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ISDA views on Sustainability Omnibus proposals

9 June 2025

ISDA strongly supports the simplification and burden reduction agenda of the new European Commission (EC) which aims to simplify and streamline the EU sustainable finance regulatory framework in order to provide much needed clarity to companies. We welcome in particular the Sustainability Omnibus package which aims to amend the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CS3D), the EU Taxonomy Regulation and the EU's Carbon Border Adjustment Mechanism (CBAM).

We have set out below our views on specific aspects of these proposals from a derivatives perspective, coupled with ISDA's recommendations, which we consider necessary to achieve the Commission's simplification and competitiveness goals.

Since 1985, ISDA's mission has been to build and promote robust, stable financial markets and a strong financial regulatory framework. Safe and efficient derivatives markets play a vital role in managing risk and facilitating sound, liquid capital markets, in turn supporting economic growth.

- Derivatives are a crucial tool for helping Europe to achieve its sustainability objectives: greening and futureproofing the European economy, with derivatives serving as a fundamental risk management tool; supporting innovative financing solutions for green technologies and net zero transition.

a. Streamlining reporting requirements

The EC should remove reporting requirements which are not providing meaningful information and which create significant costs for undertakings.

In particular, the reporting and disclosure requirements under the EU Taxonomy Regulation either do not provide meaningful information or have been overtaken by more recent sustainability reporting frameworks such as the CSRD. For example:

- It is unclear what additional value GAR reporting achieves that will not be covered by the CSRD and forthcoming Transition Plan requirements. These frameworks are designed to provide detailed and actionable insights into an institution's sustainability performance and transition plans, which are more aligned with investor needs and regulatory objectives. By comparison, the process of GAR reporting is costly and resource-intensive. It requires significant management attention and financial resources that are disproportionate to the outcome.
- Similarly, the Commission has recognised that the Trading Book KPI is "not relevant or decision-useful for financial undertakings".

On this basis, we would propose the permanent removal of all the reporting and disclosure obligations for financial undertakings under the Taxonomy Regulation, or conversion to a voluntary regime. We comment below on our main concerns with the Taxonomy Regulation and the steps that we would propose to address these if the Commission does not permanently remove all reporting and disclosure obligations.

As mentioned above, we welcome the Commission's recognition that the Trading Book KPI "is not relevant and decision-useful for financial undertakings"[1], and we strongly believe that this KPI will not provide useful information but will only create additional significant reporting burdens for credit institutions and other financial undertakings without benefit. Therefore, instead of the suspension of the Trading Book KPI until 1 January 2027, we would like to see its permanent removal for the following reasons[2]:

- a credit institution does not have the necessary visibility to assess a client on a transaction's intention, in relation to the Taxonomy and the underlying asset, such that a full alignment analysis is not possible.
- the composition of a trading book is contingent by nature and its size and content are not the result of any asset allocation policy.
- a trading book is flow-driven and of a short-term nature. As a result, the measurement of the Trading Book KPI can only provide a snapshot at a given point in time and may not always provide valuable information.

In view of the above considerations, it is extremely challenging to comprehend how a financial undertaking would take into account environmental factors when managing its trading book. The Trading Booking KPI is not used in financial reporting or risk management and would thus require very significant implementation efforts without any obvious information value.

We have provided detailed feedback on the Commission's proposed amendments to the EU Taxonomy Delegated Acts, jointly with the Association for Financial Markets in Europe (AFME)[3]. We support the following priority Taxonomy reporting measures for the EU authorities to consider in the context of the Sustainability Omnibus:

- Consider extending the proposed voluntary Taxonomy reporting to remove all mandatory Taxonomy reporting for financial undertakings.
- Remove the Fees & Commissions KPI ("F&C KPI") and the KPI for the trading portfolio ("Trading Book KPI").
- Remove Taxonomy disclosures, including the GAR and associated KPIs, from Pillar 3 ESG disclosures.
- If the Green Asset Ratio (GAR) is not removed through the Omnibus proposals, at a minimum it is essential to suspend the GAR under both the Taxonomy and Pillar 3 reporting pending the outcome of the review of the Disclosures Delegated Act ("DDA") and the Taxonomy Technical Screening Criteria ("TSC").

[1] See Recital 7 of the Draft Delegated Regulation.
[2] See the Platform, "Platform Recommendations on Data and Usability", October 2022 (pg. 103) and the European Banking Authority (EBA), "EBA Report: Advice to the Commission on KPIs and methodology for disclosure by credit institutions and investment firms under the NFRD on how and to what extent their activities qualify as environmentally sustainable according to the EU Taxonomy Regulation", March 2021 (pg. 17).
[3] AFME ISDA response to European Commission consultation on amendments to the Taxonomy Delegated Acts.pdf

- The timeline for the application of the EBA guidelines on ESG risk management (which are due to apply from January 2026) should be updated to reflect the impact of the Omnibus CSRD directive and a proportionate approach to assessing banks' compliance with those guidelines. In light of this, we also consider a staggered approach is needed with regard to the scenario analysis guidelines, which should follow 12 months after banks have implemented the guidelines on risk management to allow for embedding of the materiality assessment among other aspects[4].

