EU Newsletter
#3 Sustainability Reporting

June 2022 – Part C

While there has been much focus on the standard-setting initiatives of sustainability reporting, there are still developments as regards other Taxonomy and SFDR regulations.

This final part of the June issue provides an insight on the first taxonomy-related disclosures for corporates and into the banking industry, it shows that more clarity in the provisions of the Taxonomy Regulation is needed to allow investors to make meaningful comparisons.

It also discusses the recommendations made by the European Platform on Sustainable Finance for an extension of the current environmental taxonomy framework and a social taxonomy, as planned by the Taxonomy Regulation.

And finally, it summarises the latest developments for the SFDR, which turns out to be quite difficult for financial market participants to implement.

Enjoy your reading

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Taxonomy benchmark for corporates

This year, European non-financial undertakings have made a first step in reporting on the sustainability of their activities. For the first time, non-financial undertakings must report on the "eligibility" of their activities. More specifically, non-financial undertakings are required to disclose to what extent their economic activities are described in the Taxonomy Regulation, thus qualify as potentially sustainable, by presenting three performance indicators: turnover, capital expenditures ("Capex") and operating expenses ("Opex"). Those indicators must be completed with some qualitative information explaining the published indicators and the applied methodology.

The disclosure requirements came into effect in April and June 2021 for application as of 1 January 2022, which did not give much time to prepare. They were followed by a clarification through FAQs in December 2021 and February 2022. Therefore, it could be expected that the Regulation would not be applied in a consistent manner.

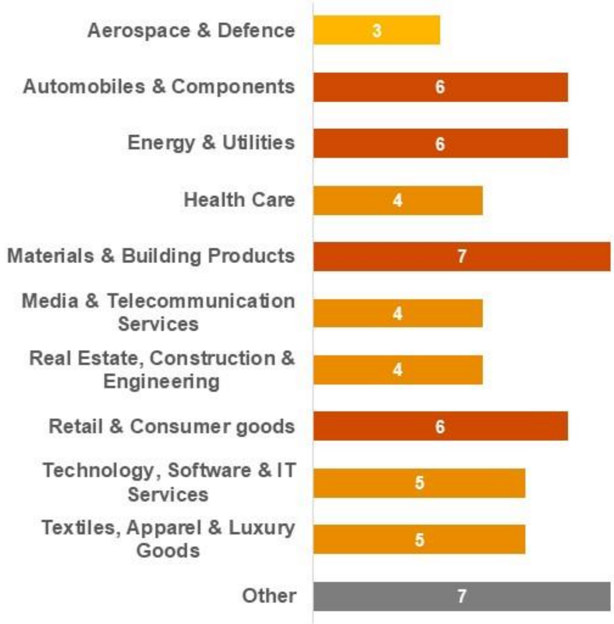
A comparison of the reported 2021 taxonomy-related disclosures shows that a large majority of non-financial undertakings have tried to comply with the eligibility requirements, but with significant differences among the industries included in the study and also different ways to calculate and disclose the taxonomy reporting.

Scope and methodology of our study on 2021 taxonomy-related disclosures

Our study of the 2021 taxonomy-related publications aimed to identify some trends or practices in the way of calculating or presenting the information related to this first reporting on the eligibility regarding the two first climate objectives.

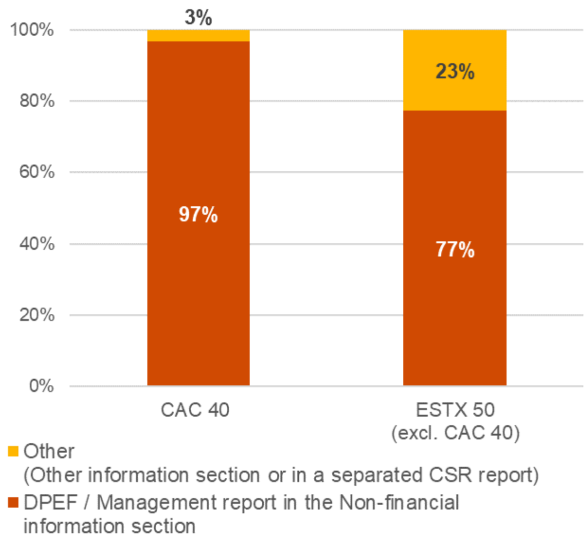
i. how the groups have disclosed the information related to the taxonomy ;
ii. to what extent they comply with the mandatory requirements for 2021 ; and
iii. to what extent they possibly went further in the 2021 exercise.

The panel review comprised 57 2021 universal registration documents or annual reports and is based on two market indices - the French CAC 40 and European ESTX 50 - allowing us to cover French publications and European disclosures.



95% of our panel (or 54 Groups) have included Taxonomy information in their 2021 annual report.
All of the following figures are based on these 54 Groups.

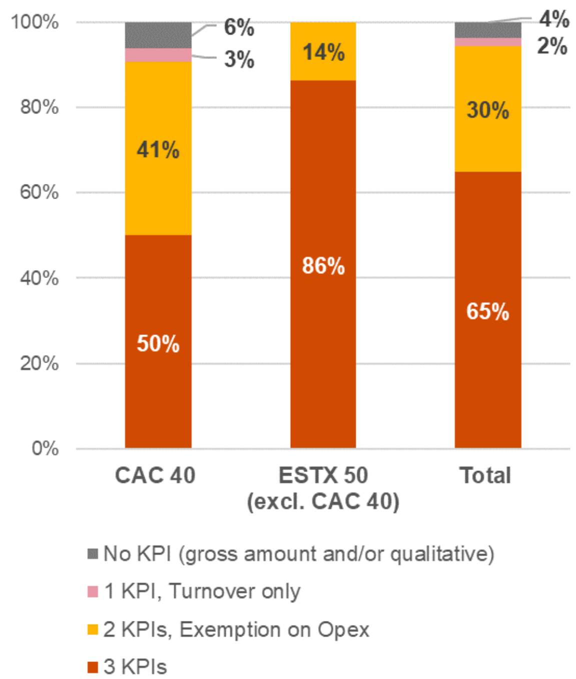
Where is the taxonomy information disclosed?



