and to a certain extent – the easiest KPI to calculate and publish. The SMSG therefore advises ESMA to also provide templates for CapEx and OpEx KPIs. The SMSG supports a common reporting table that would help a better use of data by asset managers. It will also help

preventing dichotomy between companies by giving them a standard framework which would serve as an example for companies with the flexibility to choose a different format.

Question 25: Do you consider that the standard table provided in Annex III of this Consultation Paper is fit for purpose? Do you think the standard table provides the right information, taking into account the burden on non-financial undertakings of compiling the data versus the benefit to users of receiving the data? If not, please explain and provide alternative suggestions to promote the standardisation of the disclosure obligations pursuant to Article 8 of the Taxonomy Regulation.

64. See answer to Question 24.

IV. Advice relating to asset managers

Asset managers - Questions relating to the content of the KPI

Question 28: Do you agree that a share of investments is an appropriate KPI for asset managers? If you do not, what other KPI could be appropriate, please justify.

65. The SMSG agrees that the share of investments is an appropriate KPI for asset managers and that alternative approaches should not be used. The alternative model based on fees is not the best approach as it offers less pertinent data compared to turnover. Moreover, an approach based on share of eligible investments seems more appropriate than total assets under management (some asset classes can be assessed against the taxonomy). The list of 'eligible investments' could be widened as the taxonomy regime evolves (criteria for remaining environmental objectives) and once the NFRD is reviewed.

Question 29: This advice focuses on the collective portfolio management activities of asset managers. Should this advice also cover potentially any other activities that asset managers may have a license for, such as individual portfolio management, investment advice, safekeeping and administration or reception and transmission of orders ('RTO')?

66. Most SMSG members are, in theory, open to extend the reporting to other portfolios, in particular individual mandates, but not to activities that do not involve discretionary management, such as advice, safekeeping, etc. However, they are worried that this would come with a granular public reporting obligation, which could be problematic for client confidentiality reasons. One member however pointed out that these disclosures would always be made on an aggregate basis and the risk of disclosing confidential information would therefore be minimal.

Question 30: Do you agree that for the numerator of the KPI the asset manager should consider a weighted average of the investments exposed to investee companies based on the share of turnover derived from Taxonomy-aligned activities of the investee companies? If not please propose and justify an alternative.

67. The SMSG agrees that for the numerator of the KPI, the asset manager should consider a weighted average of the investments exposed to investee companies based on the share of turnover derived from Taxonomy-aligned activities of the investee companies.

Question 31: Do you agree that in addition to a main turnover-derived Taxonomy-alignment KPI, there is merit in requiring the disclosure of CapEx and OpEx-derived figures for Taxonomy-alignment of an asset managers' investments?

68. The SMSG recommends to first use turnover. Comparability of the information is of utmost importance and turnover is a relatively simple data to collect.

69. CapEx would make sense because it helps understanding investment challenges, hence forward-looking but the main issue is its feasibility and perimeter. The CapEx KPI is probably the most interesting metric for investors. It helps understand the direction of travel of the company and validate companies' strategies whilst it is also useful for investment funds focusing on companies in transition (vs already green). Nevertheless, to cumulate the account for both figures, green capex and revenues of investment in equities or corporate debt, is probably unrealistic and a separate reporting would be needed (on an optional basis).

70. Furthermore, the granularity of communication for non-financial companies varies as quarterly reports are much lighter in certain sectors. This challenge does not relate only to taxonomy but also to classic accounting and financial reporting. The SMSG questions how data providers would ensure comparability of CapEx and OpEx data in view of the issues underlined by ESMA in the first part of the consultation.

71. As such the SMSG recommends to use turnover and when possible, with a best effort approach, to disclose CapEx and OpEx-derived figures for Taxonomy-alignment of an asset managers' investments.

Question 32: Do you think sovereign exposures, such as sovereign bonds (but excluding green bonds complying with the EU Green Bond Standard) should be considered eligible investments and if so under what methodology?

