

## **BVI's<sup>1</sup> feedback to the draft delegated Regulation under Article 8 of the EU Taxonomy**

The German fund management industry is committed to working towards the objectives of the EU Action Plan for financing sustainable growth and to supporting the transition of Europe's economy. In order to effectively contribute to these goals, the industry needs a clear and coherent regulatory framework for sustainable investments and reliable timelines for implementation.

Unfortunately, the current multitude of regulatory initiatives with relevance to sustainable finance significantly increases the complexity of the regulatory environment and has the potential of impeding, instead of facilitating, sustainable investments. This pertains also to the draft delegated Regulation proposed by the EU Commission to specify reporting requirements under Article 8 of the EU Taxonomy (subsequently referred to as the current draft) that entails several inconsistencies as compared with other EU measures. We are thus grateful for the opportunity to submit comments in this late stage of implementation. In order to enable the Taxonomy framework to exploit its full potential in terms of channelling investments towards green economic activities and guiding companies and investors in their transitioning efforts, we see the urgent need for the following changes in the proposed approach:

### **1. Timing of first reports by non-financial and financial undertakings needs to be sequenced:**

The current draft accounts for the obvious material challenges for assessing compliance of economic activities with the technical Taxonomy criteria by allowing for limited disclosures in 2022 and requiring the full set of Taxonomy-relevant KPIs from the beginning of 2023 for both non-financial and financial undertakings. However, it should be clear that financial undertakings, be it asset managers, banks or insurance companies, can only report on the share of their Taxonomy-aligned investments on the basis of relevant data disclosed by investee companies. This is even more so under the current draft that implies that only data reported directly by entities that are actually subject to the reporting obligation under NFRD shall be taken into account in the numerator for calculating the green asset ratio (GAR). While this approach as such might be questionable (cf. section 2 b) of our reply below), it is quite obvious that if retained, asset managers and other financial undertakings will entirely lack the data base necessary for calculating the Taxonomy-related KPIs by 1 January 2023.

Consequently, from the perspective of asset managers, **problems with assessing the Taxonomy alignment of their investments will be only postponed to 2023, but not resolved, by the current draft. Due to different accounting periods relevant for investee companies, asset managers and other financial market participants will only be able to build up the necessary data basis for assessing their holdings against the EU Taxonomy during 2023 and to report on the share of their green investments in 2024. This sequencing of reporting events should be reflected in Article 11 of the current draft, potentially in a new paragraph 3b, by specifying that financial undertakings shall report the key performance indicators pursuant**

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<sup>1</sup> BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of nearly 4 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit [www.bvi.de/en](http://www.bvi.de/en).



**to this Regulation from 1 January 2024 and by prolonging the intermediate solution in paragraph 2 to 2023 accordingly.**

In addition, we would like to point out that the new reporting regime proposed under the current draft will have significant implications also for sustainable products that wish to align their investment strategies with the EU Taxonomy or to consider Taxonomy criteria as part of a broader ESG approach. Also here, it should be clear that if specific KPIs on the proportion of Taxonomy-aligned activities in companies were available only from the beginning of 2023, no product will be able to assess the likely share of Taxonomy-aligned investments that are in line with its investment strategy in order to make firm commitments as regards their minimum proportion to investors before that date. This also means that by October 2022 – which is the expected time of entry into force of the new provisions on sustainability preferences under MiFID II and IDD – there will be virtually no products that offer investors a minimum proportion of investments in line with the EU Taxonomy as anticipated under Art. 2 (7)(a) of MiFID II Delegated Regulation and Art. 2 (4)(a) of IDD Delegated Regulation to be amended in line with the Commission's proposal from 21 April 2021. The only potential exception will be real estate funds that do not need to rely on companies' disclosures, but are able to internally evaluate the technical criteria for green real estate activities specified under the Taxonomy framework (for further details, cf. our suggestions under 2 a) below).