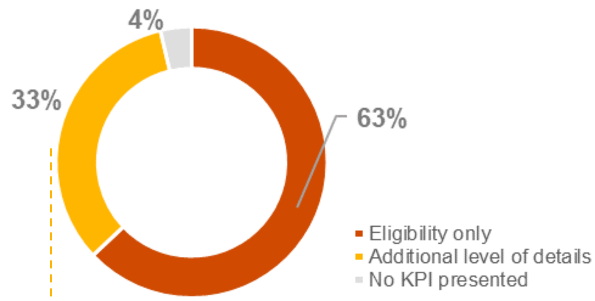
- Mainly included in the **"DPEF" for the French groups** or in the **non-financial information part of the management report for European groups**
- The taxonomy Regulation was also **regularly mentioned in other sections** such as **Governance** (for example, review of the EU Taxonomy by the audit committee) for 37% of our panel**, Risk Factors** (for example, included in the risk related to regulatory compliance) for 23% and, to a lesser extent, Company profile & strategy (20%) or Financials (11%).

Disclosures compliance with the mandatory requirements

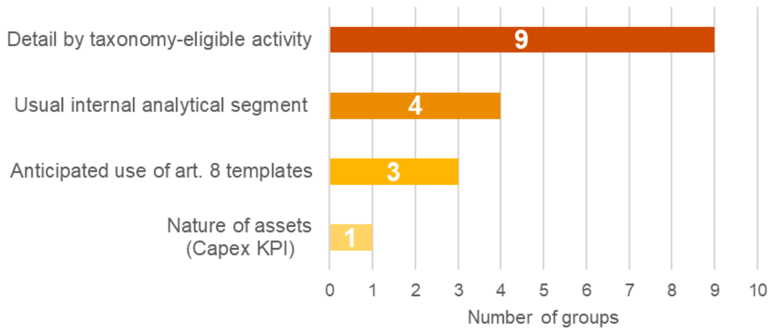
3 KPIs (Turnover, Capex and Opex)...



... disclosing eligibility and non-eligibility parts

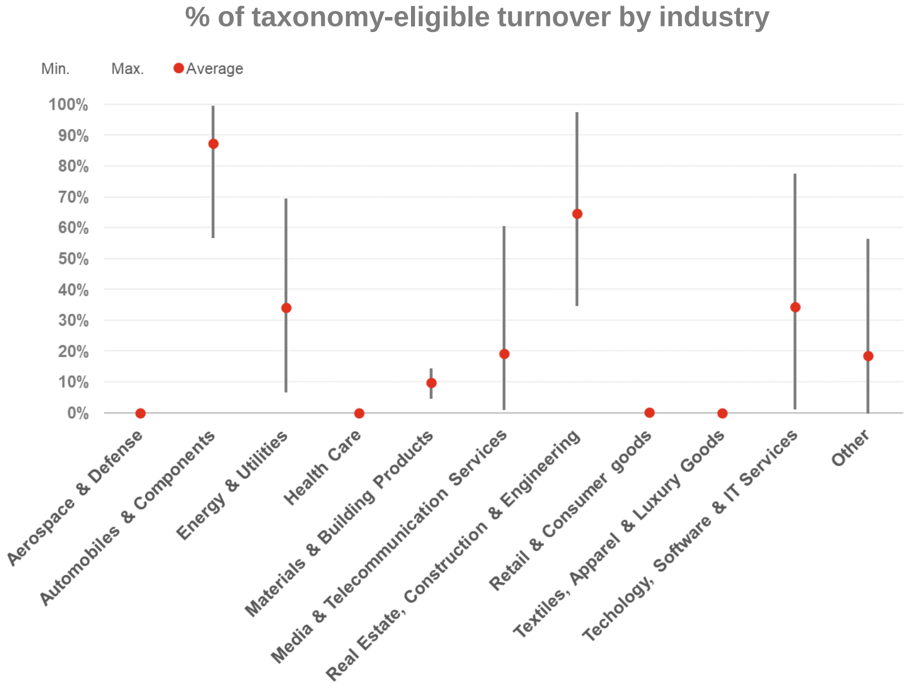


Which additional details ?



- **95%** of our panel Groups are compliant with the requirements on the KPIs to disclose (that is, turnover, Capex and Opex) except where the materiality exemption can be used for the Opex ratio.
- Groups have disclosed **eligible / non-eligible split**, mainly using a **table or a graph**, few of them (17 or 33%) have included **complementary details and** 3 of them have anticipated the use of the **article 8 template**.
- All Groups have included qualitative information but with a **variable level of detail,** most of them have also included useful information to **reconcile the ratios with financial statements notes.**

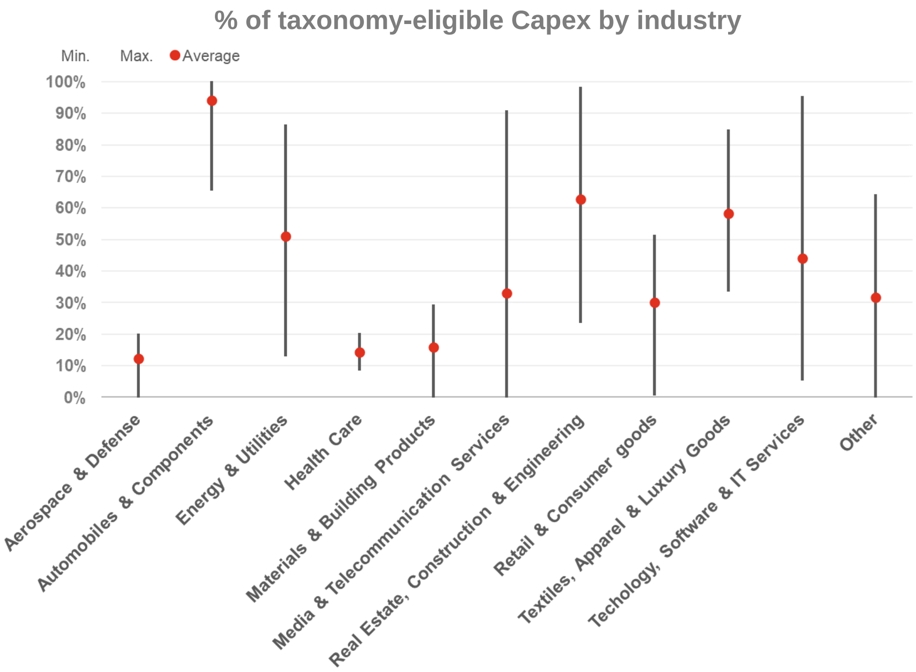
Focus on taxonomy-eligible turnover



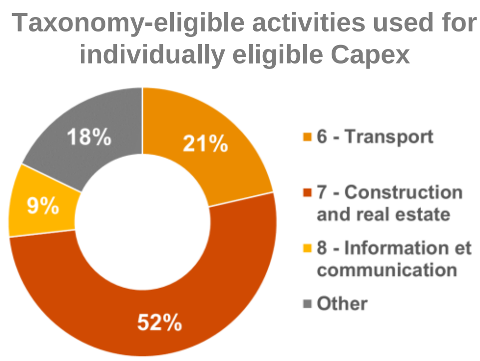
- Following eligibility requirements, **most concerned Groups** belong to the **Automobiles and Real estate, construction and engineering industries**
- **Some industries are not covered** by the two Climate objectives (Aerospace & Defence, Health Care, Retail & Consumer goods) for their core businesses
- Even in a common industry, **% of taxonomy-eligible turnover differs significantly from one Group to another**
- Groups have disclosed eligible activities mainly through the **Objective 1 - Climate change mitigation**

