

## European Supervisory Authorities Publish Final Report on Taxonomy-related Disclosures

October 2021

On 22 October 2021, the European Supervisory Authorities (“**ESAs**”) published their **final report** setting out draft regulatory technical standards (“**Draft RTS**”) on disclosures under the Taxonomy Regulation.

This final report follows the publication of the ESA’s March 2021 consultation on Taxonomy-related disclosures and amends the draft RTS set out in the ESAs’ earlier final report on disclosures under the Sustainable Finance Disclosure Regulation (“**SFDR**”), published in February 2021 (the “**SFDR RTS**” – see [Joint ESAs Final Report on RTS under the SFDR](#)).

The October final report includes a consolidated version of the RTS (omitting Annex I on principal adverse impact statements). Both reports are now being considered by the European Commission (“**Commission**”) with a view to establishing a single rulebook for sustainability disclosures that will apply from the same date.

The consolidated RTS cover:

- the “do no significant harm” principle for sustainable investments;
- the PAIS template for those electing to consider principal adverse impacts;
- Article 8 SFDR and Article 9 SFDR product pre-contractual disclosures;
- Article 8 SFDR and Article 9 SFDR product website disclosures; and
- Article 8 SFDR and Article 9 SFDR product periodic disclosures.

The October final report has moved on from the March proposals in a number of respects, as detailed further below.

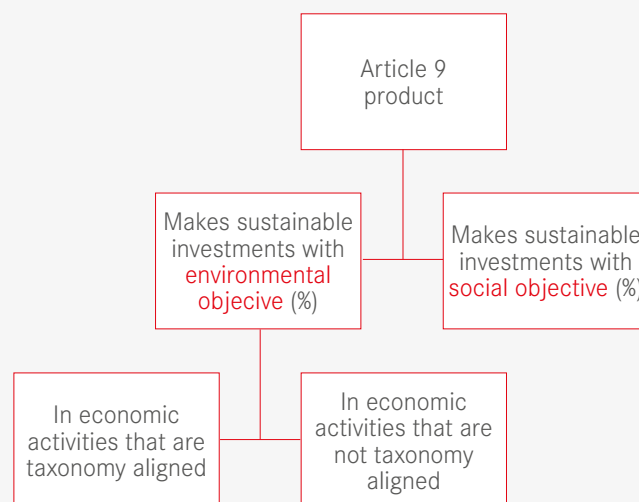
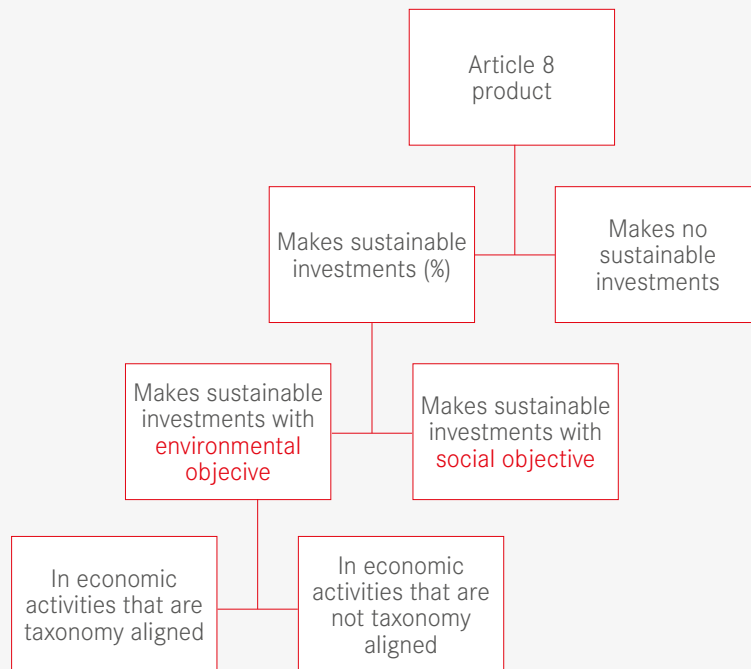
### **Sub-categories of Article 8 and Article 9 SFDR Funds**

The amendments to the mandatory disclosure templates set out in the Draft RTS include a new form of “tick-the-box” disclosure, which will introduce the concept of sub-categories of Article 8 SFDR and Article 9 SFDR funds. These sub-categories will be identifiable in the opening section of the pre-contractual and periodic disclosure templates. Article 8 funds (which promote environmental or social characteristics) will be required to identify whether or not they commit to investing in sustainable investments. Where an Article 8 fund commits to making sustainable investments, it must identify the percentage of such investments the fund will make and confirm

whether those investments contribute to an environmental objective or to a social objective. Where an Article 8 fund makes sustainable investments with an environmental objective, it must further identify whether such investments are Taxonomy-aligned or not.

Similarly, Article 9 funds (which have sustainable investment as an objective) are now required to identify whether they are pursuing an environmental or a social objective.

Article 8 funds that commit to making sustainable investments and Article 9 funds must disclose a percentage minimum share of sustainable investments.



## Taxonomy Alignment Disclosure

The latest Draft RTS propose that two types of graph are included in the pre-contractual disclosures for funds making Taxonomy-related disclosures. The mandatory templates now include two pie charts, one showing the Taxonomy alignment of investments including sovereign exposures and one showing Taxonomy alignment excluding sovereign exposures. The ESAs define sovereign exposures as any investment that results in “an exposure to central governments, central banks and supranational issuers”. The ESAs outlined their concern to the Commission when submitting the Draft RTS that the inclusion of two graphical representations of the extent of Taxonomy-alignment introduces increased complexity to the disclosures.