**2. Scope of Taxonomy-aligned investments that can be included in the numerator has to be widened:** The current draft introduces a very narrow understanding of assets that are eligible for consideration as Taxonomy-aligned in the numerator of the KPI calculations. This narrow understanding is counterproductive to the very goal of the EU Taxonomy which is channelling of capital flows towards sustainable investments and fully exploiting the relevant potential of the internal market.<sup>2</sup> Against this background, we urge the Commission to adapt the current draft in order to account for the following:

**a. Allow consideration of exposures to real estate assets that fulfil the criteria for environmentally sustainable activities in the numerator of KPI calculations:** Economic activities in the real estate sector are explicitly recognised as Taxonomy-eligible in the context of both climate change mitigation and adaptation according to section 7 of Annex I and II respectively. The eligible activities comprise i.e. construction of new buildings, renovation of existing buildings, and above all, acquisition and ownership of buildings. These activities are directly relevant for asset managers and other financial undertakings. Asset managers invest directly in real estate on behalf of investors in real estate investment funds, retail and institutional alike. In Germany, real estate investment funds make up a significant share of the fund market. Real estate funds managed by BVI members, both open- and closed-ended, account for EUR 254 bn of assets under management. Moreover, among BVI members there are 34 management companies that focus solely on managing real estate assets. Given that asset managers are fiduciary owners of these assets that are held either directly or via SPVs, they have full access to the data needed for assessing compliance with the relevant technical criteria under the EU Taxonomy.

**In view of the relevance of real estate activities under the EU Taxonomy, it is strictly necessary to allow for consideration of investments in real estate when calculating Taxonomy-aligned KPIs. This is also in line with the approach proposed by the ESAs for the purpose of calculating the share of green investments at the product level under**

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<sup>2</sup> Cf. recital 9 of Taxonomy Regulation



**Articles 5 and 6 of Taxonomy Regulation.** In this respect, the ESAs specify that the market value of investments in real estate assets which qualify as environmentally sustainable economic activities should be taken into account.<sup>3</sup> As regards the current draft, it is necessary to complement the specifications on assets to be included in the numerator of KPI calculations according to section 1.1 of Annex III (KPI of asset managers) by a subparagraph (f) stating the following:

*(f) for investments in real estate assets, the market value of those investments which qualify as environmentally sustainable economic activities.*

References to Taxonomy-aligned economic activities “of investee companies” that limit the scope of consideration in the numerator should be deleted throughout section 1.1. Moreover, respective amendments to other annexes specifying the KPI calculations for credit institutions (Annex V), investment firms (Annex VII) and insurance / reinsurance undertakings (Annex IX) should be considered.

- b. Admit consideration of investments in undertakings that are not subject to reporting obligations under NFRD, but for which reliable data on environmentally sustainable activities is available:** It is inconceivable why the current draft actually prohibits consideration of investments in undertakings that provide information about the share of their environmentally sustainable activities in line with the EU Taxonomy on a voluntary basis. Under this approach, until the envisaged CSDR becomes effective, GAR would only reflect investments in large listed companies based in the EU. These are at best around 11,000 out of more than 60,000 listed companies around the world that make up the investment universe for asset managers and other financial undertakings.

EU asset managers invest globally on behalf of European investors. A significant share of equity held by German funds is invested in companies from outside the EU (43% for retail, 53% for institutional funds). Approximately 30% of European ESG funds accounting for approximately 40% of AuM are investing globally. Non-European countries, such as the United States, Japan and Canada, represent more than 70% weight of the MSCI World Index. A strict reduction of Taxonomy-aligned quota solely to investments in European companies would lead to a skewed GAR reporting, given that there are many companies outside Europe that are committed to sustainable business models and willing to provide investors with the relevant data.