Focus on taxonomy-eligible Capex

94% of our panel (or 51 Groups) have presented the Capex indicator in their 2021 taxonomy reporting



- Although some Groups did not identify any taxonomy-eligible activities among their core businesses, **most of them were able to disclose taxonomy-eligible Capex**
- **73%** of our panel Groups have included **individually eligible Capex** which mainly comprised investments related to the 7 and 6 activities (Real estate and vehicle fleet)

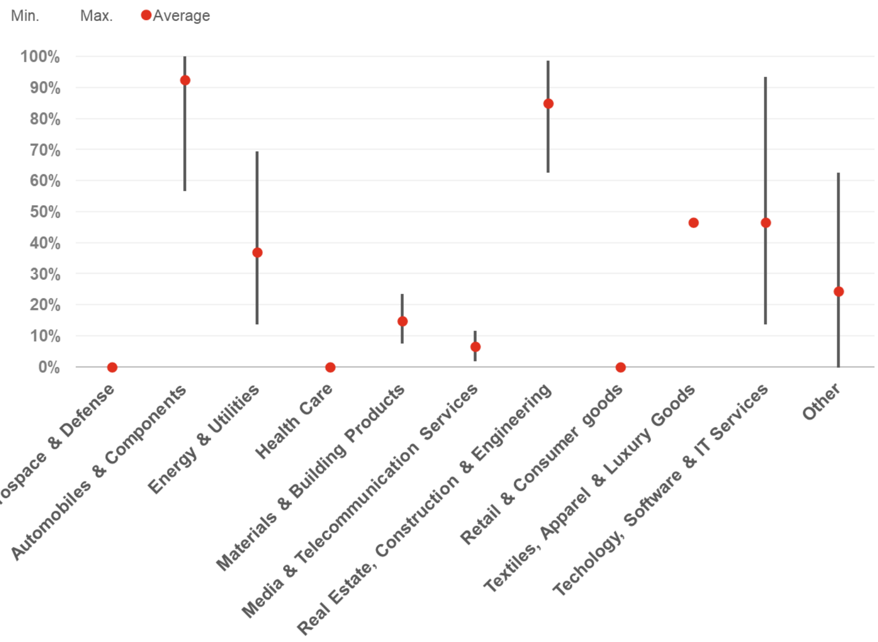


Focus on taxonomy-eligible Opex

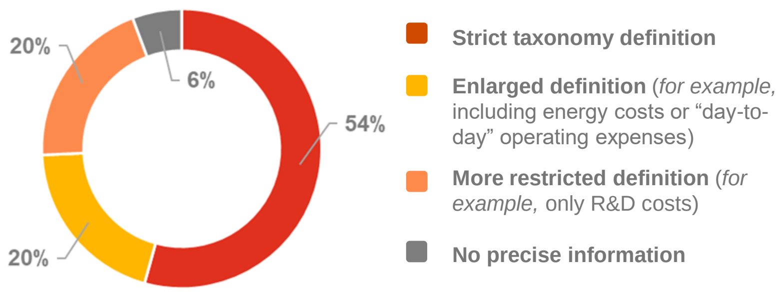
65% of our panel (or 35 Groups) have presented the Opex indicator in their 2021 taxonomy reporting.

- We observe the same trend as for the turnover ratio (that is, some industries without any eligible Opex and some industries with high ratios such as automobile and real estate)
- When the indicator is presented, the Opex included in the indicator to comply with the **taxonomy definition differs between the Groups reviewed** (see graph below)
- Among the 19 Groups which did not disclose the indicators, 14 Groups (~74%) **explicitly mentioned the use of the permitted exemption** but applied using **different thresholds** (see graph below)

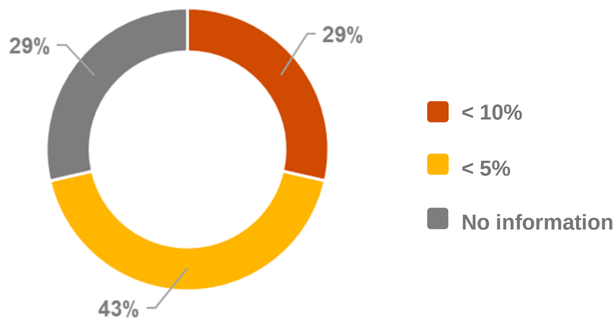
% of taxonomy-eligible Opex by industry



Opex definition used to determined the taxonomy-eligible ratio



Threshold disclosed to justify the use of the materiality exemption



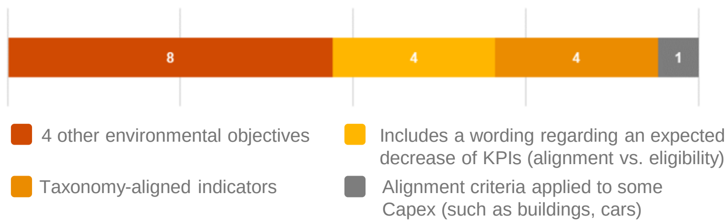
Additional disclosures

5 Groups of our panel have disclosed additional indicator(s) on eligibility

Each Group has chosen a **different** additional KPI based on:

- Extensive **consolidated perimeter** (turnover and Capex including JV)
- Restatement of **one-off significant transactions** (Capex)
- KPI definition (turnover including activities not listed in the delegated act)
- **Addition of "green" activities** not taxonomy-eligible (adjusted turnover, such as Turnover excluding service charge income)
- Taxonomy-eligible **EBITDA**

17 Groups of our panel have presented some information in anticipation of the future reporting requirements



- **4 groups** belonging to the **automobile or energy industries** have calculated **aligned indicators**
- **8 groups** have provided information related to the **4 following objectives with different levels of details** from only a short sentence mentioning that the group will be more concerned by the following objectives to a quantitative information (1 group).

