1 June 2021
Financials

# Sustainable disclosures

## A three-layer transparency path towards darker green bond markets

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# Introduction

**In Fixed Income ESG still represents a small part of the universe. We expect numbers and volumes to increase as the headline domination of ESG in FI is only in its infancy.**

**Article 8 & 9 categorizations will stimulate higher ESG allocation and demand. However, uncertainty on SFDR interpretation and its exact definitions has contributed to a cautious classification thus far by asset managers.**

**The principal adverse impact component will need more clarity in order to grow in importance. The publication of PAI statements is the first step.**

**The taxonomy-related disclosures will impact all bonds issued, whether marketed as sustainable or not. Investors will favour those contributing most to the taxonomy KPIs.**

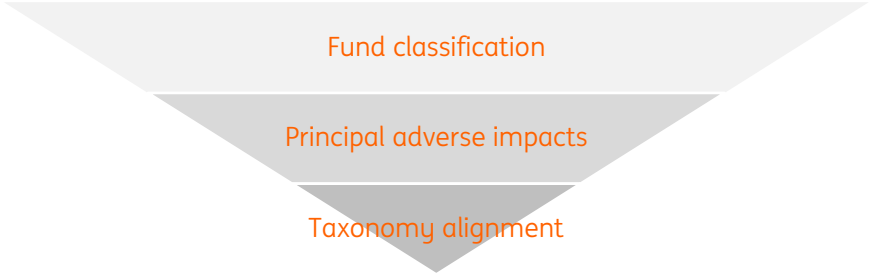
**All in all, the SFDR pushes the buyside (demand) further in the direction of ESG and thus further stimulates issuers to print sustainable bonds (supply). The slow lagging effect of this one-sided push adds, in the meantime, to a wider "greenium" (green premium).**

Since 10 March 2021 the EU sustainable finance disclosure regulation (SFDR) requires portfolio managers to "show colour" as to what extent their investment funds and portfolios consider sustainability aspects. For now these disclosures only concern the high level and principle-based provisions (level 1) detailed in the SFDR. However, once there is more clarity on the level 2 disclosure technicalities, this important piece of ESG disclosure regulation will only serve to further guide investments away from less sustainable issuers and assets and towards more sustainable alternatives.

The SFDR has three important funnel stages to achieve this goal, which we will discuss in more detail later in this report.

- The **classification of funds as Article 6, 8 or 9**: asset managers will strive to classify most funds in the light green (Article 8) and, preferably, the dark green (Article 9) categories. This will increase the demand for assets supporting ESG objectives.
- The **principal adverse impact (PAI) assessments** will form an additional incentive for asset managers to stay away from investments that realise substantial negative sustainability impacts, such as in companies active in the fossil fuel segment.
- The **reporting on EU taxonomy compliant investments**: transparency requirements on the taxonomy alignment of investments will support the demand for investment alternatives that do qualify as environmentally sustainable under the taxonomy, such as for bonds issued in line with the forthcoming EU green bond standard.

**Fig 1 The SFDR provides for three disclosure layers impacting investment decisions**




Source: SFDR, Taxonomy regulation, ING

**The SFDR time schedule**

The sustainable finance disclosures regulation (SFDR) came into force on 29 December 2019 and applies for the level 1 provisions since 10 March 2021. The level 2 regulatory technical standards (RTS), yet to be adopted by the European Commission, will work out the further disclosure technicalities. On 4 February 2021, the three European supervisory authorities (ESAs) published their final draft RTS on the SFDR disclosures, proposing to apply these RTS from 1 January 2022.[1] However the ESAs encouraged those in scope to already use the draft RTS as a reference during the interim period.[2] On 15 March 2021, the ESAs also published their joint consultation paper on the taxonomy related sustainability disclosures, advising to integrate these disclosures into the draft RTS to establish one single rulebook for all sustainability related level 2 disclosures. The taxonomy related disclosure requirements should apply from 1 January 2022 for the climate change mitigation and climate change adaptation objectives and from 1 January 2023 for the remaining four environmental objectives identified in the EU taxonomy regulation.[3]

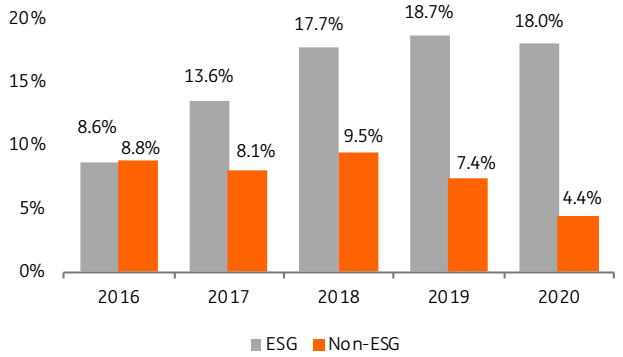
## Ample room for ESG to grow within fixed income

The integration of sustainability criteria by asset managers in their investment policies has clearly accelerated in the past number of years, not only thanks to the regulatory push in this direction, but also due to the generally increased social and environmental awareness and focus. This has prompted investors to increasingly integrate ESG considerations and exclusionary criteria into their investment processes, and to progressively allocate funds to assets realising positive ESG impacts.

*"Sustainable assets under management are ten times as much as a decade ago"*

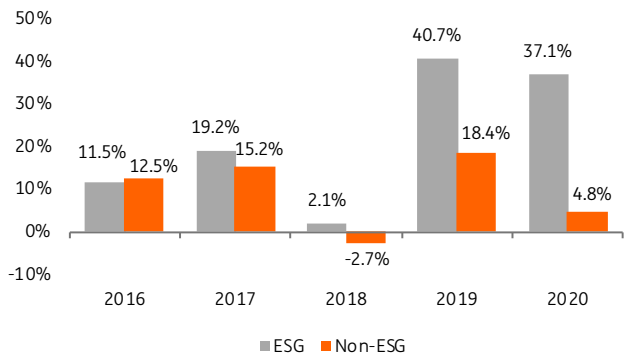
According to Morningstar Direct, European sustainable assets under management summed to €1,101bn by the end of 2020, almost ten times as much as a decade ago, with the number of sustainable funds reaching 3,196, through both newly launched and rebranded funds.[4] The European Fund and Asset Management Association (EFAMA) also recently illustrated how strongly the growth in the number of ESG funds and the amount of ESG related assets under management in Europe has outpaced the growth in non-ESG funds and assets in the past five years (Figures 2 and 3).[5]

**Fig 2 Yearly change in the number of funds**




Source: EFAMA calculations based on Morningstar Direct Platform, ING

**Fig 3 Yearly change in net assets**




Source: EFAMA calculations based on Morningstar Direct Platform, ING

[1] https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

[2] https://www.esma.europa.eu/sites/default/files/library/jc_2021_06_joint_esas_supervisory_statement_-_sfdr.pdf

[3] https://www.esma.europa.eu/press-news/consultations/joint-consultation-taxonomy-related-sustainability-disclosures

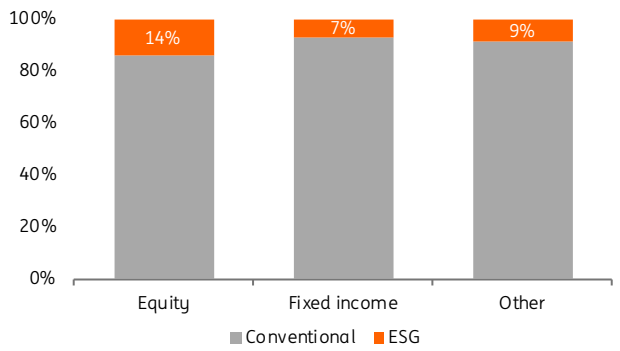
[4] Morningstar, European Sustainable Funds Landscape: 2020 in Review, A year of broken records heralding a new era for sustainable investing in Europe, February 2021

[5] EFAMA Markets Insights, ESG investing in the UCITS market, a powerful and inexorable trend, March 2021

> *"Bond markets still have ample unchartered territory for the ESG segment to grow"*

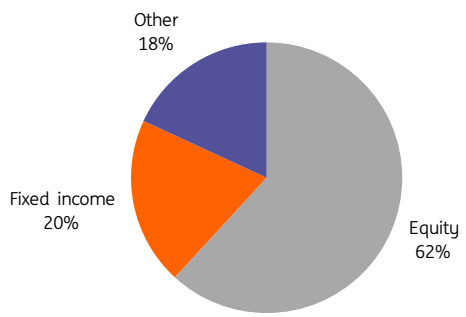
This trend is here to stay (see also our article *"Covid the catalyst for ESG in credit"*, available on the ING Think website). By the end of 2020, ESG related assets represented 11% of the assets under management, up from 7% in 2016. Equity funds have thus far led the way, partly thanks to the rise in equity prices in recent years. Instead, the share of ESG funds in the fixed income market is still relatively modest at 7% in comparison to the 14% share of ESG funds in the equity market (Figure 4). Fixed income assets only represent 20% of total ESG assets under management (Figure 5), which compares with a 33% share in the non-ESG space. This, in our view, shows that the fixed income market still has plenty of ground left unexplored for the ESG segment to grow.

