



ADVICE TO ESMA

Advice on SFDR RTS for certain fossil gas and nuclear energy activities.

I. Executive summary

This advice assumes the approval of the Complementary Delegated Act which adds certain fossil gas and nuclear energy activities to the transitional package under the Taxonomy Regulation. The focus is on how to disclose the exposure to fossil gas and nuclear energy in the templates for precontractual information and periodic reporting under the Sustainable Finance Disclosure Regulation. The SMSG is of the opinion that this should be done in such a way that investors can take an informed decision. Too much complexity should be avoided and meaningful transparency is pivotal. The SMSG acknowledges that investors may have different preferences with regard to exposure to fossil gas and nuclear energy. Hence, the disclosure should enable investors to comprehend the inclusion in the taxonomy for transitional reasons. Meaningful transparency facilitates informed decisions.

To reach these goals, it is useful to differentiate between precontractual information and periodic reporting, as they cater for different needs. Precontractual information is to help investors to make an informed investment decision and to enable them to compare financial products. As such it should be understandable to a broad audience. Periodic reporting on the other hand is to facilitate the analysis of investments and as such should also keep more specialized readers in mind.

Another difference refers to the use of observed ex post exposures in the periodic reporting, as compared to envisaged “minimum percentages” in the precontractual information. The SMSG is aware that the Level 1 legislation requires the indication of “minimum percentages” when referring to taxonomy alignment or to sustainable investments as defined by the Sustainable Finance Disclosure Regulation. However, the SMSG warns against the unintended side-effects of certain proposed visualisations in precontractual information, which could be interpreted as suggesting that the asset manager should commit to maintaining a minimum percentage of fossil gas and nuclear energy. The SMSG questions whether it is truly in line with the intentions of the European Commission and the co-legislators, as expressed in the proposals for a European Green Deal and the Action Plan on Financing Sustainable Growth, to effectively oblige asset managers to commit to minimum allocations to fossil gas and nuclear energy investments.

While the advice is primarily on the templates, the SMSG also points at a relation with Principal Adverse Impact Indicators. The scope 2 emissions from electricity production out of fossil gas has come under increasing scrutiny of public opinion, due to methane leaks in gas wells (see for example COP 26: Global Methane Pledge). The SMSG believes investors have a right to see whether electricity producers using fossil gas get their gas from sources where methane leaks are carefully monitored or sources where this is not the case. This must be reflected in the Scope 2 PAI indicator.

Finally, the SMSG voices a concern about the timing. The new indicators require changes to templates that are currently being developed by financial institutions. These last minute changes, and the relative paucity of good quality data, add to the already very challenging timing.

II. Full text

1. This advice assumes the approval of the Complementary Delegated Act which adds certain fossil gas and nuclear energy activities to the transitional package (art 10(2)) under the EU's Taxonomy Regulation. The SMSG was invited to advise on draft proposals on how to disclose the exposure to fossil gas and nuclear energy in the templates for pre-contractual information and periodic reporting under the Sustainable Finance Disclosure Regulation.
2. The SMSG is of the opinion that the following criteria should be taken into account when designing the templates:
 - a. The investor should be enabled to take an informed decision;
 - b. One should be careful not to add too much complexity to the templates as they should remain understandable;
 - c. Meaningful transparency is pivotal.
3. The SMSG acknowledges that investors may have different preferences with regard to exposure to fossil gas and nuclear energy. Hence, the disclosure should enable investors to comprehend the inclusion in the taxonomy for transitional reasons. Meaningful transparency facilitates informed decisions. The possibility was discussed to attract more attention to the specific situation of fossil gas and nuclear energy as "transitional". This is because the proposed charts to depict their potential share are situated somewhere in the middle of the document. Hence, they could be overlooked. It was suggested to include earlier in the template an additional text explaining the specific situation of fossil gas and nuclear energy as transitional. However, this option was not maintained by the SMSG as it would increase the amount of text in the already lengthy documents.
4. The SMSG believes that precontractual information and periodic reporting cater for different needs. The primary function of precontractual information is to facilitate informed decisions. As such, it should be understandable for a broad audience of potential investors. Periodic reports should facilitate the analysis of the actual investments in the portfolios. As such, it should rather take into account the needs of a more specialized audience, like analysts, and of more sophisticated investors.
5. For this reason, the SMSG started by discussing option 1 for periodic reporting and option 2a for pre-contractual information. For precontractual disclosure, some favour option 2a and some others option 1.
6. With regard to periodic reporting the table format (option 1) with precise numbers was considered the most useful way to convey information. However, it is suggested to reorder the sequence of rows. Rather than a sequence fossil gas measured by turnover; nuclear energy measured by turnover; fossil gas measured by CapEx; nuclear measured by CapEx... it would be easier to group fossil gas, as indicated by turnover; CapEx and OpEx together and subsequently nuclear energy grouped together.
7. Still with regard to periodic information, the table in option 1 does on its own not show the proportion of taxonomy aligned investments, let alone investments in taxonomy-aligned investments other than gas and nuclear energy. For those investors or analysts interested to have this detail, this could be deduced from the graph by making a subtraction (total taxonomy aligned as depicted in the bar chart minus the proportions as indicated in the table). Some members considered the alternative to replace the chart in option 1 by the bar chart in option 2. However, as a counterargument it was argued that this would require that precise percentages should be indicated in the already compact graph. The SMSG was in no position to assess whether this would be feasible. Assuming that this would not be possible, left option 1, with 2 layers of information (bar chart showing the total proportion of taxonomy aligned investments and table with details on fossil gas and nuclear energy) as the most viable option.