More importantly, the exclusion of non-EU companies would significantly weaken the potential of the EU Taxonomy to channel capital flows towards sustainable investments. The EU legislators saw it as the key objective of the Taxonomy framework “to remove obstacles to the efficient movement of capital into sustainable investments in the internal market and to prevent new obstacles from emerging”<sup>4</sup>. They also explicitly recognise “the systemic nature of global environmental challenges” and the “need for a systemic and forward-looking approach to environmental sustainability that addresses growing negative trends”.<sup>5</sup> It is clear that the global environmental challenges being at the heart of the EU Taxonomy cannot be effectively addressed by measures confined to investments in EU undertakings. The EU Taxonomy can

<sup>3</sup> Cf. Article 16b (1)(d) of the draft RTS to SFDR as amended by the Joint Consultation Paper on Taxonomy-related sustainability disclosures from 15 March 2021 (JC 2021 22)

<sup>4</sup> Recital 9 of Taxonomy Regulation

<sup>5</sup> Recital 7 of Taxonomy Regulation



only develop its full potential if it is promoted as a gold standard of environmental sustainability on a global scale and provides incentives for non-EU companies to report relevant KPIs in line with the Taxonomy framework in order to remain attractive for institutional investors from the EU. The same reasoning applies to investments in private companies that are either headquartered in Europe or seeking financing from the EU.

**Given the urgency of active climate protection needed to attain the goals of the Paris agreement and the current momentum in the development of the EU Taxonomy, the basis for calculating Taxonomy KPIs in terms of eligible undertakings should be kept wide from the beginning. The exclusion of non-EU and private equity undertakings from the numerator of KPI calculations as proposed in Article 8 (3) of the current draft should thus be deleted. Exposure to any undertaking that performs Taxonomy-eligible economic activities should be able to be assessed against the Taxonomy criteria, provided that data on Taxonomy-related KPIs has been made available by that undertaking either bilaterally to the asset manager or via an ESG data provider. This is also consistent with the approach proposed by the ESAs for product-level disclosures under Articles 5 and 6 of Taxonomy Regulation where exposures to investee companies not subject to reporting obligations under NFRD shall be taken into account “on the basis of equivalent information”.<sup>6</sup>**

The review clause foreseen in Article 10 (b) of the current draft could be kept in order to assess the appropriateness of this solution in light of the upcoming CSRD framework that will hopefully extend the scope of reporting requirements also to non-EU undertakings that are listed on regulated markets in the EU.

In addition, we have supported ESMA’s suggestion in the final report under Article 8 of Taxonomy Regulation for considering the development of a common methodology for estimating the share of Taxonomy-aligned activities in different economic sectors.<sup>7</sup> Even though the Commission seems not inclined to allow for any kind of estimations when calculating Taxonomy quota, it is important to bear in mind that without such estimations, the share of Taxonomy-aligned investments will remain very low in the next years. The results of recent BVI research show that for a simulated fund portfolio investing in global equities by applying a dedicated ESG strategy (including minimum exclusions and a “best in class” investment approach), the expected share of Taxonomy-aligned investments will be disappointingly low, in the specific case amounting to 3.93 percent, even if taking into account estimated figures and proxies available from ESG data vendors.<sup>8</sup> If calculation of Taxonomy-relevant KPIs were to be allowed only with reference to data reported under the NFRD framework, it should be clear that Taxonomy-aligned investments in most products will be further marginalised. Only thematic funds focusing on green investments and overweighting EU markets would then be able to calculate meaningful Taxonomy quota. This situation would persist unless the scope of the EU Taxonomy will be widened by establishing technical criteria for further environmental objectives and a wider range of economic activities.

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<sup>6</sup> Cf. Art. 16b (2)(b) of the draft RTS to SFDR as amended by the Joint Consultation Paper on Taxonomy-related sustainability disclosures from 15 March 2021 (JC 2021 22)

<sup>7</sup> Cf. section B.2 and Annex VII of ESMA’s final report “Advice on Article 8 of Taxonomy Regulation” from 26 February 2021

<sup>8</sup> BVI research paper “How Taxonomy-aligned are ESG strategy funds? A practical example” from 1 June 2021, available under [https://www.bvi.de/fileadmin/user\\_upload/Statistik/Research/Taxonomy\\_Paper.pdf](https://www.bvi.de/fileadmin/user_upload/Statistik/Research/Taxonomy_Paper.pdf)