**Fig 4 ESG funds more moderate in fixed income**




Source: Morningstar Direct (4Q20), ING

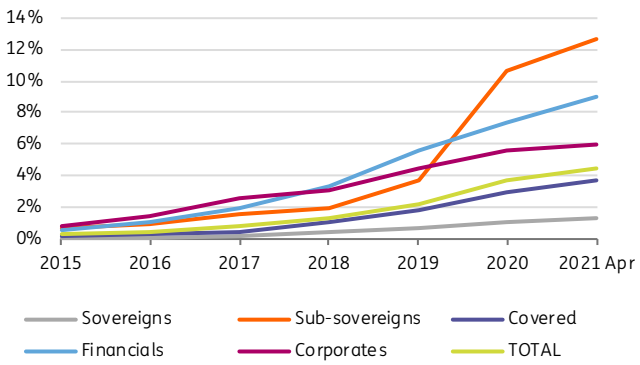
**Fig 5 Equity funds dominate the ESG space**




Source: Morningstar Direct (4Q20), ING

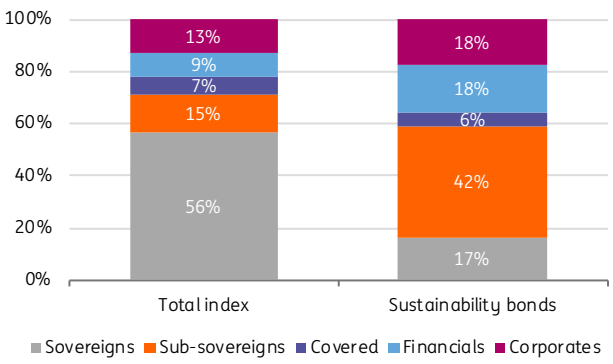
While this holds for all fixed income asset classes, this is perhaps most obviously the case for the sovereign bond segment. Figure 6 shows how the share of sustainability bonds within the Markit iBoxx EUR investment grade bond indices has gradually risen in the past five years. Last year, this rise has been particularly strong in sub-sovereigns due to the substantial Covid-19 related social issuance activity by among others the EU. Nonetheless, overall the portion of sustainable bonds remains relatively modest, particularly for sovereign bonds where it just tops 1%.

**Fig 6 Share of sustainability bonds rises per bond class***




* Nominal share
Source: Markit iBoxx, ING

**Fig 7 Sovereigns have a small share in sustainable bonds***




* Nominal share
Source: Markit iBoxx, ING

> *"Particularly in the sovereign bond market ESG bonds still have a small share"*

Figure 7 confirms that the Markit iBoxx EUR sovereign index represents 56% of the overall EUR investment grade index domain, while the sustainability bonds that are part of the EUR sovereign index make up only 17% of the total amount of sustainability bonds included in the five major IG indices. Instead, sub-sovereigns have a 15% share in the total Markit iBoxx EUR bond space, but a 42% share in the sustainability segment.

Hence, in light of the ambitious political sustainability agendas there seems ample room for the sustainable sovereign bond segment to grow, particularly once the data availability and standards to measure sovereign ESG factors evolve. Besides, sovereigns have much larger budgets to issue bonds with a dedicated green or social use of proceeds. This contrasts for example with regions within the sub-sovereign segment. Some of these regions would like to issue pure green, but because of the skew of regional budgets towards social expenditures they are often forced to issue in sustainable format to at least be able to include some green assets.

## Sustainable disclosures will facilitate green supply

In our view, the sustainable finance disclosure requirements, will be an important support to the further growth of the ESG market in general. During the first stage this may even more so be the case though for the financials and non-financial segment than for sovereigns, for which no ESG reporting requirements have been established so far.

*"ESG disclosures will grow the demand for and supply of sustainable bonds"*

The SFDR disclosure requirements will not only increase the ***demand for sustainable assets*** by asset managers that wish to make sure they look good in terms of their ESG performance. They will also facilitate the ***supply of sustainable bonds***. After all, the transparency that financial and non-financial corporations have to offer on their ESG performance, should serve to improve their abilities to tag portfolios of sustainable assets in favour of the issuance of sustainable bonds.

That said, this process will take time, meaning that in the years to come the demand for sustainable bonds will likely continue to outpace supply. This will remain a performance positive for sustainable bonds, even though relative value considerations, in our view, will always set their natural boundaries to 'greeniums', ie constrain the maximum achievable spread advantage of sustainable bonds versus vanilla alternatives.

# Sustainable disclosures

For asset managers, the sustainable finance disclosure regulation (SFDR) will coincide with major administrative efforts in terms of prospectus updates, website disclosures, and for preparing the required disclosures for their periodic reports (see Appendix 1 for more details). However, the transparency that has to be offered will bring about further shifts in investment behaviour that will impact bond market performance, particularly via the following product disclosures:

- The classification of funds as Article 6, 8 or 9;
- The principal adverse impact assessment;
- The reporting of the taxonomy compliant investments.

## Mapping investments from non-green to dark green

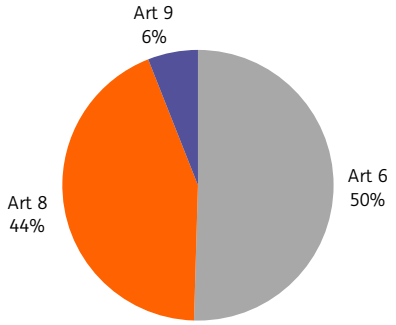
The SFDR basically requires asset managers to disclose whether their products (a) promote environmental or social characteristics (**Article 8 or light green products**), (b) invest in an economic activity that contributes to an environmental or social objective (**Article 9 or dark green products**), or have neither one of these two purposes (**Article 6 or non-green products**) (see Appendix 1 for further information).

*"Morningstar estimates that the sustainable fund market could be worth as much as €2.5trn based on SFDR definitions"*

According to Morningstar, the European ESG and sustainable fund market could currently be worth as much as €2.5trn based on SFDR definitions. After reviewing 49.3% of the 11,500 open-end funds and exchange-traded funds domiciled in Luxembourg, the investment analysis platform calculated that 21% of the funds and 25% of the European fund assets were classified as Article 8 or Article 9. Of these funds, 18% were classified as Article 8 and 3.6% as Article 9.[6] Based upon a survey of 30 different asset managers on their article 8 and 9 funds, Morningstar also found that particularly Nordic and Dutch asset managers were among those with the highest proportion of funds classified as Article 8 and 9.

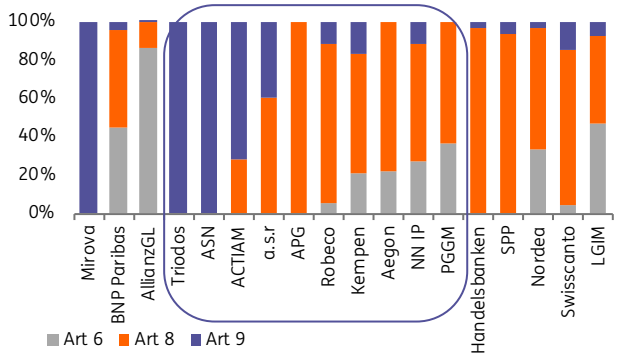
We gathered **fund classification** information for a somewhat different sample of 19 asset managers, of which ten are located in the Netherlands (see Figures 8 to 11). This group of asset managers has already classified 50% of their funds as Article 8 or 9, representing 73% of their combined assets under management.

**Fig 8 Distribution Article 6, 8 and 9 funds**




*Sample of 17 AM, excluding Axa and Kempen
Source: Asset manager information, ING

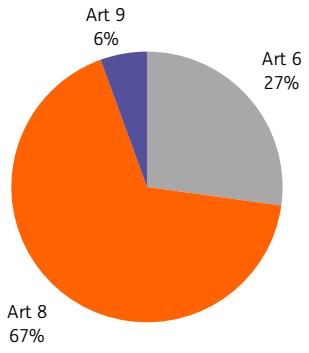
**Fig 9 Distribution Article 6, 8 and 9 funds per AM**




*Fund distribution chart excludes Axa
Source: Asset manager information, ING

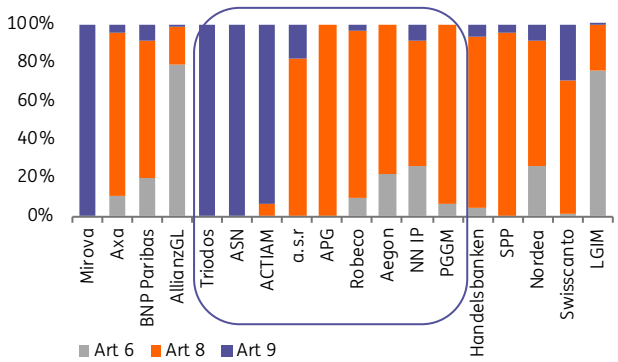
[6] Morningstar, SFDR – The First 20 Days, What the early batch of new disclosures are telling us so far, March 2021

**Fig 10 Distribution Article 6, 8 and 9 AuM**




*Sample of 17 AM, excluding Axa and Kempen
Source: Asset manager information, ING

**Fig 11 Distribution Article 6, 8 and 9 AuM per AM**




*Assets under management chart excludes Kempen
Source: Asset manager information, ING

Indeed, Dutch asset managers do already categorize a substantial share of their funds and assets under management as light or dark green. However, also here we see fund managers taking different approaches. Smaller size investors, such as Triodos Asset Management, or ASN Impact Investors, which explicitly strive to realise positive environmental and social outcomes, have classified all their funds as Article 9. Also ACTIAM has categorized most of its assets under management in the Article 9 bucket.