8. With regard to precontractual information, some members considered the pie-chart proposed in option 2a the clearest and most concise for precontractual information, as potential investors are enabled to understand at first sight the amounts of taxonomy-aligned investment and the minimum exposures to fossil gas and nuclear without having to undergo any calculation exercise. This reflects the view that precontractual information should appeal to a broader audience than the periodic reports. Nevertheless, some also saw the advantages of the precision of a table, notably when the table makes it easier to read all information (like the transition explanation) versus the propension to only look at the chart (without reading the context of the information given below the chart). In addition, the latter also think that the total proportion of taxonomy alignment is a useful information (versus being obliged to add three figures to have it).

9. However, apart from the discussion on format (chart vs table; bar chart vs pie chart...), there is a more profound remark with regard to the content of precontractual information. Is it really desirable to specify *ex ante* different categories of minimum percentages (of fossil gas, nuclear energy and activities without fossil gas and nuclear energy)? The SMSG acknowledges that in terms of the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation defining minimum percentages is needed for transparency reasons. However, it questions the level of granularity by which this should be done. In particular, the SMSG questions whether it is truly in line with the intentions of the European Commission and the co-legislators, as expressed in the proposals for a European Green Deal and the Action Plan on Financing Sustainable Growth, to effectively oblige asset managers to commit to minimum, rather than maximum, allocations to fossil gas and nuclear energy investments. Imagine a situation where a fund manager has engaged to invest minimum 10% of assets into taxonomy-aligned investments, of which 5% into renewables (the remaining 5% could be invested into fossil gas or nuclear energy). Now, imagine that the exposure to renewables increases to 7%. If the exposure to gas and nuclear energy was defined as a minimum percentage, the fund manager would be obliged to keep the proportion at 5%. Apart from introducing requirements that appear to be incompatible with the policy objectives of the Taxonomy Regulation, this approach also imposes unnecessary restrictions on the fund managers' investment policies.

10. Different alternatives were discussed with pro and cons. A first one consisted of a pie chart depicting the minimum proportion of taxonomy aligned investment, combined with a table showing the actual proportion of investments in fossil gas and nuclear energy (precontractual disclosure option 1). The advantage of this approach is its simplicity. It also avoids giving the impression that investment objectives of minimum proportions of taxonomy aligned investments are set by activity. The disadvantage is that the actual percentage of exposure to fossil gas and nuclear energy may be fluctuating and hence, regular updates of precontractual information would be required in case of material changes to the product portfolio. The other elements in the template for precontractual information are rather static, so introducing indicators that require updates would change the nature of a document which at present is a rather static document. Some members suggested another alternative, related to option 2a, i.e. a chart (or table) defining (i) the minimum percentage invested in taxonomy aligned assets and (ii) the minimum percentage in taxonomy aligned assets excluding gas and nuclear energy. An explanatory sentence could be added. "Electricity production out of fossil gas and nuclear energy is for transitional reasons considered to be taxonomy-aligned. To distinguish these from other taxonomy-aligned investments, the graphs show the total minimum proportion of taxonomy aligned investments and the minimum proportion of taxonomy aligned investments excluding fossil gas and nuclear energy". Whatever option is chosen should also be compared with the mandate received by the ESA's within the legal context of the current texts.

11. The remarks above refer to precontractual information and not to periodic reporting. The *ex post* periodic reporting refers to actual exposures and not to minimum proportions. The SMSG considers it useful to distinguish in periodic reporting the actual proportions of fossil gas, nuclear energy, and taxonomy aligned investments other than fossil gas and nuclear energy.

12. While the current advice is primarily about the templates for precontractual information and periodic reporting, the SMSG also points at a particular relation with Principal Adverse Impact Indicators. This is particularly relevant as the ESA's received a mandate to review and revise regulatory technical standards under SFDR, in particular Principal Adverse Impact indicators

(FISMA.C.4/LB/mp(2022)2726506). The current Table 1 Principal Adverse Impact indicators on greenhouse gas emissions include both Scope 1 and Scope 2 emissions. With regard to electricity production from fossil gas, not only the greenhouse gas emission of the electricity production itself (scope 1) is relevant. Increasingly, the scope 2 emissions have come under public scrutiny due to methane leaks in gas wells. This has resulted in the Global Methane Pledge at COP-26 in Glasgow. Reducing methane emission is considered to be one of most effective levers to reduce climate warming in the next 25 years. For this reason, the SMSG believes investors have a right to see whether electricity producers using fossil gas get their gas from sources where methane leaks are carefully monitored or sources where this is not so. This must be reflected in the Scope 2 PAI indicator.

13. The SMSG has repeatedly pointed out the unrealistic timings behind the Sustainable Finance Disclosure Regulation. The proposed changes to the templates exacerbate this concern. Financial institutions need to dedicate their ICT resources to a whole set of priorities. This means that ICT resources are already committed and cannot be shifted due to last minute legislative changes. As it is, it will be very taxing for financial institutions to implement these templates by 1.1.2023. Inasmuch as it will be a challenge to collect good quality data for some time, future evolutions to the templates should take due account of the availability of quality data. With regard to the reliability of data, it should also be kept in mind that only exposure to gas and nuclear energy which fulfils the necessary conditions as outlined in the Complementary Delegated Act can be considered as taxonomy-aligned, and that data specific to these conditions may be difficult to obtain.

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[signed]

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