72. The SMSG is of the opinion that the following distinction should be made.

73. Sovereign analysis is not mature enough yet. Therefore, classic sovereign exposure should not be considered as eligible investment as it would mean asset managers will do national cost accounting which is not the objective. Moreover, there is no upstream allocation of the debt. Asset managers are not equipped to check whether countries are keeping their commitments. If sovereign bonds were considered eligible investment, it is unclear how corporate debt and sovereign debt would have to be aggregated and how the debt of state entities with mixed activities, such as sovereign wealth funds, would be classified. Thus, the information sent to investors would be less relevant.

74. Having said that, sovereign Green Bonds should be treated differently. When talking about Sovereign debt, only sovereign Green Bonds complying with the EU GBS should be taken into account. This will encourage Member States to issue Green Bonds.

75. However, the SMSG notes that EU Green Bonds are eligible investments only if compatible with the EU Green Bond Standard. The SMSG questions whether the same criterion applies where the issue is in compliance with a similar type of standards that is not an EU standard. The SMSG is of the opinion that the value of sovereign Green Bonds cannot be limited to those that comply with the EU GBS. The SMSG therefore advises that, while those that comply with the EU GBS should be counted for their entire value (100%), other sovereign Green Bonds should be included for their value aligned with the Taxonomy.

Question 33: Do you agree that the denominator should consist of the value of eligible investments in the funds managed by the asset manager or should it be simply the value of all assets in the funds managed by the asset manager?

76. The SMSG agrees, subject to the following reservations.

77. The SMSG recommends that the exclusion for sovereign Green Bonds is removed and that they are included as part of the denominator for those calculations. They are an important part of the market and there is no reason for excluding them from the scope. Furthermore, the EU commission will be issuing Green Bonds in the future under the scheme. The objective is to provide the capital and private funds to finance the economic growth and the transition and transformation of the European economy.

78. Some members of the SMSG believe the scope of the denominator should consist of the value of eligible investments in the funds managed by the asset manager, whilst other members believe it should consist

in the value of all assets in the funds managed by the asset manager. In any event, consistency between numerator and denominator is important.

Question: 34: Do you support restricting the denominator to funds managed by the asset manager with sustainability characteristics or objectives (i.e. governed by Article 8 or 9 of Regulation (EU) 2019/2088)? What are the benefits and drawbacks of such an approach?

79. The SMSG agrees with ESMA's view, as set out in section 183 of the Discussion Paper, that the definition of "eligible investments" should be broad and not limited to funds that qualify as sustainable investments under Article 9 or investments with ESG characteristics under Article 8 of SFRD. This objective would be best served by a definition of "eligible investments" that includes green bonds (compliant with the EU Green Bond Standard), public and private equity, real estate and corporate bond investments in investee companies, as suggested in section 188 of the Discussion Paper (first option). This broad approach provides a more accurate view as to what proportion of an asset manager's total investments is invested in environmentally sustainable economic activities, which is the ultimate objective of the proposed disclosures.

80. One member of the SMSG supports an approach based on article 8 and 9 (section 188, second option), arguing that it allows a precise perimeter that will be controlled by the asset manager, hence checked, compliant and secured. We therefore recommend using the application of the Article 8 and 9 funds denominator only as an additional indicator, but it should not replace the eligible investments indicator in question 33.

Question 35: Is it appropriate to combine equity and fixed income investments in the KPI, bearing in mind that these funding tools are used for different purposes by investee companies? If not, what alternative would you propose?

81. The SMSG agrees that it is appropriate to combine equity and fixed income investments in the KPI as most shares are bought on the secondary market anyways. Moreover, it allows focusing on funds with sustainability claims and tackling more accurately concerns around greenwashing

Asset managers - Questions relating to the methodology for preparing the KPI

Question 37: What are the benefits and drawbacks of limiting Taxonomy-aligned activities to those reported by Non-Financial Reporting Directive companies?

82. Some member, representing asset managers, support asking companies as much information as possible because they know their own business model. They are of the opinion that, in the meantime, the use of standardised proxies provided by a public entity seems like a sensible idea to avoid capital only flowing towards large issuers (review of the NFRD is expected to take several years).