Larger Dutch asset management groups such as NNIP and Robeco have classified the majority of their funds as Article 8. NNIP considers traditional strategies that take sustainability risks into account when making investment decisions as Article 6, ESG-integrated strategies that promote E/S characteristics and establish good governance requirements for investee companies as Article 8, while sustainable strategies and impact strategies classify as Article 9.[7] Robeco classifies only the impact investing range of strategies as Article 9, while the majority of strategies are classified as Article 8 (ie those that have ESG integrated as standard, or where more specific targets are set such as achieving a lower carbon footprint than the benchmark).

*"Considering the regulatory unknowns asset managers are cautious not to immediately classify funds as dark green"*

APG classifies all its financial products as Article 8, but at this point does not consider any of them to have sustainable investments as their main objective (Article 9). The reasons cited are the uncertainty around the interpretation of SFDR definitions, the unavailability of data to substantiate the claim of being a sustainable investment, and the draft status of the RTS completing the SFDR.

It is indeed fair to say that part of the **asset managers**' landscape appears to **prefer to err on the safe side in terms of classifying their funds**, considering the fact that the regulatory backdrop setting the criteria for such classification is still evolving. This means that some funds that are now considered to be non-green may still be reclassified to the light green bucket later on, while funds that are now identified as light green may still be upgraded to dark green.

Such a reclassification of funds will, in our view, not have a major impact on demand, to the extent that it is simply driven by asset managers gaining greater comfort to categorize funds as light or dark green. However, such reclassification may contribute to shifts in demand where asset managers come to the conclusion that certain assets included in their portfolios do not perfectly serve the targeted Article 8 or 9 purposes.

[7] The NN Green Bond fund is for instance a fund classified as an Article 9 financial product.

> *"The preference to classify funds as light or dark green will remain constructive to the demand for sustainable bonds"*

That said, asset managers will likely strive to classify most of their existing and new funds in the Article 8 and, preferably, 9 categories as a way of showing their commitment to putting funds to work in the most sustainable manner. This will remain a very constructive factor to the demand for sustainable assets, including for sustainable bonds or, alternatively, sustainability linked bonds.

**Sustainable bonds** with a dedicated environmentally sustainable or social use of proceeds should in principal be within the scope of investment funds pursuing Article 9 sustainable investment objectives, if they do no significant harm to other environmental or social objectives, and where it has been ensured that investee companies follow good governance practices. This should by definition hold for bonds that are 100% taxonomy aligned such as bonds issued in line with the future EU green bond standard.

> *"For SLB it may be more challenging to proof that they fit the Article 9 definitions than for use of proceed bonds"*

For Article 9 funds the assessment that a bond fits their sustainable investment objectives may become a bit more complicated for **sustainability linked bonds** (SLB), where the bond proceeds are used for general purposes, but where the characteristics of the bond (such as the coupon) can vary depending on whether or not the issuer meets certain predefined ESG performance targets.

For example, Berlin Hyp's sustainability linked preferred senior unsecured bond has a 40% reduction in the carbon intensity of the bank's loan portfolio between 2020 and 2030 as sustainability performance target. Even though the target is benchmarked against the German plan to reach the Paris Agreement, the implied annual 4% reduction in carbon intensity is less than the 7% annual reduction in GHG intensity for debt securities advocated by the EU climate related benchmarks. This may not be ambitious enough for dark green products that have a reduction of carbon emissions as objective. Having said that, investors may initially not be that harsh on the 7% target given that it is challenging to realise and dependent upon so many transitional uncertainties.[8]

## Adverse impact aspects favour those most transparent

The SFDR requires financial market participants that monitor **principal adverse impacts** (PAI) on sustainability factors, to publish due diligence policies related to those impacts (see Appendix 2). The first disclosures by European asset managers do indicate that principal adverse impacts are generally taken into account on an entity level. However in our view, the importance of the negative impact assessments will only increase once the PAI technicalities have been finalised, the data availability to make these assessments further improves and the product level adverse impacts also have to be disclosed.

**Fig 12 Principal adverse impact indicators**

| | Universal mandatory indicators (18) | | | Opt-in additional indicators (≥2) | | |
|---|---|---|---|---|---|---|
| | **Environmental** | **Social** | **Total** | **Environmental** | **Social** | **Total** |
| Investee companies | 9 | 5 | 14 | 16 | 17 | 33 |
| Sovereigns & supras | 1 | 1 | 2 | 1 | 7 | 8 |
| Real estate assets | 2 | | 2 | 5 | | 5 |
| **Total** | **12** | **6** | **18** | **22** | **24** | **46** |

Source: ESAs draft RTS

[8] Berlin Hyp, for instance, targets only a 14% reduction in carbon intensity by 2025 (2.8% per year for the first five years), a 27% reduction by 2028 (4.3% per annum for the subsequent three years) and 40% by 2030 (6.5% per annum for the final two years). This upward sloping path accounts for the assumption that a) many regulations targeting the reduction of carbon emissions have yet to be implemented, b) the bank believes it will only over time be able to build up a sizeable portfolio of transformation loans financing the renovation of buildings, and c) the decarbonization of energy production will add positively to the energy transition in the real estate sector.

The ESAs draft RTS for entity level principal adverse impact reporting distinguishes 18 **universal mandatory** and 46 **additional opt-in** indicators for both climate related and social impacts. Financial market participants have to describe the adverse impacts for all the mandatory indicators, but only for at least one of the additional climate related indicators and at least one of the additional social indicators.

*"We believe investors will strive to show as limited adverse impacts as possible"*

The degrees of freedom offered with reference to the opt-in additional indicators means that the principal adverse impact considerations will likely differ from entity to entity and from product to product. As such they may have somewhat different demand impacts. At first though the PAI statement only has to be provided on an entity level, and therefore will not say much yet about the products itself. It may also not be as leading to demand as the pre-contractual (Article 6, 8 and 9) disclosures. That said, we do believe that also the principal adverse impact analyses will guide investments towards sustainable alternatives, as investors will strive to show as limited adverse impacts as possible. This is a factor that is not only of importance to sustainable bonds, but which will also have an impact on the relative performance of vanilla bonds.

To name an example, ***mandatory indicators*** revealing the share of investments in companies active in the fossil fuel sector and the use of non-renewable energy sources by investee companies, do favour renewable investment alternatives over fossil dependent activities. Besides, investments in companies that have a modest carbon footprint will reflect positively upon the negative impact disclosures. The same holds for investments in companies that pay more attention to gender equality.

Elsewhere, the optional ***additional indicators*** on green securities will form an extra incentive to invest in securities that are certified as green under the future legislation on the EU green bond standard, at least for those investors considering them in their adverse impact assessment. While not certain yet, the forthcoming EU green bond standard is anticipated to require full taxonomy alignment.

*"Look-through requirements support green over vanilla real estate related bond assets"*

The draft RTS also provides for certain provisions, where the principal adverse impact assessment could indirectly impact fixed income products:

- For the adverse impact assessment, both the **direct and indirect investments** in investee companies, sovereigns, supranational entities and real estate should be included. More specifically, for holding companies, CIUs or SPVs, financial market participants should in principle **look through** to the individual underlying investments of these companies and consider the adverse impacts arising from them.
- Where **an investment exclusively finances a project or type of project**, such as an investment in a green bond, social bond or a project bond, the adverse impact assessment of the investment decision should be limited to the adverse impact of the targeted project or type of project.

To our interpretation, these two provisions make the principal adverse impact indicators for real estate assets quite relevant for investment managers, not only for their direct real estate exposures, but potentially also indirectly where they invest in vanilla bonds issued for instance by real estate investment trusts (REITs) or in covered bonds or RMBS. After all, investors have to consider exposures to **energy-inefficient real estate assets** in their negative impact assessment. This may form an incentive to target green bonds, where the proceeds are used to finance energy efficient real estate assets, over vanilla bonds where a bigger impact of real-estate energy inefficiencies may have to be considered. Besides, the provisions could also result in better demand for vanilla bonds

financing real estate assets that have better energy efficiency metrics versus those that are less energy efficient. We do note however, that the draft RTS does not give an exact definition of what real estate assets should precisely be seen as energy inefficient.