- 3. Calculation approach for financial undertakings under Article 8 has to be comprehensible and fully consistent with the calculation method applied at the product level under Articles 5 and 6 Taxonomy Regulation:** The specifications for the calculation of Taxonomy KPIs by financial undertakings proposed in the current draft are inconsistent which means that the Taxonomy-aligned quota will be prone to misinterpretations. It is inconceivable why, on the one hand, exposures to sovereign issuers shall be excluded from both the numerator and the denominator of the calculation, while on the other hand, exposures to derivatives and non-EU/private equity companies are excluded from the nominator only, but still included in the denominator. Under this approach, investments in sovereign bonds would be calculation-neutral, but investments in derivatives and non-EU/private equity companies would have detrimental effect on the outcome of the calculations, given that they are out of scope of potentially Taxonomy-aligned assets included in the numerator. This arbitrary treatment of different assets is not appropriate from the public policy perspective. Moreover, it will produce calculation results that are likely to be misinterpreted even by market professionals.

**In our view, it is mandatory to base the calculations on Taxonomy quota on a consistent treatment of assets that are not Taxonomy-eligible. Two alternative approaches should be considered:**

- **Approach 1: All non-eligible assets are generally excluded from the denominator. The Taxonomy KPIs would then be expressed as the share of Taxonomy-aligned investments measured against all Taxonomy-eligible investments at the level of a financial undertaking.**
- **Approach 2: All non-eligible assets are generally included in the denominator. The Taxonomy KPIs would then measure the proportion of Taxonomy-aligned exposures in relation to all investments.**

There are pros and cons to both approaches. While the early stage of the development of Taxonomy framework and difficulties with obtaining relevant data from investee companies might support the first approach in order to enable financial undertakings to make meaningful disclosures about the extent of financing of green economic activities, the second approach might be more appropriate in the longer term in order to ensure a clear picture of Taxonomy-aligned investments at the company level.

**In any case, the approach chosen with regard to disclosures of Taxonomy quota by financial undertakings under Article 8 of Taxonomy Regulation must be fully aligned with the corresponding calculations for the purpose of product-level disclosures under Articles 5 and 6 of Taxonomy Regulation.** The concept for Taxonomy-related disclosures at the product level has been consulted by the ESAs in March 2021 and is about to be finalised shortly. It deviates from the proposal made in Article 8 of the current draft as regards the following key provisions for calculation:

- **Treatment of sovereign exposures:** The ESAs propose to include the market value of all investments of the financial product in the denominator; this would also include exposures to central governments and central banks.<sup>9</sup>
- **Treatment of real estate assets:** Investments in real estate assets which qualify as environmentally sustainable economic activities shall be included in the numerator under the ESA's proposal (cf. our suggestion in section 2 a) above).

<sup>9</sup> Art. 16b (1) of the draft RTS to SFDR as amended by the Joint Consultation Paper on Taxonomy-related sustainability disclosures from 15 March 2021 (JC 2021 22)



- Treatment of investments in non-EU / private equity companies: Exposures to companies not subject to reporting requirements under NFRD shall be included in the numerator on the basis of equivalent information that justifies their evaluation as environmentally sustainable according to the Taxonomy technical criteria (cf. our request in section 2 b) above).
- Treatment of derivatives: The ESAs envisage to extend consideration of Taxonomy-eligible investments in the numerator of the calculation to derivatives such as contracts for differences.<sup>10</sup>

Such major divergences in calculation approaches should be unacceptable with a view to both the uniformity of the EU legal system and the ultimate goal of providing comprehensible information about the proportion of green investments for investors and other stakeholders. The underlying logic to calculating GAR should be fully consistent at both entity and product levels.

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<sup>10</sup> Cf. Question 4 on page 14 of the Joint Consultation Paper on Taxonomy-related sustainability disclosures from 15 March 2021 (JC 2021 22).