83. Other members of the SMSG disagree with the proposed use of proxies. The ultimate purpose of imposing a KPI disclosure framework is to encourage, and enforce the production of authentic, empirical data that inform investment decisions and the general political and societal debate. The introduction of proxies would only reduce incentives for companies and financial intermediaries to furnish actual data. Moreover, it could also dilute the quality of the disclosures provided. Finally, if the use of such proxies by asset managers would be optional only, this potentially expensive and time-consuming exercise would be much less informative.

Question 38: Do you agree with ESMA's recommendation that the Commission develop a methodology to allow a sector-coefficient to be assigned for non-reporting investee companies?

84. The SMSG agrees with ESMA's recommendation that the Commission develop a temporary methodology to allow a sector-coefficient to be assigned for those non-reporting investee companies. To avoid conflicts of interest, the SMSG encourages the Commission to develop a dedicated transitional methodology. This transitional methodology should be time-limited, however that should be replaced by the Non-Financial Reporting Directive as soon as this is in place, and actual data should be prioritised and encouraged whenever possible.

Question 39: Should netting be allowed, on the lines of Article 3 of the Short-Selling Regulation?

85. The SMSG agrees with ESMA to allow for netting short positions on the lines of Article 3 of the Short-Selling Regulation at fund level, and with the adequate transparency.

Question 40: How should derivatives be treated for the calculation purposes? Should futures be considered as potential Taxonomy-aligned investments?

86. The SMSG agrees with ESMA's position that the calculation on taxonomy-alignment should exclude derivatives.

87. **Question 41: What are the costs and benefits associated with the different options for non-reported activity coverage, netting and derivatives treatment presented above? Please provide a quantitative estimate for each option, distinguishing between one-off and on-going costs.**

88. Regarding non-reported activity coverage and companies that do not publish the information, asset managers need data and hence a methodology developed by the European Commission.

89. Regarding netting, the SMSG agrees. Regarding derivatives, for now, since derivatives are off-balance sheet, the SMSG suggests to exclude them.

Asset managers - Questions relating to the presentation of the KPI

Question 42: Do you have any views on the proposed advice recommending a standardised table for presentation of the KPI for asset managers in Annex IV?

90. The SMSG supports the proposed template except for:

- a. The inclusion of OpEx: the SMSG sees little value in including OpEx at asset management level.
- b. While the breakdown by environmental objective makes perfect sense, the activities of one company might contribute to more than one objective. And while for the calculation of the overall taxonomy-alignment there cannot be double-counting and investors will use the overall % disclosed or estimated per company, an accurate reporting per environmental objective should be done based on the companies' breakdown disclosures, and should allow the inclusion of one activity in more than one environmental objective.
- c. A number of asset managers raised concerns regarding the merits of having to break down their AuM by economic activity, as recommended by ESMA in section 4.4.2 of the draft advice on page 77 ("the presentation of the disclosure should identify which environmental objectives the investments contribute to and where possible the activities invested in should be identified for each environmental objective"). There are a total of 21 NACE macro sectors, with 7 of these having been identified as relevant by the TEG for climate mitigation. These 7 macro sectors have been further broken down into over 70 more detailed economic activities. As the remaining four environmental objectives are screened, we are likely to see this list multiply considerably. Given that most asset managers invest across the market, disclosures by economic activity would become extremely cumbersome for asset manager. Such level of reporting is also not useful to either investors or distributors.

- d. The proposed template assumes that for all environmental objectives there are and/or will be transitioning and enabling activities. However, that is not the case for climate adaptation and no decision has been taken regarding the other objectives. The SMSG is of the opinion that the breakdown should only be applied – for the time being – to climate change mitigation activities.

Question 44: Do you agree that there would be merit in including in the accompanying information a link, if relevant, to an asset managers' entity-level disclosures on principal adverse impacts of investment decisions on sustainability factors?

91. Some members of the SMSG believe there would be no merit in including a link and recommend to keep this link on a voluntary basis, since both types of information fall under different regulations. Other members find it is a good proposal as information on principle adverse impacts will be very helpful for investors to better evaluate sustainability of the investment, especially in the absence of a Taxonomy of environmentally harmful activities. Providing a reference to those disclosures in the accompanying information will make it easier to locate such disclosures.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 16 December 2020,

[signed]

Veerle Colaert
Chair
Securities and Markets Stakeholder Group

[signed]

Florence Bindelle
Rapporteur