Taxonomy benchmark of European banks

This year, European banks have made a first step in reporting on the sustainability of their financing activities. A comparison of the reported 2021 taxonomy-related disclosures shows that large differences exist among the 17 banks included in the study. The Taxonomy Regulation has been eagerly anticipated. For the first time, banks must report on the sustainability of their financing. More specifically, banks are required to disclose to what extent they are financing economic activities that are described in the Taxonomy Regulation and thus qualify as potentially sustainable. The Taxonomy Regulation is part of a large and complex set of continuously developing EU regulations, originating from the ambitious European Green Deal.

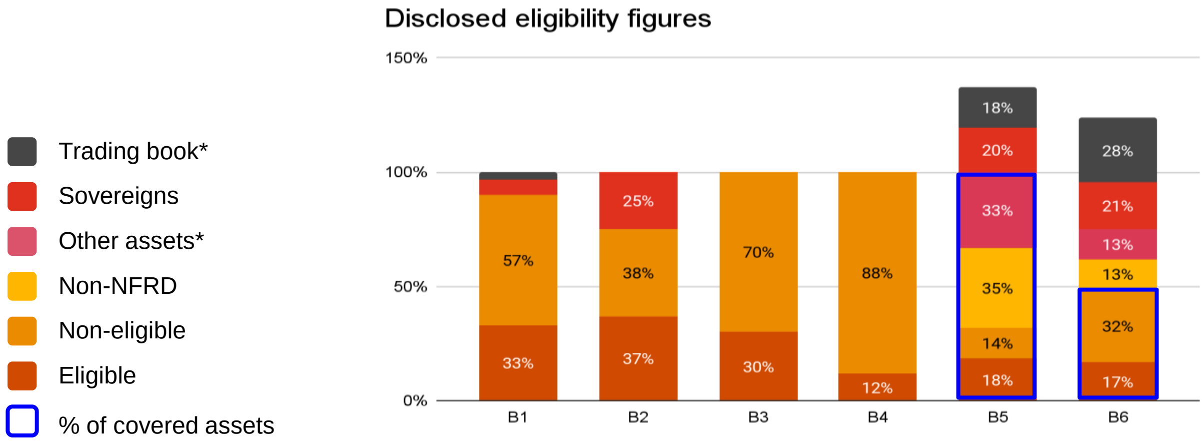
The disclosure requirements came into effect in April and June 2021 for application as of 1 January 2022, which did not give banks much time to prepare. They were followed by a clarification through FAQs in December and even in the beginning of 2022. Therefore, it could be expected that the Regulation would not be applied in a consistent manner. Nevertheless, the significance of the identified differences is quite surprising.

Different interpretations make it difficult to compare eligibility disclosures

Our research among 17 banks in the Netherlands, Germany, Belgium, France, and Spain, shows that there are roughly five different ways to determine the 'total assets', which is the denominator in the calculation of the so-called 'eligibility score' (that is, the share of 'potentially sustainable' assets). We also observed the use of four different definitions of 'non-eligibility' and that only some banks include 'cash held at central banks' in their eligibility score.

In general, banks are not trying to pretend to be better than they are. However, some banks choose an interpretation of certain disclosure requirements that is not in line with the intentions of the legislator and which an auditor might not easily approve.

As a result of the current design of the Taxonomy Regulation and the different interpretations, it is challenging to compare the disclosures and to draw conclusions about the sustainability characteristics of the individual banks. For example, the scope of the Taxonomy Regulation is still limited. Certain asset classes or economic activities that contribute to social sustainable goals are currently out of scope. In particular, loans to companies that are not in scope of the NFRD are therefore by definition not sustainable according to the Taxonomy Regulation. For instance, financing a sustainable start-up, a social enterprise in Africa, or an investment in green government bonds will not lead to a higher sustainability score according to the Taxonomy Regulation.

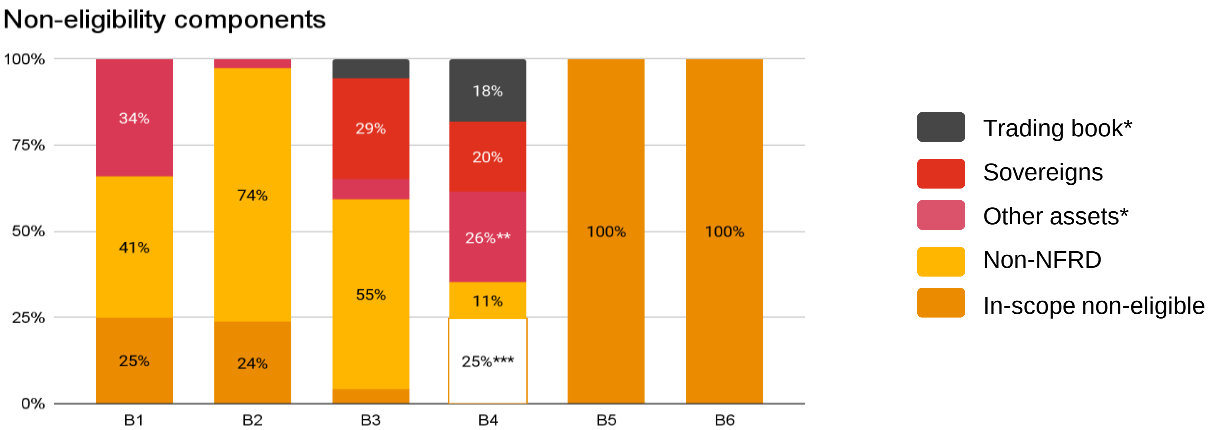


Eligible assets

- For all banks, eligible assets consist ~100% of household mortgages. B5 also considered SPVs and B6 household renovation loans (% unspecified)
- All banks except B5 estimated eligibility of NFRD exposures, in addition to the household mortgages, using NACE codes. This increased eligibility by: B1 1%, B2 8%, B3 0.09%, B4 2%, B6 9%. B5 did not provide estimates
- B1 and B6 reported estimates in the same table as the mandatory disclosures; B2, B3 and B4 reported them in a separate table

Denominator

- B1, B2, B3 and B4 used total assets as denominator
- B5 and B6 used a mix of total assets and covered assets, resulting in a sum of percentages >100%



