

European Commission
DG FISMA
Rue de Spa 2
1000 Brussels
Belgium

24 September 2021

Dear Sirs,

We wanted to update you on our members' current thoughts and key concerns about SFDR and the Taxonomy Regulation. We have chosen this moment to write having digested the [Q&A](#) published on 26 July, for which thanks.

We believe that some remaining uncertainties could be resolved through revisions, which we understand may be contemplated to the draft SFDR Regulatory Technical Standards, due to come into effect on 1 July 2022.

Please could you let us know when the final draft RTS (or any further consultation on revisions) are expected to be published please?

Please could you provide (or ask the ESAs to provide) guidance on the issues raised in this letter in the meantime?

Interaction between SFDR and the Taxonomy Regulation

There remains considerable uncertainty in the market about the relationship between the Taxonomy Regulation and Article 8 SFDR.

We addressed this topic in our [response](#) (dated 12 May 2021) to the ESAs' Joint Consultation¹ and again in our email to the European Commission of 26 April 2021 (copy enclosed). We have not yet received any substantive response to our questions.

It is clear that all products subject to Article 8 marketed on the basis that they make environmentally sustainable investments must include in their pre-contractual disclosures and annual reports prescribed disclosures about the extent to which they pursue Taxonomy alignment (Articles 8(2a) and 11(1)(d) SFDR and Article 6 Taxonomy Regulation) - at a minimum, the requirement to state that the non-sustainable investments do not take into account EU criteria for environmentally sustainable activities.

It is also clear that a product which falls within Article 8 SFDR because it has promoted only a social (as opposed to any environmental) characteristic will not be required to gather data and report periodically on the percentage of investments which are Taxonomy-aligned². (This could change following implementation

¹ [ESAs' Joint Consultation Paper](#) on Taxonomy-related sustainability disclosures, JC 2021 22, 15 March 2021

² A description of how and to what extent the product's investments are in economic activities that qualify as environmentally sustainable within the meaning of Article 3 of the Taxonomy Regulation, specifying the following as percentages of all the product's investments: (a) the proportion that are in *environmentally sustainable economic activities*; and (b) the proportions that are in *enabling and transitional activities*.

of an EU Social Taxonomy.) Equally, as explained on page 2 of our [response](#) (dated 12 May 2021) to the ESAs’ Joint Consultation, we are not expecting managers to report Taxonomy alignment for investments that they have not categorised as “sustainable investments” within Article 8 funds.

However, it remains important for our members to receive final confirmation that not every product subject to Article 8 on the basis of an environmental characteristic must also gather data and report periodically on the extent of Taxonomy Regulation alignment. The ongoing uncertainty arises from the consultation draft SFDR Regulatory Technical Standards, as amended by the draft Taxonomy-related sustainability disclosures (which was the subject of the ESAs’ Joint Consultation).

In order to explain the point, it is simplest to look first at Annex II (template pre-contractual disclosures for Article 8 products) to the draft RTS. By means of tick-box disclosures, the draft pre-contractual disclosures set up a distinction between:

- (1) an “ordinary” Article 8 product which promotes an environmental characteristic but does not (commit to) make any one or more sustainable investments (as defined in Article 2(17) SFDR) (a “light green product”); and
- (2) an Article 8 product which promotes an environmental characteristic and (commits to) make at least one sustainable investment (which sustainable investment(s) may or may not be Taxonomy-aligned) (a “mid-green product”).

For the purposes of clarity, we have pasted below the relevant section of the template pre-contractual disclosures.

Annex I

ANNEX II

Template precontractual disclosure for financial products referred to in Article 8(1) of Regulation (EU) 2019/2088

Product name/legal identifier: [complete]

Environmental and/or social characteristics

[tick when relevant]
This product: Promotes environmental or social characteristics, but does not have as its objective a sustainable investment

It does not invest in sustainable investments

It invests partially in sustainable investments

In activities aligned with the EU Taxonomy

In activities not aligned with the EU Taxonomy

(These categories are obviously each distinct from an Article 9 product, which has sustainable investment as its objective, in the sense (clarified by the 26 July Q&A) that it makes (or commits to make) *exclusively* sustainable investments.)

The disclosure of Taxonomy alignment for Article 8 products in their periodic reports is set out in Article 61a of the draft RTS.