## Calculation Methodology for Taxonomy Alignment

The Draft RTS make changes to the methodology used to calculate Taxonomy alignment. The list of asset classes that may be included in the numerator when calculating Taxonomy alignment has been expanded so that the list now includes:

- Equities
- Corporate bonds
- Green bonds issued under the future EU Green Bond Standard
- Other green bonds
- Investments in real estate assets
- Investments in infrastructure assets
- Investments in securitisation positions
- Investments in other financial produces falling with the scope of Article 5 and 6 of the Taxonomy Regulation

Turnover must be used as the default key performance indicator (“**KPI**”) when calculating the Taxonomy alignment of investments in non-financial undertakings for pre-contractual disclosures. Capital expenditure (“**Capex**”) or operational expenditure (“**Opex**”) may be used as an alternative KPI if considered more appropriate taking into account the features of the relevant fund. The same KPI must be used for all investments in the pre-contractual disclosure. Periodic reports must disclose the Taxonomy alignment of the portfolio using all three KPI for non-financial undertakings.

For financial investee companies, managers must use the KPIs prescribed for financial institutions under Article 8 of the Taxonomy Regulation.

In light of the rules relating to the use of KPIs, for pre-contractual disclosure, the extent of taxonomy alignment will be made by way of the pie chart referred to above, whereas for periodic disclosures, given the three separate KPIs, the extent of Taxonomy alignment will be illustrated by way of a bar chart.

The Draft RTS also provide that derivatives cannot be included in the numerator when calculating the Taxonomy alignment of a portfolio.

## External Assurance

The Draft RTS retain the requirement set out in the March 2021 consultation for managers to disclose whether their Taxonomy alignment disclosures will be / have been subject to an assurance review by an auditor or another third party, despite pushback by industry in relation to this proposal. If such a review is to take place, the fund manager must name the auditor or third party.

## The Do No Significant Harm Principle

In a departure from the March 2021 proposals, the ESAs have proposed in the Draft RTS that the do no significant harm (“**DNSH**”) related disclosure requirements will apply to all sustainable investments, including those which are Taxonomy-aligned (the March 2021 consultation suggested that Taxonomy-aligned investments would not have to consider the DNSH requirements).

Fund managers will now need to firstly satisfy themselves that the relevant investments meet the DNSH requirements under the applicable technical screening criteria under the Taxonomy Regulation and secondly set out in their pre-contractual disclosures how the adverse impact indicators detailed in Annex I to the SFDR RTS are taken into account in the manager’s assessment.

In their letter submitting the Draft RTS to the Commission, the ESAs outline their concern relating to the increased requirements on Taxonomy-aligned investments arising from the obligation for those investments to be compliant with the DNSH provisions of the SFDR RTS, in addition to the technical screening criteria for DNSH under the Taxonomy Regulation. The ESAs recognise in the final report that, as a result of these provisions, the number of funds that will be Taxonomy-aligned will greatly decrease.

## Consideration of Principal Adverse Impacts

The Draft RTS contain a welcome clarification that an Article 9 SFDR fund is not automatically required to consider principal adverse impacts simply by virtue of the fact that it is an Article 9 fund.

## Article 8 Funds with no Commitment to Sustainable Investment

It was evident from the ESAs’ March 2021 consultation that the ESAs take the view that an Article 8 SFDR fund which does not commit to making sustainable investments does not need to make Taxonomy-related pre-contractual and periodic disclosures. This would create an important distinction between different types of Article 8 SFDR funds (perhaps creating Article 8+ and Article 8- sub-categories), where Article 8 SFDR funds with no commitment to making sustainable investments would not have to capture the relevant data in order to make the Taxonomy-related disclosures. Such funds may elect to make a statement similar to that required to be made by Article 6 SFDR funds under Article 7 of the Taxonomy Regulation (to the effect that the investments underlying the fund do not take into account the EU criteria for environmentally sustainable economic activities) or to include a clarifying disclosure in prospectuses from 1 January 2022. This is subject, of course, to the Commission not taking a different view to that adopted by the ESAs in its review of the Draft RTS.

### Application Date

The Level 2 measures under the SFDR were due to apply from 10 March 2021 and the Taxonomy Level 2 measures were due to apply from 1 January 2022. Due to delays in drafting the Draft RTS, it was announced in July of this year that the application date would be delayed to 1 July 2022. This date has now been further delayed to **1 January 2023**. The staggered application dates of the various pieces of legislation forming part of the Commission's Sustainable Finance Action plan has led to a number of implementation challenges, including the need to update prospectuses a number of times to meet the requirements within a short timeframe. Issues also arise in relation to the interaction of the legislation with the amendments to Level 2 rules under the Markets in Financial Instruments Directive ("**MiFID**") in relation to the identification of investors' sustainability preferences under amendments to the MiFID suitability assessment rules, which are due to apply from 2 August 2022. Industry continues to engage at both a domestic and European level with regulators in relation to these implementation challenges.

### Next Steps

The Commission will scrutinise the Draft RTS and decide whether to endorse them within three months of their publication (ie, by 22 January 2022). The Draft RTS will then be subject to a three month scrutiny period (extendable by a further three months) by the European Parliament and the Council of the EU ("**Council**"). If the European Parliament and Council raise no objections, the final RTS will then be published in the Official Journal of the EU.

*Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.*

*Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at [www.matheson.com](http://www.matheson.com).*

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