Non-eligibility

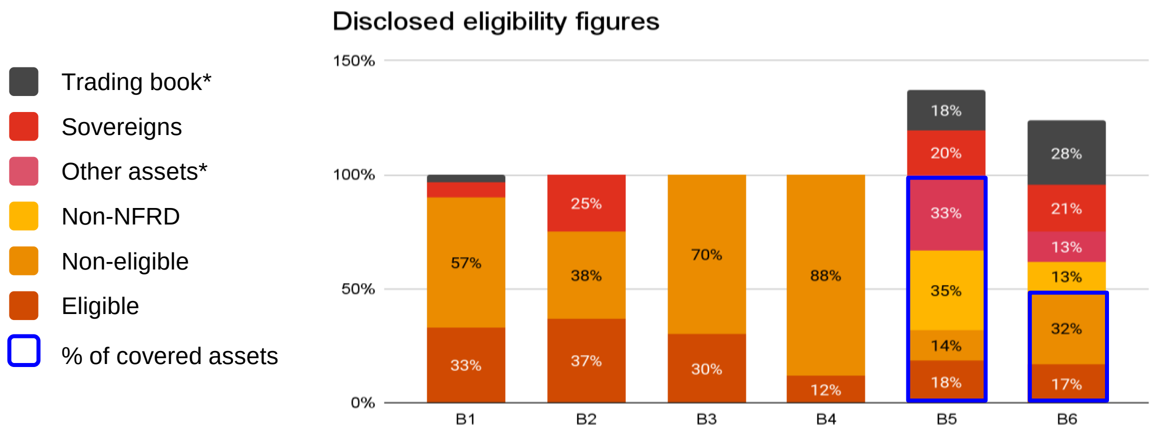
- We observed three definitions of what is regarded as non-eligible:
  - In-scope assets that are not eligible and assets excluded from the GAR, such as non-NFRD and sovereign exposure (B1, B2)
  - In-scope assets (that is, retail, NFRD, local government) that are not eligible (B5, B6)
  - All assets that are not eligible (that is, 100 % (-) eligible %) (B3, B4)

Cash held at central banks

- Requirements left room for interpretation to present as other assets (cash) or sovereign:
  - B1 and B4 present this exposure as other assets (cash)
  - B2, B3, B5 and B6 present this exposure as sovereigns

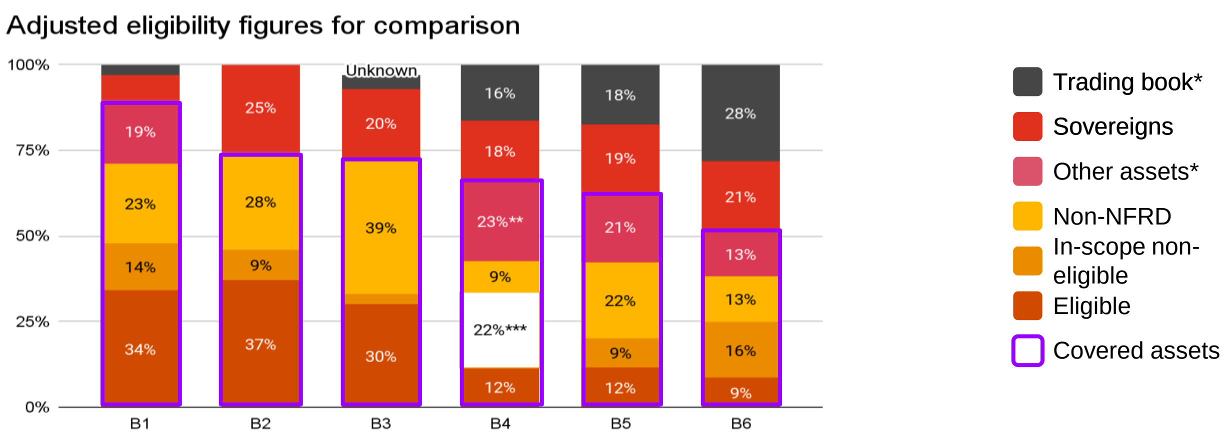
* Other assets include derivatives, on-demand interbank loans and other assets (such as, cash, PP&E, intangibles, tax)
** This concerns derivatives and on-demand interbank loans
*** From B4's disclosures it is not possible to distinguish between in-scope non-eligible assets and other assets (such as, cash, PP&E, intangibles, tax)

After correction, eligibility figures remain different due to the current design of the taxonomy Regulation and asset composition



Observations after correction:

- Differences will remain due to the design of the EUT:
  - Not all economic activities are covered
  - Not all exposures are subject to the EUT (that is. non-NFRD)
- Eligibility is about the potential to become taxonomy-aligned
- But banks with low eligibility can still have the potential to become sustainable!
- The combination of taxonomy-eligibility and taxonomy-alignment is considered to be more useful and meaningful (as of FY23)
- Currently, no bank in the peer group has reported alignment on a voluntary basis



* Other assets include derivatives, on-demand interbank loans and other assets (such as, cash, PP&E, intangibles, tax)
** This concerns derivatives and on-demand interbank loans
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More clarity is needed in European rules for sustainable financing

Given the significance of climate change, it is important that sustainable finance regulation is clear and unambiguous. It is therefore essential that the EC should provide more guidance on the application of the disclosure requirements of the Taxonomy Regulation. But there is also a task for banks themselves to work together, for example in the European Banking Federation, to pursue consistent reporting. Furthermore, banks can choose to voluntarily report taxonomy information on a larger share of their exposures on the balance sheet. Which will increase the usefulness of the sustainability score. An advantage of disclosing additional voluntary taxonomy information is that it will prepare banks for the expansion of the reporting requirements in the coming years, such as the climate risk disclosures and Banking Book taxonomy Alignment Ratio (BTAR) as part of Pillar III risk reporting, and the scope increase of the Taxonomy Regulation in line with that of the CSRD proposal, the successor to the NFRD.

Such increases in mandatory non-financial reporting requirements are urgently needed to provide insights into how European banks' financing activities contribute to a more sustainable European economy and to the climate goals set by the EC.

Social Taxonomy

Background

On 28 February 2022, the platform sustainable finance (PSF) published its final report on the Social Taxonomy (➤ here), incorporating the comments from the public consultation on the draft version published in July 2021. This report is part of the EC's mandate to investigate the provisions that would be required to extend the scope of the Taxonomy to social objectives, in accordance with Art. 26(2) of the Taxonomy Regulation.

Structure of the social taxonomy

The PSF suggested in its report that a future taxonomy should be centred around three groups of stakeholders to whose lives and livelihoods economic activities can make a positive contribution:

- Workforce (including value-chain workers);
- End-users / consumers;
- Affected communities (directly or through the value chain).

The suggested structure of a social taxonomy consists of three objectives, each of which addresses the three groups of stakeholders above:

- Decent work (including value chain workers);
- Adequate living standards and well-being to end-users & consumers;
- Inclusive and sustainable communities & societies.

Each of the three objectives above is complemented by several sub-objectives. The two requirements for sub-objectives are that they cover all essential topics of the objective and that they are clearly distinguishable from each other without overlaps.