> *"Companies offering best transparency and data availability will be favoured"*

Preparing the principal adverse impact statement will come with substantial **information challenges** for asset managers, particularly during the first years of reporting. In our view, this will likely coincide with a preference of asset managers to invest in those companies that are capable of offering the best transparency on the data needed to properly assess the principal adverse impacts of investment decisions.

## Taxonomy compliance: name of the game for all bonds

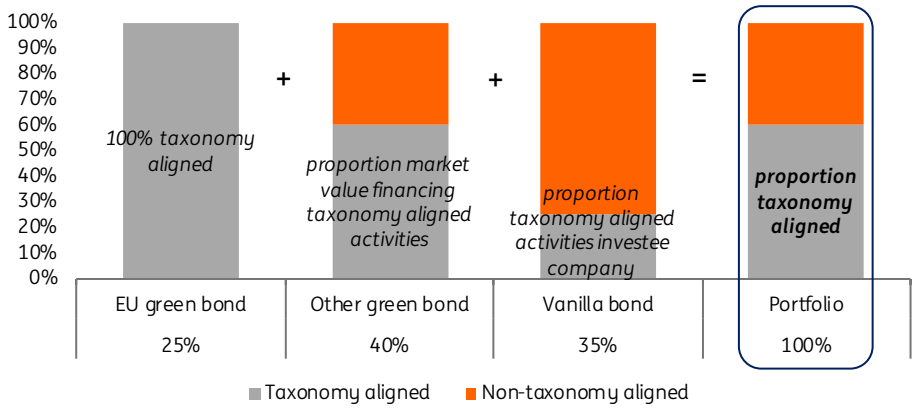
The EU taxonomy regulation introduced additional transparency requirements under the SFDR to measure the taxonomy alignment of Article 6, 8 and 9 products (see appendix 3 for further details). These disclosure requirements equally mean that **investors will become more demanding** towards issuers to be transparent on the taxonomy alignment of their activities and the sustainable bonds they issue, either via their public disclosures, or otherwise upon investor demand or via third party providers.

> *"Investors will likely request green bond issuers to offer far more details on the taxonomy alignment of their green bonds"*

A simple statement that a green bond issued is environmentally sustainable, will in our view not be enough. Issuers will likely be asked for more detailed information on the inputs supporting the conclusion that their green bonds are compliant with the applicable technical screening criteria, the do no significant harm criteria and the social safeguards.

However, the **transparency requested** on most of these matters **will** probably **stretch beyond the taxonomy related disclosures** alone. After all, financial products claiming to make sustainable investments (ie including social or non-taxonomy aligned environmental investments) also have to explain how the mandatory and additional principal adverse impacts are taken into account and whether the sustainable investments are aligned with the OECD guidelines for multinational enterprises and the UN guiding principles on business and human rights (ie social safeguards). They too have to describe how investments contributing to a sustainable investment objective are not doing significantly harm to other sustainable investment objectives. This means that any sustainable bond, and potentially even vanilla bond, issued will likely face an increased investor 'hunger' for ESG related information.

**Fig 13 Taxonomy related disclosures will impact green and vanilla bonds differently**




Source: ESAs consultation taxonomy related disclosures, ING

*"Also the performance of vanilla bonds will be supported by a better taxonomy alignment of the entities issuing them"*

The **taxonomy related disclosure requirements will** anyway practically **impact all bonds issued**, whether marketed with a sustainable use of proceeds or not (Figure 13). The ESA's proposed key performance indicator for measuring a financial product's taxonomy alignment will also consider the taxonomy compliance of vanilla bonds by means of the share of activities of the issuer that can be considered environmentally sustainable. As such companies that will be able to report a stronger taxonomy alignment under the non-financial reporting directive (NFRD), will probably see this translate into more favourable trading levels for their vanilla bonds compared to similar credits that do not score as well on their taxonomy alignment.[9] After all, investors that aim to disclose strong taxonomy KPIs will be inclined to overweight bonds issued by companies that are environmentally most sustainable.[10]

*"Bonds issued under the EU green bond standard will see best demand"*

For that reason, **fixed income investors will likely favour** those **instruments that meet** all the criteria of **the future EU green bond standard** (ie those that are considered to be 100% taxonomy aligned). This does not mean that sustainable bonds that are not fully taxonomy compliant will lose investor interest. After all, they will also count towards the taxonomy KPIs for the part that they do finance taxonomy compliant activities. However, we do believe that investors will have a preference for those bonds that are best taxonomy aligned, which should ultimately translate into a more noteworthy greenium for bonds marketed as such. The EU green bond standard may become the most commonly used measure anyway for issuers to show the taxonomy alignment of their green bonds, as investors may not always have the resources or the willingness to perform a full taxonomy compliance assessment themselves for every green bond.

Besides, we also think that there may be **a directional element** to the fact that the ESAs' propose to use the **market value** of taxonomy aligned investments versus all investments as a reference for the taxonomy KPIs of financial products. This may give investors an incentive to relatively shorten the duration of their taxonomy aligned investments versus the portfolio aggregate in an environment of rising interest rate levels, or to relatively increase the duration of their taxonomy aligned investments in the event that interest rate levels are expected to fall. This could temporarily result in wider greeniums in the longer end of the curve in a declining interest rate environment and vice versa. Ultimately though, the lower the interest rate levels and spread levels are, the less space there is for a wider greenium. This point is illustrated nicely by the relatively small spread differences between sustainable and vanilla bonds in the covered bond segment, versus the typically more noteworthy differences in bail-in senior.

*"Taxonomy disclosures may at first weigh negatively on sovereign and non-EEA paper"*

Finally, in line with EIOPA and ESMA, but in contrast with the EBA's preferences, the ESAs did propose to consider **government exposures** for taxonomy KPI calculation purposes. This is despite the difficulties to determine to which extent these exposures do actually finance taxonomy aligned activities. For now sovereign bonds should simply be assumed not to contribute positively to the taxonomy-aligned activities of Article 8 and 9 financial products. The ESAs believe that measuring the taxonomy alignment of both

[9] The NFRD will be amended via the Corporate Sustainability Reporting Directive (CSRD), which the European Commission adopted on 21 April 2021. Pending the negotiations with the European Parliament and Council, the European Commission hopes to adopt the first set of reporting standards by the end of 2022 if an agreement is reached in the first half of 2022. Sustainable finance package | European Commission (europa.eu)

[10] EnBW is an example of a company that already started to disclose its environmentally sustainable revenues, operational expenditures, capital expenditures and adjusted EBITDA, which investors can take into consideration to measure the taxonomy alignment of their investments when buying the issuer's vanilla bonds. (See https://www.enbw.com/media/bericht/bericht_2020/downloads/broschuere_eu_taxonomie.pdf)

sovereign and also non-EEA exposures requires further research and the development of appropriate methodologies. This has the potential side-effect of investors initially favouring those green bonds that already contribute positively to the taxonomy alignment of their investment portfolios, ie those bonds that are issued by non-sovereign and/or EEA entities.