Pursuant to Article 58(cc) of the draft RTS, reporting under Article 61a is only required “for a financial product which included a commitment to make sustainable investments”, i.e. in respect of a mid-green product only.

Similar (but not identical) wording is used for pre-contractual disclosures: the trigger for Article 8 products to report Taxonomy alignment in their pre-contractual disclosures under Article 16a RTS is “for a financial product which includes sustainable investments” (Article 13(3)(cc) RTS). In the context of closed-ended funds (such as private equity and venture capital funds) which may not have made any investments when the pre-contractual disclosures are finalised, the most natural reading of this trigger is where a financial product makes a commitment to make sustainable investments.

As we have previously noted, our reading of the ESAs’ Joint Consultation Paper is therefore that financial products classified as Article 8 SFDR products only need to report under Article 6 Taxonomy Regulation if: (a) such products positively commit to making environmentally sustainable investments as defined by Article 2(17) SFDR; and (b) the Article 8 SFDR product has an environmental characteristic corresponding to a Taxonomy Regulation Article 9 objective.

Accordingly, therefore, a product which makes no such commitment is not required to measure or report under Article 6 Taxonomy Regulation or the Taxonomy-related disclosure RTS. Our understanding from the ESAs joint public hearing held on 29 April 2021 was that this view is shared by the ESAs.

Please could the European Commission or the ESAs confirm that this is correct?

We believe that it follows from the above that, where an Article 8 SFDR product does not commit to making sustainable investments as defined by Article 2(17) SFDR, but then does in fact make such an investment, that product would also not be required to disclose Taxonomy alignment under Article 6 of the Taxonomy Regulation in neither its pre-contractual nor its periodic disclosures. We understand that the main purpose of the periodic disclosure requirements pursuant to Article 11 SFDR and Articles 58 *et seq.* of the RTS is to demonstrate the extent to which environmental characteristics promoted in the pre-contractual disclosures were in fact met and hence to hold financial market participants accountable regarding claims made in the pre-contractual disclosures. It follows that where there was no commitment to making sustainable investments that was expressed in the pre-contractual disclosures, but such an investment is then in fact made, there should be no requirement to measure or report pursuant to Article 6 of the Taxonomy Regulation and the RTS. We understood from the ESAs public hearing that the ESAs also share that view, but they reserved final judgement on the question.

Please could the European Commission or the ESAs confirm that our view, and the view expressed by the ESAs at the public hearing, is correct?

Significance

Although we have raised this point before with both the European Commission and the ESAs, it has taken on renewed significance in light of the 26 July Q&A. The apparent breadth of the notion of “promotion of environmental or social characteristics” makes the point very significant. It is one thing for Article 8 to require very many products to make clear disclosures towards investors in order to avoid greenwashing, and to report by reference to indicators linked to the characteristics so promoted (as Article 8 itself requires). It would be a very different and much more onerous and expensive requirement for financial market participants to undertake Taxonomy Regulation data capture and reporting in circumstances where the product is not marketed on the basis that it will make environmentally sustainable investments or, if it has

made such a commitment, in relation to those investments that it is not classifying as “sustainable” for SFDR reporting purposes.

Whilst we fully support the objectives of the Taxonomy Regulation, in the context of the climate emergency, there are not yet developed processes or systems to facilitate Taxonomy Regulation reporting or data capture in relation to non-traded, bespoke, illiquid instruments in which our members’ products invest. The development of such systems would come at significant cost to investors. In addition, Taxonomy reporting at portfolio company level can be challenging and places a significant burden on management teams. Indeed, it is important to recognise the data limitations in relation to smaller unlisted companies whose entry into a private equity and venture capital portfolio will often represent their first encounter with climate-related reporting requirements.

Above all, our members require legal certainty on the issue. In the absence of such certainty, some of our members are being very cautious not to promote any environmental or social characteristic in a way which would purport to qualify their duty to maximise risk-adjusted returns, since (as confirmed helpfully in the Q&A), mere integration of sustainability risks, as defined by Article 2(22) SFDR, is not sufficient for Article 8 to apply. This caution could in some cases create a barrier to better environmental, social or governance practices, which our members might otherwise wish to adopt and actively promote, as best practice.

We should be delighted to discuss these issues further.

Yours sincerely,

Martin Bresson
Director of Public Affairs

Enclosure:

- Invest Europe email to the European Commission of 26 April 2021 on the interaction between SFDR and the Taxonomy Regulation (Interpretation of Article 8)