Decent work
(including value-chain workers)

1. **Promoting decent work**
   a. Social dialogue
   b. Living wages
   c. Formal working relationships
   d. Health and Safety
   e. Lifelong learning
   f. Social protection
   g. End forced labour
   h. End child labour
2. **Promoting equalities and non-discrimination at work**
   a. Equal employment opportunities for women
   b. Creating jobs for women
   c. Pay gap is not excessive
   d. Living income for farmers
3. **Ensuring respect for human rights and workers´ rights of affected workers in the value chain**

Adequate living standards and well-being for end-users

1. **Ensuring healthy and safe products and services**
2. **Products to be durable and repairable**
3. **Protection of personal data and privacy**
4. **Responsible marketing practices**
5. **Access to quality healthcare products and services**
6. **Improving access to healthy and highly nutritious food**
7. **Improving access to good-quality drinking water**
8. **Improving access to good-quality housing**
9. **Improving access to education and lifelong learning**

Inclusive and sustainable communities & societies

1. **Promoting equality and inclusive growth**
2. **Supporting sustainable livelihoods and land rights**
3. **Ensuring respect for human rights of affected communities by carrying out risk-based due diligence**

The environmental taxonomy has served as the basis for the social taxonomy and follows the same qualification steps:

1. Identification of the activity deemed social;
2. Substantial contribution of the activity;
3. Harm to other social objectives (DNSH Do Not significant Harm); and
4. Minimum guarantees.

Under this proposed Social Taxonomy, it would be possible to make a substantial contribution to several of the objectives and sub-objectives simultaneously.

Substantial contribution

For a social activity to qualify as having a substantial contribution, it needs to fulfil one of these three requirements:

- Avoiding and addressing negative impact;
- Enhancing the positive impacts of social goods and services as well as basic economic infrastructure;
- Enabling activities (with potential to enable substantial risk reductions in other sectors).

However, an economic activity does not need to make a substantial contribution to all sub-objectives included in an objective in order to qualify as sustainable.

The PSF acknowledges that the development of technical screening criteria with respect to social topics poses a major challenge, as social issues are not easily quantifiable and frequently encompass a qualitative dimension. Accordingly, the final report proposes criteria for possible indicators but no metrics

DNSH criteria and minimum safeguards

In line with the environmental taxonomy, the social DNSH criteria ensure that substantial contributions to a social objective do not hurt any of the other objectives. The DNSH criteria will be linked to a specific activity. For issues that are entity-related, such as transparent and non-aggressive tax policy, minimum safeguards will be employed to avoid inconsistencies. Generally speaking, corporate governance topics will be linked to the entity and be recognised in minimum safeguard criteria.

Art. 18 of the Taxonomy Regulation does not include information on the practical application of the minimum safeguards. The PSF is also in charge of developing more guidance on this topic. Minimum safeguards and a social taxonomy are two topics that are intertwined and interdependent. For that reason, the PSF also needs to assess the impacts of Art. 18 of the Taxonomy Regulation for the social taxonomy. Among the questions to be addressed is whether there will be environmental minimum safeguards in parallel to the social minimum safeguards that will apply to the economic entities included in the social taxonomy. More detailed guidance has been published with the PSF's report on minimum safeguards in July 2022 (here).

Governance

The PSF was asked to include in particular a reflection on other sustainability objectives which could potentially be covered, such as objectives linked to

business ethics, governance, anti-bribery or tax-compliance matters, as well as a discussion of the merits of covering these objectives.

The report identifies two high-level objectives related to governance, each with specific sub-objectives:

Strengthening sustainability aspects of traditional corporate governance
Sustainability-assessment skills in the highest governance body
Transparency on sustainability objectives and targets

Strengthening corporate-governance aspects important for sustainability
Anti-bribery and anti-corruption measurements
Responsible lobbying and political engagement
Transparent and non-aggressive tax planning
Diversity of board members
The option for employee representation on supervisory boards

Interaction with other Green Pact legislation

Link with the Corporate Sustainable Due Diligence Directive (CSDDD) proposal

The objectives of the social taxonomy on decent work, end-users and communities intersect with those of the CSDDD proposal, such as improving business respect for human rights. However, the CSDDD proposal focuses on companies while a taxonomy links its criteria to the activities of companies.

The importance of key international social standards is recognised and included as minimum safeguards in existing taxonomic regulations. This was deemed necessary when creating a taxonomy focusing on environmental sustainability, in order to avoid classifying certain activities as sustainable, when the entity carrying out these activities violates fundamental human rights, workers' rights, or sustainable principles of governance. Once the CSDDD proposal is finalised, the role of a social taxonomy in the CSDDD will have to be defined.

Link with the CSRD proposal

There is clearly an overlap between the social and governance factors that companies will need to report on, as part of CSRD proposal and the information companies need for a social taxonomy. Going forward, this thematic overlap should result in overlapping reporting requirements of these two different initiatives. A first step in this direction has been taken by structuring the objectives of the social taxonomy in a manner similar to the structure of the CSRD proposal.

Social and environmental taxonomies pursue different objectives than pure reporting compliance. Social taxonomy sets criteria for activities to define a substantial contribution of that activity in the social sphere while the CSRD proposal focuses on entities. Social taxonomy also encompasses the availability and accessibility of social products and services such as health care products, social housing or public transport, subjects which will probably not be addressed in the CSRD proposal.

Relationship between a social taxonomy and the existing environmental taxonomy

Two optional models shaping the relationship between the social and the environmental taxonomy have been considered:

- The first model is that just as social and governance-related minimum safeguards (UNGPs and OECD guidelines on multinationals) are part of the Taxonomy Regulation, minimum environmental safeguards should be part of a future social taxonomy.
- The second model would integrate the social and environmental taxonomy more closely with environmental and social DNSH criteria being valid for both the social and the environmental part of all activities

Next steps

As regards next steps, the Platform finds it necessary to:

- Clarify the minimum safeguards - PSF report expected by July 2022 ;
- Conduct a study on the impacts of a social taxonomy, considering different options for applications and designs;
- Work out the rationale for prioritisation of objectives and sub-objectives;
- Prioritise objectives according to the rationale;
- Define substantial contribution and DNSH criteria for the first objective(s).

The report will now be reviewed by the EC but the legal implementation of a social taxonomy is expected only after 2024.