*"Taxonomy alignment will rise over time"*

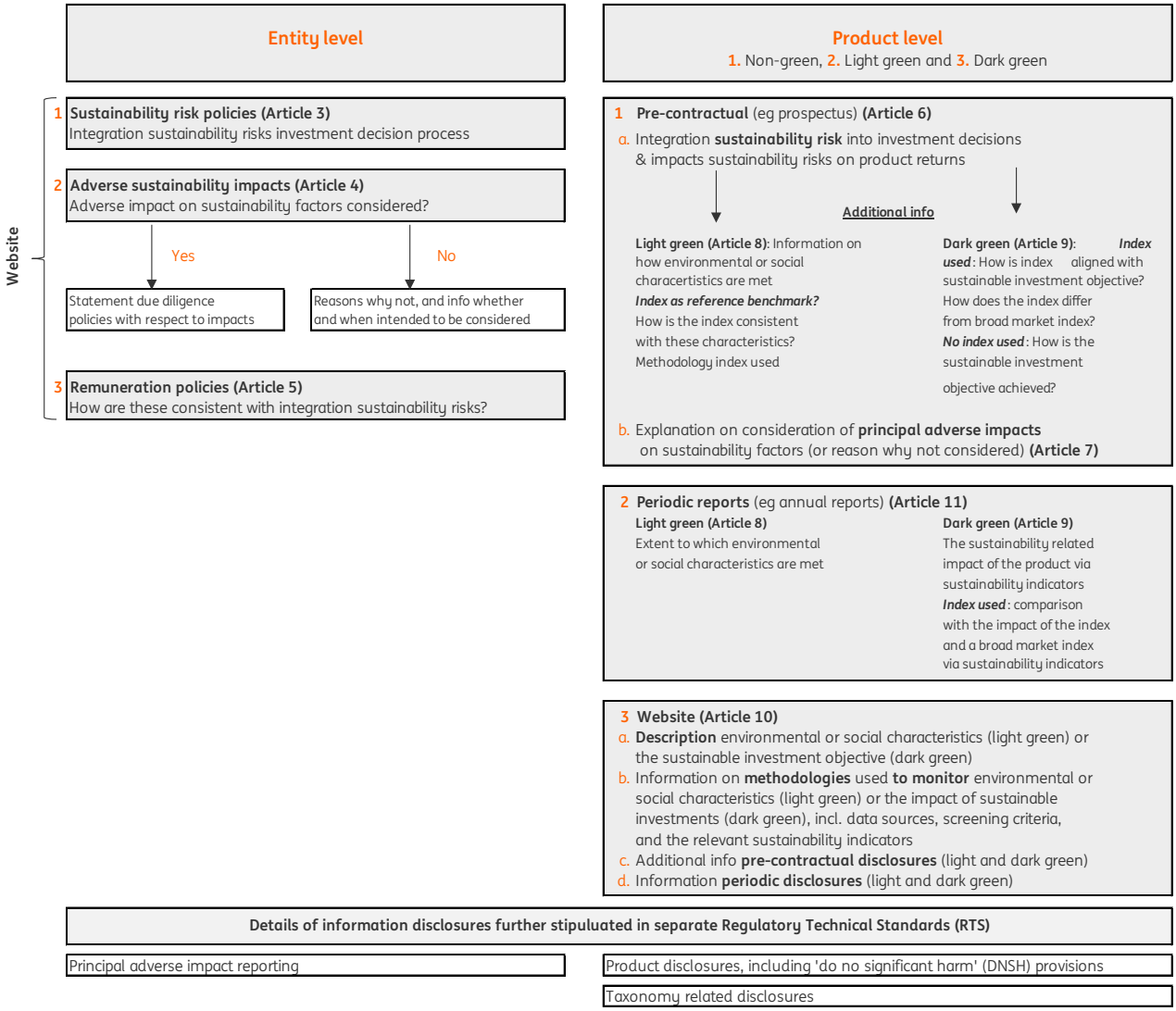
The inclusion of sovereign exposures as not taxonomy aligned will **initially** also contribute to the reporting of **lower taxonomy KPIs**. That said, it is fair to assume that investors will report smaller shares of taxonomy aligned investments anyway during the early reporting phase. Many companies may not yet have provided the relevant taxonomy disclosures. Besides, investors will at first likely take a conservative approach when marketing their taxonomy compliance. Over time, these percentages can be expected to rise, not only because companies will start to report more information, but also because these disclosures will allow investors to better target those assets that are most taxonomy aligned.

# Appendix 1

## What are Article 6, 8 and 9 investments?

The SFDR sets out general disclosure requirements both on an entity level and on a product level. For financial market participants, the **entity level disclosures** should provide information on the integration of sustainability risks in the investment decision process, the consideration of adverse impacts on sustainability factors and to what extent the renumeration policies are consistent with the integration of sustainability risks. The **product level disclosures** provide for product transparency (a) on a pre-contractual basis, (b) in periodic reports and (c) on the website.

**Fig 14 SFDR disclosure requirements for financial market participants**




Source: SFDR, Taxonomy regulation, ING

Particularly the product level disclosures give valuable insights into how ESG factors are integrated in investment decisions. The SFDR distinguishes three types of products:

- **Non-green products**: financial products that a) do not promote environmental or social characteristics and b) do not invest in economic activities that contribute to an environmental/social objective. (*Article 6*, only pre-contractual disclosures required).

- **Light green products**: financial products that promote environmental or social characteristics (*Article 8*, additional information required on how the environmental or social characteristics are met and, where applicable, whether and how the index designated as a reference benchmark is consistent with those characteristics).
- **Dark green products**: financial products that invest in an economic activity that contributes to an environmental or social objective, provided that these investments ***do no significant harm*** to any of these objectives and that the investee companies do follow ***good governance practices*** (sustainable investments per Art 2(17)) (*Article 9*, explanation on how the environmental/social objective is accomplished):
  - **Passive investment strategy**: An index is used as reference benchmark to achieve the sustainable investment objective (Art 9(1), explanation required on how the index is aligned with the investment objective, and why and how the index differs from a broad market index).
  - **Active investment strategy**: No index is used as a reference benchmark to achieve the sustainable investment objective (Art 9(2), explanation required on how the investment objectives are to be achieved).

  Where the financial product has the **objective of reducing carbon emissions** the information to be disclosed should include the objective of low carbon emission exposure in view of achieving the long term global warming objectives of the Paris agreement. Where no EU climate related benchmarks are available, financial market participants have to explain how the carbon emission reduction objective is ensured in view of achieving the Paris agreement objectives (Art 9(3) SFDR).

### The EU climate related benchmarks

The EU benchmark regulation that entered into force on 7 July 2020 identifies two climate related benchmarks:

***EU climate transition benchmarks***, where the underlying assets are selected, weighted or excluded in such a way that the resulting benchmark portfolio is on a decarbonisation trajectory towards alignment with the objectives of the Paris agreement (ie global warming limit of 1.5 ºC versus pre-industrial levels, with no or limited overshoot). These benchmarks target a **reduction of 30% in greenhouse gas emissions** versus the investable universe, and a reduction in GHG intensity or absolute GHG emissions of at least 7% per annum for equity and debt securities. By 31 December 2022 these benchmarks should comply with the same exclusion criteria as the Paris aligned benchmarks.

***EU Paris-aligned benchmarks***, where the underlying assets are selected in such a manner that the resulting benchmark portfolio's GHG emissions are aligned with the 1.5 ºC long-term global warming target of the Paris climate agreement. These benchmarks target **50% lower greenhouse gas emissions** versus the investable universe, and a reduction in GHG intensity or absolute GHG emissions of at least 7% per annum for equity and debt securities. They **exclude** several **companies**:

(a) companies involved in activities related to **controversial weapons**;

(b) companies involved in the cultivation and production of **tobacco**;

(c) companies in **violation of** the **UNGC principles** or **OECD guidelines for multinational enterprises**;

(d) companies deriving ≥ 1% of their revenues from exploration, mining, extraction, distribution or refining of **hard coal and lignite**;

(e) companies deriving ≥ 10% of their revenues from exploration, mining, extraction, distribution or refining of **oil fuels**;

(f) companies deriving ≥ 50% of their revenues from exploration, mining, extraction, manufacturing or distribution of **gaseous fuels**;

(g) companies deriving ≥ 50% of their revenues from **electricity generation** with a GHG intensity of more than 100 g $CO_2$ e/kWh.

# Appendix 2

## Principal adverse impacts

The SFDR requires financial market participants to offer transparency on adverse sustainability impacts, both on an entity level (Article 4) and on a product level (Article 7). Where financial market participants monitor the principal adverse impacts of their investment decisions on sustainability factors, they have to publish a statement on their due diligence policies with respect to those impacts.[11] If negative sustainability impacts are not monitored, clear reasons have to be given why not, and whether and when they are intended to be considered.

*"If adverse impacts are monitored on an entity level, they also have to be disclosed on a product level by end 2022"*

The adverse impact disclosures apply on a comply and explain basis since 10 March 2021. However, for large financial market participants or group entities with more than 500 employees, disclosing due diligence policies with reference to principal adverse impacts will become mandatory per 30 June 2021. Where negative sustainability impacts are monitored on an entity level, the pre-contractual product level disclosures also have to explain by 30 December 2022 whether and how the financial product considers adverse sustainability impacts.[12]

**Entity level principal adverse impact statement (draft RTS)**

1. **Summary**: includes the name of the financial market participant, the fact that principal adverse impacts are considered, reference period, and a summary of the PAI statement.
2. **Description of principal adverse sustainability impacts** and related actions taken and planned: 18 universal mandatory indicators (12 climate and 6 social), at least one of the 22 opt-in climate related additional indicators, at least one of the 24 opt-in social additional indicators, or any other indicators used. (Average 4 quarterly calculations reference period, plus historical comparison).
3. Description of **policies to identify and prioritise principal adverse sustainability impacts**: date of approval policies, allocation of implementation responsibilities, description methods to select opt-in additional indicators and assess the principal adverse impacts, explanation of error margins, data sources.
4. **Engagement policies**: summary of engagement policies relating to reducing principal adverse impacts, including a description of the adverse impacts considered and how these policies are adapted if the impacts are not reduced.
5. **References to international standards**: description adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting, and where relevant the degree of alignment with the objectives of the Paris agreement. The description contains the PAIs used, the methodology and data used to measure adherence, plus an identification of forward-looking climate scenario used (or why such a scenario is not used).

[11] This takes into account the size, nature and scale of their activities and the types of financial products they make available.

[12] These product level disclosures should also explicitly state that the principal adverse impact information is available in the relevant periodic report of the financial product.

*"The ESAs' draft RTS identify 18 mandatory and 46 additional indicators for principal adverse impacts"*

The level 2 technical details provided by the ESAs draft RTS for entity level principal adverse impact reporting distinguish a set of 18 **universal mandatory** and 46 **additional opt-in** indicators for both:

- **Climate** and other environment-related adverse impacts, and
- Adverse impacts in the field of **social** and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

These indicators are split by investments in:

- Investee companies;
- Sovereigns (and supranationals);
- Real estate assets.

The description of principal adverse impacts on sustainability factors of the investment decisions of financial market participant, will include all **18 mandatory indicators**, as well as at least one of the 22 additional indicators related to adverse impacts on a climate or other environment related sustainability factor, and at least one of the 24 additional indicators related to the principal adverse impacts on a social, employee, human rights, anti-corruption or anti-bribery sustainability factor (see Figures 15 to 17).

# Mandatory and additional indicators

**Fig 15 Universal mandatory indicators**

| | Indicator | Metric |
|---|---|---|
| | **Investee companies** | |
| | **Environmental** | |
| | **Greenhouse gas emissions** | |
| 1 | GHG emissions | $\sum_{n}^{i} \frac{current\ value\ of\ investment_i}{investee\ company's\ enterprise\ value_i}\ x\ investee\ company's\ scope(x)\ GHG\ emissions_i$<br>Scope 1 GHG emissions<br>Scope 2 GHG emissions<br>Scope 3 GHG emissions (from 1 Jan 23)<br>*Total GHG emissions* |
| 2 | Carbon footprint | $\frac{\sum_{n}^{i} \frac{current\ value\ of\ investment_i}{investee\ company's\ enterprise\ value_i}\ x\ investee\ company's\ scope\ 1,2\ and\ 3\ GHG\ emissions_i}{current\ value\ of\ all\ investments\ (€m)}$ |
| 3 | GHG intensity of investee company | $\sum_{n}^{i} \frac{current\ value\ of\ investment_i}{current\ value\ of\ all\ investments\ (€m)}\ x\ \frac{investee\ company'scope\ 1,2\ and\ 3\ GHG\ emissions_i}{investee\ company's\ €m\ revenue_i}$ |
| 4 | Exposure to companies active in the fossil fuel sector | Share of investments in companies active in the fossil fuel sector |
| 5 | Share of non-renewable energy consumption and production | Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage |
| 6 | Energy consumption intensity per high impact climate sector | Energy consumption in GWh per €m of revenue of investee companies, per high impact climate sector |
| | **Biodiversity** | |
| 7 | Activities negatively affecting biodiversity-sensitive areas | Share of investments in investee companies with sites/operations located in or near to biodiversity sensitive areas where activities of those investee companies negatively affect those areas |
| | **Water** | |
| 8 | Emissions to water | Tonnes of emissions to water generated by investee companies, per €m invested, expressed as a weighted average |
| | **Waste** | |
| 9 | Hazardous waste ratio | Tonnes of hazardous waste generated by investee companies, per €m invested, expressed as a weighted average |
| | **Social & employee, respect for human rights, anti-corruption and anti-bribery matters** | |
| | **Social and employee matters** | |
| 10 | Violations of UN Global Compact principles and OECD guidelines for multinational enterprises | Share of investments in investee companies that have been involved in violations of UN Global Compact principles and OECD guidelines for multinational enterprises |
| 11 | Lack of process and compliance mechanisms to monitor compliance with UN Global Compact Principles and OECD Guidelines for Multinational Enterprises | Share of investments in investee companies without policies to monitor compliance with UN Global Compact principles and OECD guidelines for multinational enterprises |
| 12 | Unadjusted gender pay gap | Average unadjusted gender pay gap of investee companies |
| 13 | Board gender diversity | Average ratio of female to male board members in investee companies |
| 14 | Exposure to controversial weapons (anti-personnel mines, cluster munition, chemical weapons, biological weapons) | Share of investments in investee companies involved in the manufacture or selling of controversial weapons |
| | **Sovereign and supranational** | |
| | **Environmental** | |
| 15 | GHG intensity | $\sum_{n}^{i} \frac{current\ value\ of\ investment_i}{current\ value\ of\ all\ investments\ (€m)}\ x\ \frac{country's\ scope\ 1,2\ and\ 3\ GHG\ emissions_i}{GDP_i(€m)}$ |
| | **Social** | |
| 16 | Investee countries subject to social violations | Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, UN principles and national law |
| | **Real estate assets** | |
| | **Environmental** | |
| 17 | Exposures to fossil fuels through real estate assets | Share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels |
| 18 | Exposure to energy-inefficient real estate assets | Share of investments in energy-inefficient real estate assets |

Source: ESAs final report on draft RTS, ING

**Fig 16 Additional climate and other environment-related indicators**

| | Indicator | Metric |
|---|---|---|
| | **Investee companies** | |
| | **Greenhouse gas emissions** | |
| 1 | Emissions of inorganic pollutants | Tonnes of inorganic pollutants equivalent per €m invested, expressed as a weighted average |
| 2 | Emissions of air pollutants | Tonnes of air pollutants equivalent per €m invested, expressed as a weighted average |
| 3 | Emissions of ozone depletion substances | Tonnes of ozone depletion substances equivalent per €m invested, expressed as a weighted average |
| 4 | Investments in companies without carbon emission reduction initiatives | Share of investments in investee companies without carbon emission reduction initiatives aimed at aligning with the Paris agreement |
| | **Energy performance** | |
| 5 | Breakdown of energy consumption by type of non-renewable sources of energy | Share of energy from non-renewable sources used by investee companies broken down by each non-renewable source |
| | **Water, waste and material emissions** | |
| 6 | Water usages and recycling | 1. Average amount of water consumed and reclaimed by the investee companies (in $m_2$) per €m revenue of investee companies, 2. Weighted average percentage of water recycled and reused by investee companies |
| 7 | Investments in companies without water management policies | Share of investments in investee companies without water management |
| 8 | Exposures to areas of high water stress | Share of investments in investee companies with sites located in areas of high water stress without a water management policy |
| 9 | Investments in companies producing chemicals | Share of investments in investee companies the activities of which fall under NACE division 20.2 ie manufacture of pesticides and other agrochemical products |
| 10 | Land degradation, desertification, soil sealing | Share of investments in investee companies the activities of which cause land degradation, desertification or soil sealing |
| 11 | Investments in companies without sustainable land/agriculture practices | Share of investments in investee companies without sustainable land/agriculture practices or policies |
| 12 | Investment in companies without sustainable oceans/seas practices | Share of investments in investee companies without sustainable oceans/seas practices or policies |
| 13 | Non-recycled waste ratio | Tonnes of non-recycles waste generated by investee companies per €m invested, expressed as a weighted average |
| 14 | Natural species and protected areas | 1. Share of investments in investee companies whose operations affect threatened species, 2. Share of investments in investee companies without a biodiversity protection policy covering operational sites owned, leased, managed in, or adjacent to, a protected area or an area of high biodiversity value outside protected areas |
| 15 | Deforestation | Share of investments in companies without a policy to address deforestation |
| | **Green securities** | |
| 16 | Share of securities not certified as green under a future EU legal act setting up an EU Green Bond Standard | Share of securities in investments not certified as green |
| | **Sovereign and supranational** | |
| | **Green securities** | |
| 17 | Share of securities not certified as green under a future EU legal act setting up an EU Green Bond Standard | Share of bonds not certified as green |
| | **Real estate assets** | |
| 18 | GHG emissions | Scope 1 GHG emissions generated by real estate assets<br>Scope 2 GHG emissions generated by real estate assets<br>Scope 3 GHG emissions generated by real estate assets (from 1 Jan 23)<br>*Total GHG emissions generated by real estate assets* |
| | **Energy consumption** | |
| 19 | Energy consumption intensity | Energy consumption in GWh of owned real estate assets per $m_2$ |
| | **Waste** | |
| 20 | Waste production in operations | Share of real estate assets no equipped with facilities for waste sorting and not covered by a waste recovery or recycling contract |
| | **Resource consumption** | |
| 21 | Raw materials consumption for new construction and major renovations | Share of raw building materials (excluding recovered, recycled and biosourced) compared to the total weight of building materials used in new construction and major renovations |
| | **Biodiversity** | |
| 22 | Land artificialisation | Share of non-vegetated surface area (surfaces that have not been vegetated in ground, as well as on roofs, terraces and walls) compared to the total surface area of the plots of all assets |