Extended Environmental Taxonomy

Background

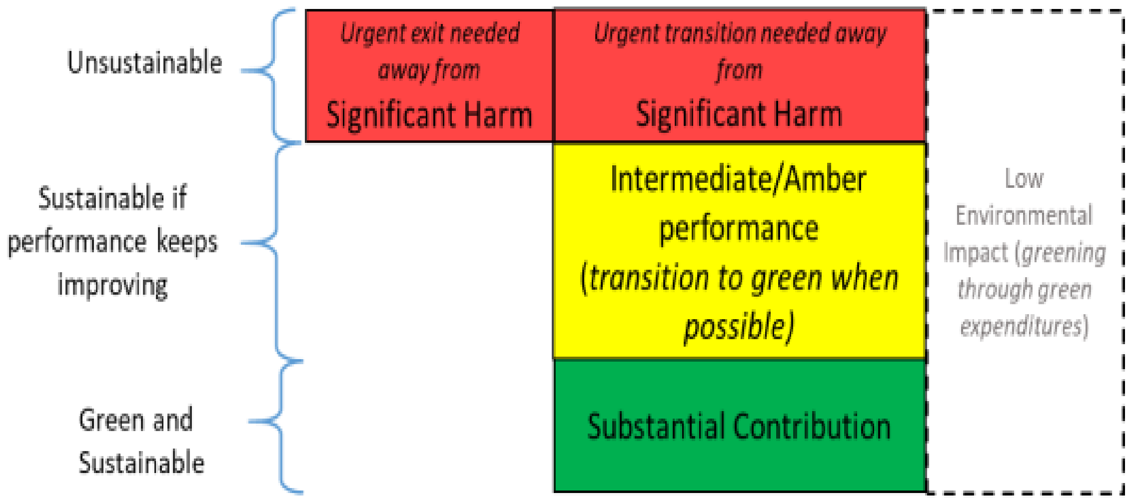
The PSF published their final report on Taxonomy extension options supporting a sustainable transition on 29 March 2022 (➤ here). In this report the PSF suggests extending the Environmental ("green") Taxonomy by adding additional categories of activities. This extension could provide more transparency on economic activities that do not (yet) meet the technical screening criteria set out in the Climate Delegated Act (➤ here) and activities that are not (yet) covered by the Climate Delegated Act.

Potential extensions

The PSF recommends establishing the following categories of economic activities to extend the green Taxonomy using a traffic light system:

"**Red**" activities that significantly harm one or more of the environmental objectives set out in the green Taxonomy.
For these activities transition or – if a transition is not possible – exit or decommissioning is urgently needed.

"**Amber**" ("orange or yellow") activities cover activities with intermediate performance, i.e. activities that currently do no significant harm to any environmental objective but also do not substantially contribute to any of the environmental objectives. Financing is regularly needed to further improve the environmental performance in order to upgrade such activities to "green" activities (see below) as well as maintaining the level of intermediate performance. Due to so-called falling curves of tightening criteria over time, substantial contribution and significant harm



Source: Platform on Sustainable Finance: The Extended Environmental Taxonomy, diagram 1 (p. 8)..

thresholds regularly become stricter and, thus, require continuous investment to avoid significant harm in the future.

"**Green**" activities represent environmentally sustainable activities as defined by the Taxonomy and the Climate Delegated Act. These activities substantially contribute to at least one objective while doing no significant harm to another objective and while complying with minimum social safeguards.

Note that this colour system would also apply to economic activities that have not yet been included in the Climate Delegated Act but will be included in the Climate or the Environmental Delegated Act in the future.

The PSF further considers economic activities with low impact on the six environmental objectives as a separate category of activities. These low environmental impact activities neither have the potential to provide a substantial contribution nor are they at risk of doing significant harm to any of the environmental objectives (while meeting minimum safeguards). Therefore, these activities are and will most likely not be covered by the green Taxonomy. Examples of low environmental impact activities are professional (law, auditing) services, engineering services and advertising or education activities. Even though their environmental impact is low, these activities cover presumably about 35% of the EU economy according to the PSF report.

The approaches to extend the green Taxonomy suggested by the PSF could increase transparency regarding economic activities that are not or not yet considered "green" (environmentally sustainable) by further distinguishing among these activities. Not qualifying as green under the current Taxonomy does not render an activity unsustainable (sometimes referred to as "brown"). Hence, even though the current Taxonomy only distinguishes between green and not green, the system is not intended to be only binary. The suggested extension of the green Taxonomy would alleviate this issue and further support transition finance enabling undertakings to move away from significantly harmful activities.

Next steps

The final PSF report includes several recommendations on how the green Taxonomy could be extended. The report constitutes the PSF's input to the report to be published by the EC on the potential extension of the Taxonomy following Art. 26(2) of the Taxonomy Regulation.

The EC is to decide whether to extend the green Taxonomy on a mandatory or voluntary basis.

SFDR - Latest developments

Updated Joint Supervisory Statement

On 24 March 2022, the market saw the publication of an updated joint supervisory statement (➤ here) regarding the application of the SFDR which was published to mitigate the risk of divergent application of the SFDR and disclosures pursuant to Art. 5 and 6 of the Taxonomy Regulation disclosures in the interim period until SFDR Level II enters into force on 1 January 2023.

There are several areas of uncertainty in the market regarding the application of both of these. The statement focused on particular elements for clarification of current market practices:

- Disclosures pursuant to Art. 5 and 6 of the Taxonomy Regulation with regard to the first two environmental objectives, i.e. climate change mitigation and climate change adaptation, are to be made as the Taxonomy with regard to both objectives has been in force since 1 January 2022.
- It was confirmed that quantitative disclosures regarding the Taxonomy-alignment of the investments underlying the financial products are expected and information on Taxonomy-eligibility is neither desired nor sufficient. However, the quantitative disclosure can be accompanied by a qualitative clarification.
- It was confirmed that estimates regarding Taxonomy-alignment should not be used but equivalent information obtained from investee companies or from third party providers can fill the gap where information is not readily available from public disclosures by investee companies. There is no further clarification as to what equivalent information means whilst estimates may not be regarded as equivalent.
- The draft RTS in the final report published on 22 October 2021 can be used as a reference for the preparations for SFDR level II.
- Detailed collection of application timelines.

In general, the supervisory statement confirmed several current market practices but did not provide substantial additional clarifications.

Adoption of RTS by the EC

Shortly after the publication of the supervisory statement, the EC adopted on 6 April 2022 the Regulatory Technical Standards (➤ here).

No substantial changes regarding level II provisions were made whilst several detail-related clarifications were included, most notably:

- As the market grew to regard SFDR classifications as a label for ESG products in the absence of a generally available and appropriate framework, the EC pronounced at the beginning of the RTS that the SFDR is a disclosure and not a labelling regime marking the importance of the differentiation.
- The requirement for all sustainable investments to apply the do no significant harm test taking into account the mandatory Principal Adverse Impact (PAI) indicators and any relevant additional adverse impact indicators in the corresponding annexes was confirmed after its inclusion in the last published draft RTS on 22 October 2021.

- The rationale and interpretation behind the differentiation of PAI indicators in mandatory and additional disclosures was provided in the sense that the mandatory indicators cover adverse impacts that are always principal whilst the additional indicators refer to adverse impacts on sustainability factors that can turn out to be principal depending on further factors.
- The EC renewed their statement in the last Q&A document that Art. 9 SFDR products should only make sustainable investments whilst allowing to some extent other investments where required under sector-specific rules. In the Q&A document they specified those exception cases, for example, as hedging and liquidity purposes.
- Regarding the data for the calculation of Taxonomy-alignment of the investments underlying the financial products, the EC introduced a case differentiation for companies in and out of scope of Art. 8 of the Taxonomy Regulation. There was a slight change in wording for the case where companies in the scope of Art. 8 of the Taxonomy Regulation have not yet reported Taxonomy-alignment data stating that financial market participants may rely on third party data providers. The exact impact remains to be seen as previous statements raised concerns regarding estimations in methodologies developed by data providers.
- Entity-level PAI statement:
    - Calculations and definitions for some indicators added and further specified;
    - Update to include actions planned or targets set for the subsequent period to avoid or reduce the PAIs identified.
- Website disclosures:
    - Deletion of requirement to describe actions taken to address limitations of methodologies and data employed;
    - The level of detail for the 'Proportion of investments' section changed for Art. 8 products, while remaining the same for Art. 9 products.
- Pre-contractual disclosures and periodic reports: clarification regarding the representation of the share of investments which qualify as investments in environmentally sustainable economic activities as per Art. 3 of the Taxonomy Regulation.

In addition to the adopted English version of the RTS, the EC also made available the proposed delegated regulation plus annexes in the official languages of all Member States. Before the RTS is published in the Official Journal of the European Union in their final version, the European Parliament and the Council are reviewing the proposed delegated regulation in the next step.

Significant uncertainty remains in the market

The proposed delegated regulation include a certain number of minor changes that require implementation changes for ongoing SFDR level II initiatives. Nevertheless, significant uncertainty remains in the market and open questions heavily discussed cover a wide range:

- Methodology for the 'do no significant harm' assessment with mandatory and any relevant additional PAI indicators;
- Unclear definition of environmental or social characteristics;
- Unspecified definition of sustainable investments and therefore unclear options of constituting Art. 9 products with equities;
- No further clarification regarding the application cases of products which have a reduction in carbon emissions as their objective (Art. 9 par. 3);
- Unspecified approach regarding derivatives;
- No minimum standards for Art. 8 products such that a wide and diverse range of products are currently classified as Art. 8 products in the market. Under level II disclosures the exact extent of that range will become apparent.

In the absence of further guidance from the EC, market organisations and national competent authorities will continue to discuss the requirements and agree on views. These fractured approaches bear the risk of regional differences as was already seen from the Taxonomy-related disclosures.

Adjustments to SFDR requirements under review

Whilst the SFDR RTS are now subject to the scrutiny of the European Parliament and the Council, the EC has already mandated the ESAs to review further developments.

Subsequent to the inclusion of nuclear energy and gas in the Taxonomy Regulation through the adoption of the Complementary Climate Delegated Act, the EC is expecting a proposal for a transparent disclosure of financial products' exposures to these economic activities. These changes are planned for the pre-contractual and periodic reporting templates as well as website disclosures. The ESAs are scheduled to submit their recommendations until the end of September, at the latest. Given prospectus review periods after the submission to the regulator and overall tight timelines, the adjustments are not expected to enter into force by 1 January 2023. However, there is no certainty except that such a last-minute adjustment would require exceptional efforts for financial market participants.

Additionally, the ESAs were also mandated to review the PAI indicators regarding the need for additional indicators and additional specifications for existing indicators. The guiding principle to avoid "safeguard washing" by provision of well-reasoned proof regarding the consistency of investments with PAI measures, as well as their implementation, was issued by the EC with the general mandate.

Furthermore, the EC asked for a draft RTS adjustment concerning financial products with the objective of a reduction in carbon emissions and a review on the sufficiency of the level of detail for Taxonomy-aligned investments.

Both of these elements are to be developed within a 12-month timeframe, such that public consultations could be expected.

Further guidance published regarding the application of SFDR

The EC published on 25 May 2022 a Q&A document (➤ here) aiming to answer a number of questions that the ESAs submitted as regards the interpretation of aspects of the SFDR and the Taxonomy Regulation. The questions can be grouped into four broad themes:

- Product-level compliance with the principal adverse impact (PAI) regime in situations where the manager does not comply with entity-level PAI;
- How SFDR disclosure requirements apply to pre-existing open and closed products;
- Good governance requirements for Art. 8 and Art. 9 products;
- how Taxonomy-alignment disclosures apply to Art. 8 and Art. 9 products which do not actively pursue environmental objectives.

In addition, on 31 May 2022, the ESMA published a supervisory briefing regarding sustainability risk and the disclosures under SFDR (➤ here). The document also encloses a detailed checklist suggested to the national competent authorities for checking the SFDR disclosures.

It was closely followed on 2 June 2022 by a document aiming to provide clarifications for the SFDR RTS (➤ here), which covers the following broad themes:

- Principal adverse impact (PAI) regime and indicators
- Broad product-level disclosures required by SFDR and Taxonomy
- 'Do no significant harm' disclosures.

Abbreviations

CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standards Board
CSRD	Corporate Sustainability Reporting Directive
DA	Delegated Act
DNSH	Do no significant harm
DR	Disclosure Requirements
ED	Exposure Draft
EFRAG	The European Financial Reporting Advisory Group
ESG	Environmental, social and corporate governance
ESMA	European Securities and Markets Authority
ESRS	European sustainability reporting standards
GRI	Global Reporting Initiative
IOSCO	International Organization of Securities Commissions
ISSB	International Sustainability Standards Board - IFRS Foundation
IFAC	International Federation of Accountants
KPI	Key Performance Indicator
NFRD	The Non-Financial Reporting Directive
PAI	Principal Adverse Impact
PTF-ESRS	Project Task Force on European Sustainability Reporting Standards
RTS	Regulatory Technical Standards
SASB	Sustainability Accounting Standards Board
SEC	Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
SMEs	Small and medium-sized enterprises
TCFD	Task Force on Climate-Related Financial Disclosures
TRWG	Technical Readiness Working Group - IFRS Foundation
VRF	Value Reporting Foundation

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