Source: ESAs final report on draft RTS, ING

**Fig 17 Additional indicators for social and employee, respect for human rights, anti-corruption and anti-bribery maters**

| | Indicator | Metric |
|---|---|---|
| | **Investee companies** | |
| | **Social and employee matters** | |
| 1 | Investments in companies without workplace accident prevention policies | Share of investments in investee companies without a workplace accident prevention policy |
| 2 | Rate of accidents | Rate of accidents in investee companies, expressed as a weighted average |
| 3 | Number of days lost to injuries, accidents, fatalities or illness | Number of workdays lost to injuries, accidents, fatalities or illness of investee companies, expressed as a weighted average |
| 4 | Lack or supplier code of conduct | Share of investments in investee companies without any supplier code of conduct (against unsafe working conditions, precarious work, child labour and forced labour) |
| 5 | Lack of grievance/complaints handling mechanism related to employee matters | Share of investments in investee companies without any grievance/complaints handling mechanism related to employee matters |
| 6 | Insufficient whistle-blower protection | Share of investments in entities without policies on the protection of whistle-blowers |
| 7 | Incidents of discrimination | 1. Number of incidents of discrimination reported in investee companies, expressed as a weighted average, 2. Number of incidents of discrimination leading to sanctions in investee companies, expressed as a weighted average |
| 8 | Excessive CEO pay ratio | Average ratio within investee companies of the annual total compensation for the highest compensated individual to the median annual total compensation for all employees (excluding the highest-compensated individual) |
| | **Human rights** | |
| 9 | Lack of a human rights policy | Share of investments in entities without a human rights policy |
| 10 | Lack of due diligence | Share of investments in entities without a due diligence process to identify, prevent, mitigate and address adverse human rights impacts |
| 11 | Lack of processes and measures for preventing trafficking in human beings | Share of investments in investee companies without policies against trafficking in human beings |
| 12 | Operations and suppliers at significant risk of incidents of child labour | Share of investments in investee companies exposed to operations and suppliers at significant risk of incidents of child labour exposed to hazardous work in terms of geographic areas or type of operation |
| 13 | Operations and suppliers at significant risk of incidents of forced or compulsory labour | Share of the investments in investee companies exposed to operations and suppliers at significant risk of incidents of forced or compulsory labour in terms of geographic areas and/or the type of operation |
| 14 | Number of identified cases of severe human rights issues and incidents | Number of cases of severe human rights issues and incidents connected to investee companies on a weighted average basis |
| | **Anti-corruption and anti-bribery** | |
| 15 | Lack of anti-corruption and anti-bribery policies | Share of investment in entities without policies on anti-corruption and anti-bribery consistent with the UN convention against corruption |
| 16 | Cases of insufficient action taken to address breaches of standards of anti-corruption and anti-bribery | Share of investments in investee companies with identified insufficiencies in actions taken to address breaches in procedures and standards of anti-corruption and anti-bribery |
| 17 | Number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws | Number of convictions and amounts of fines for violations of anti-corruption and anti-bribery laws by investee companies |
| | **Sovereign and supranational** | |
| | **Social** | |
| 18 | Average income inequality score | The distribution of income and economic inequality among the participants in a particular economy including a quantitative indicator explained in the explanation column |
| 19 | Average freedom of expression score | Measuring the extent to which political and civil society organisations can operate freely including a quantitative indicator explained in the explanation column |
| | **Human rights** | |
| 20 | Average human rights performance | Measure of the average human right performance of investee countries using a quantitative indicator explained in the explanation column |
| | **Governance** | |
| 21 | Average corruption score | Measure of the perceived level of public sector corruption using a quantitative indicator explained in the explanation column |
| 22 | Non-cooperative tax jurisdiction | Investments in jurisdictions on the EU list of non-cooperative jurisdictions for tax purposes |
| 23 | Average political stability score | Measure of the likelihood that the current regime will be overthrown by the use of force using a quantitative indicator explained the explanation column |
| 24 | Average rule of law score | Measure of the level of corruption, lack of fundamental rights, and the deficiencies in civil and criminal justice using the explanation column |

Source: ESAs final report on draft RTS, ING

# Appendix 3

## Taxonomy related disclosures

*"The ESAs aim to integrate the taxonomy related disclosures into the draft RTS"*

The EU taxonomy regulation introduced additional transparency requirements under the SFDR's pre-contractual disclosures and periodic reports to measure the taxonomy alignment of the Article 6, 8 and 9 financial products. In their joint consultation paper of 15 March 2021 the European Supervisory Authorities (ESAs) proposed to integrate these taxonomy-related disclosures into the draft SFDR RTS, with the purpose of establishing one single rule book for all level 2 SFDR disclosures.

**Environmentally sustainable activities under the EU taxonomy regulation**

The EU taxonomy regulation, that came into force on 12 July 2020, identifies the following **six sustainability objectives**:

1) Climate change mitigation;
2) Climate change adaptation;
3) Sustainable use and protection of water and marine resources;
4) Transition to a circular economy, waste prevention and recycling;
5) Pollution prevention and control;
6) Protection and restoration of biodiversity and ecosystems.

An **economic activity** is considered **environmentally sustainable** and thus taxonomy eligible if it meets the following **criteria**:

a) The economic activity **contributes** substantially **to one of the environmental objectives** identified;
b) The economic activity **does not significantly harm** (DNSH) any of these environmental objectives;
c) The economic activity is carried out in compliance with the **minimum (social) safeguards**;
d) The economic activity complies with the **technical screening criteria**.

Companies must include in their non-financial statement information about the extent their activities are environmentally sustainable.

*"Investments in taxonomy aligned activities are in principle dark green"*

In essence, investments in taxonomy aligned activities are 'dark green' (ie Article 9), but also Article 8 (light green) or Article 6 (non-green) financial products can invest in these activities.

The taxonomy regulation therefore stipulates that both Article 8 and Article 9 financial product disclosures should additionally include:

- Information on the environmental objective(s) defined in the taxonomy regulation to which the investment contributes;
- A description of how and to what extent the investments are in economic activities that **qualify as environmentally sustainable**, or more specifically

  a) contribute to one of the six taxonomy environmental objectives;

  b) do not significantly harm any of the other environmental objective;

  c) are carried out in compliance with the minimum social safeguards and comply with the technical screening criteria.

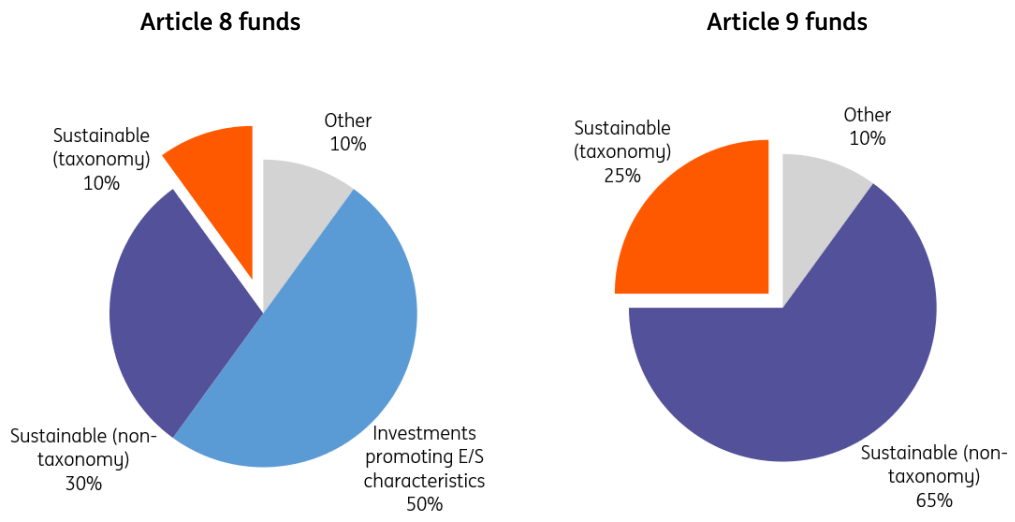
This description should specify **the proportion of investments in environmentally sustainable activities** selected for the financial products **as a percentage of all investments** selected for the financial product, and should also include details on the proportions of enabling and transitional activities.

Figures 19 at the end of this section gives an overview of the draft RTS pre-contractual product disclosure requirements, including the proposed integration of the taxonomy related disclosures. Figures 20 and 21 give a similar summary overview for the draft periodic website disclosure requirements, without explaining them in further detail.

*"Both Article 8 and 9 products should represent their taxonomy alignment"*

With reference to the **pre-contractual disclosures**, the ESAs propose that both article 8 and 9 financial products should graphically represent the minimum taxonomy alignment of their investments and give a description of the environmentally sustainable investments.[13] To the extent that investments have been made in economic activities that are not environmentally sustainable (ie not taxonomy aligned) the reasons for that should be clearly explained.

**Fig 18 Examples of Article 8 and 9 fund investments in specific assets**




Source: Draft RTS, consultation taxonomy related disclosures, ING

For financial products committing to making one or more sustainable investments (ie social or (non-taxonomy aligned) environmental as represented by the dark blue parts in Figure 18), a description should be given of how the sustainable investments contribute to a sustainable investment objective, while **not doing significant harm** to any of the sustainable investment objectives. This includes:

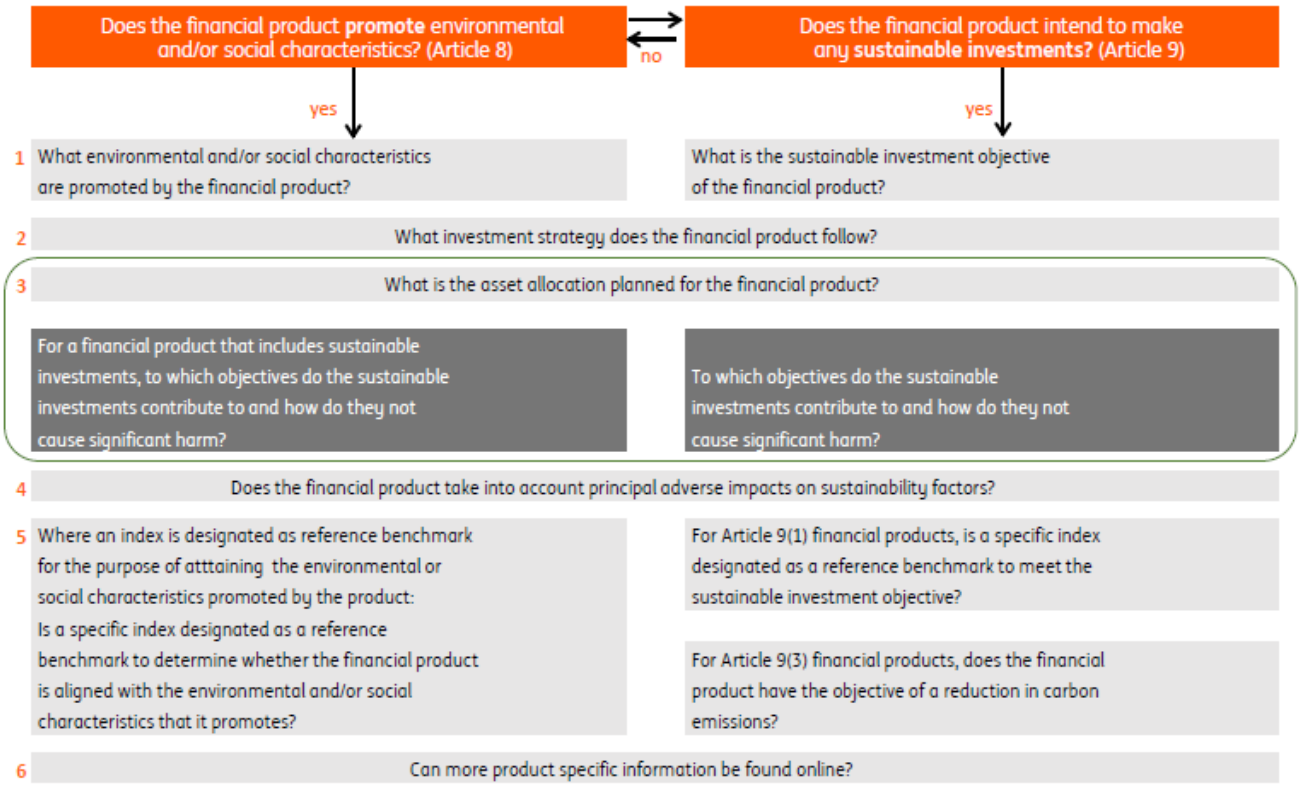
- An explanation of how the **mandatory and additional principal adverse impact indicators** are taken into account, and
- Whether the sustainable investment is aligned with
  - The OECD guidelines for multinational enterprises;
  - The UN guiding principles on business and human rights.

[13] This description includes: a) for non-financial corporations, whether the taxonomy alignment is measured by turnover, capital expenditure or operational expenditure, and the reason for that choice (including how that choice is appropriate for investors in the financial product), b) where information on the taxonomy alignment is not available from public disclosures, details of how the equivalent information was obtained i. directly from the investee companies, ii via third party providers, and c) a breakdown of the minimum proportions of investments in enabling activities and transitional activities, stated as a percentage of all investments of the financial product.

As the **taxonomy aligned sustainable investments** already have to meet the 'do no significant harm criteria' and comparable minimum social safeguards under the taxonomy regulation, the description for these investments should only include:

- A **statement** that the economic activities invested in are environmentally sustainable economic activities;
  - Whether the statement has been subject to an **assurance** provided **by an auditor or** a review by **a third party**;
  - If so, the name of that third party.

**Fig 19 Pre-contractual product disclosures, including taxonomy related disclosures**




Source: Draft RTS, consultation taxonomy related disclosures, ING

**Fig 20 Periodic disclosures, including taxonomy related disclosures**

| | Financial products that promote environmental and/or social characteristics (Article 8) | Financial product that intend to make sustainable investments (Article 9) |
|---|---|---|
| 1 | Attainment of the E/S characteristics promoted | Attainment of the sustainable investment objective |
| 2 | Top investments of the financial product | |
| 3 | Proportion of sustainability-related investments | |
| | For a financial product which included a commitment to make sustainable investments, "To which objectives do the sustainable investments contribute to, and how do they not cause significant harm" | To which objectives do the sustainable investments contribute, and how do they not cause significant harm |
| 4 | Actions taken to meet the E/S characteristics | Actions taken to meet the sustainable investment objective |
| 5 | Performance versus the designated as reference benchmark to attain the environmental or social characteristics promoted by the product: | For Article 9(1) financial products, how is the financial product perform compared to the reference sustainable benchmark?<br><br>For Article 9(3) financial products, how was the objective of a reduction in carbon emissions aligned with the Paris agreement? |

Source: Draft RTS, consultation taxonomy related disclosures, ING

**Fig 21 Website disclosures, including taxonomy related disclosures**

| | Financial products that **promote** environmental and/or social characteristics (Article 8) | Financial product that intend to make **sustainable investments** (Article 9) |
|---|---|---|
| 1 | Summary | |
| 2 | No sustainable investment objective | No significant harm to the sustainable investment objective |
| 3 | Environment or social characteristics of the financial product | Sustainable investment objective of the financial product |
| 4 | Investment strategy | |
| 5 | Proportion of investments | |
| 6 | Monitoring of environmental and social characteristics | Monitoring sustainable investment objectives |
| 7 | Methodologies | |
| 8 | Data sourcing and processing | |
| 9 | Limitations to methodologies and data | |
| 10 | Due diligence | |
| 11 | Engagement policies | |
| 12 | Where an index is designated as reference benchmark for the purpose of atttaining the environmental or social characteristics promoted by the product: *"Designated reference benchmark"* | **Atainment of investment objective**<br>For Article 9(1) financial products, how is the index designated as a reference benchmark aligned with the sustainable investment objective?<br><br>For Article 9(3) financial products, a statement that the reference benchmark qualifies as 1. an EU climate transition benchmark, or 2 EU Paris aligned benchmark* |

* If not available, how is the objective achieved in light of the Paris agreement, and to what extent does the product comply with the EU benchmark regulation
Source: Draft RTS, consultation taxonomy related disclosures, ING

## Calculating the taxonomy alignment of investments

The proposed **key performance indicator** (KPI) for measuring the taxonomy alignment should reflect the share of the taxonomy compliant investments of a financial product as a weighted average of all investments. The methodology recommended by the ESAs for calculating this KPI does take into account the ESAs' (EIOPA, ESMA, EBA) individual technical advice to the European Commission on the taxonomy related reporting requirements under the NFRD.

> *"The ESAs propose to include sovereign exposures for taxonomy KPI purposes"*

Importantly, in line with the EIOPA and ESMA proposals, but in contrast with the EBA's preferences, also **exposures to governments** are included, despite the difficulties to determine to which extent these actually finance taxonomy aligned activities. For now sovereign bonds will under the proposals simply be assumed not to contribute positively to the taxonomy-aligned activities of Article 8 and 9 financial products. The ESAs stress that measuring the taxonomy alignment of both sovereign and non-EEA exposures requires further research and the development of appropriate methodologies.

The **taxonomy alignment** of the investment should under the ESA's proposals be calculated as follows:

$$KPI = \frac{\text{Market value of all taxonomy aligned investments of the financial product}}{\text{Market value of all investments of the financial prodcut}}$$

The taxonomy-aligned investments will be calculated as the weighted average of the following components:

- **Green bonds** issued under the future **EU green bond standard** (GBS) = 100% market value;
- **Other green bonds** = proportion of the market value corresponding to the proportion of the proceeds used to finance taxonomy aligned activities;
- **Debt instruments** and equities in **investee companies** = market value of the proportion of debt instruments/equities reflecting the proportion of activities of the investee companies that is associated with environmentally sustainable activities:
  - Non-financial companies:
  - Value of the securities invested in companies weighted by the share of turnover (or capital expenditures or operational expenditures) contributing to the environmentally sustainable activity:
    1) For companies subject to disclosure requirements under the non-financial reporting directive (NFRD) -> the disclosed KPI or (green asset) ratio on the taxonomy alignment under NFRD disclosures
    2) For companies not subject to disclosure requirements under the NFRD -> privately obtained data from a) the investee companies or b) third parties.
  - **Financial companies**:
    The share of environmentally sustainable activities to be disclosed under the NFRD (reported KPI/green asset ratio).
- **Investments in real estate assets** = the market value of those investments that qualify as environmentally sustainable economic activities.

## Disclaimer