From a digital regulatory perspective, ISDA strongly supports the Commission's view that machine readability of data is crucial for the purpose of using financial and sustainability data for a variety of financing or investing activities. Enabling the use of artificial intelligence and other data science methods to analyse and identify trends, risks and opportunities will accelerate their development. It is of crucial importance that the sustainability data universe can also align to clear open standards in a similar vein to the reporting of financial information. Developing the digital XBRL taxonomies based on reliable digital standards and data models such as ISDA's Common Domain Model (CDM)[5] will further enable the digital tagging of sustainability statements in a consistent manner. Furthermore, building on a foundation of digital standards would help to resolve data issues in tracking and reporting of sustainability risks and factors to reduce firms' operational challenge of conforming to new reporting requirements.

b. Contribution and Measurement of Derivatives to Sustainable Finance

<u>We are of the view that derivatives providing exposure to companies' debt or equity have the potential to contribute positively to the channeling of capital to sustainable economic activities.</u>

Derivatives whose underlyings are companies' equity and debt contribute to sustainability objectives characteristics proportionately to the exposure they offer to their underlyings. They contribute to defining a company's cost of capital (i.e. cost of its refinancing in the future) and b) allow end investors to tailor risk in retail investments (i.e. via structured products). Therefore, credit and equity derivatives should be eligible for inclusion in the numerator of Taxonomy and SFDR relevant ratios to accurately reflect their contribution to sustainable finance.[6]

We strongly support the European Supervisory Authorities' (ESAs) view[7] that the measurement of derivatives' exposures should be assessed on the basis of their **delta** which reflects the economic exposure that the derivative provides to the underlying asset(s) / companies. The delta of the derivative, already referenced in a variety of EU regulations[8], is the equivalent cash amount that would be invested in companies' debt or equities.

<u>In light of the EU's simplification strategy, it is urgent to harmonise the measurement of sustainable contribution through equivalent economic exposure in all European sustainable finance regulations which refer to these ratios.</u>

[4] AFME-ISD response - EBA consultation on scenario analysis GLs v11 160425 final (002).pdf
[5] CDM – International Swaps and Derivatives Association
[6] The findings from PSF 1.0 indicated that only equity and credit derivatives were fit for purpose. However, additional asset classes may be assessed and considered for Taxonomy alignment in the future as new objectives and methodologies develop.
[7] The ESAs have previously considered derivatives as an investment decision measured according to their equivalent position in the underlying asset, called Delta, when calculating PAIs. This is consistent with the EU PSF derivatives recommendations and ISDA's views as set out in our response to the funds naming consultation relating to Sustainable Investments.
[8] For example, both the Transparency Directive and Short Selling Regulation use delta-adjusted values for derivatives when calculating long and short exposures to EU listed companies for the purposes of public disclosure obligations, and in UCITS regulation Annex I & II of the AIFMD Level 2 Regulations and in CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS

c. Regulatory Treatment of Derivatives

Although the treatment of derivatives is not directly mentioned in the EC's proposed changes to EU Taxonomy Regulation reporting, we would like to emphasise that the current EU regulatory framework provides for an inconsistent treatment of derivatives and an unclear representation of their role in sustainability. This is especially problematic for regulations that are already in application, such as the Disclosures Taxonomy Delegated Act, the Sustainable Finance Disclosure Regulation (SFDR) and the EU MiFID II Delegated Regulation integrating sustainability preferences, which cover the use of derivatives in an unclear and inconsistent way.

As per the Platform on Sustainable Finance's recent derivatives recommendations[9], we would like to highlight the importance of applying a consistent approach to account for derivatives across the sustainable finance framework and related indicators.

More specifically, the treatment of derivatives in financial entities' Taxonomy reporting is not consistent with disclosures under the SFDR at entity and – more importantly – at product level. This makes it challenging for investors to establish which products and investments will best meet their sustainability objectives, and negatively penalises derivatives investment versus cash.

Derivatives are treated inconsistently across:

(i) the SFDR product KPIs (Taxonomy alignment, Sustainable Investment and Principal Adverse Impacts: PAI product disclosures include derivatives when Taxonomy product KPI ignores them and SI remains silent), and

(ii) the SFDR and Taxonomy regulations (the SFDR Asset Manager entity disclosure, i.e. the Principal Adverse Impact statement, includes derivatives when the Taxonomy Asset Manager green investment ratio "GIR" excludes them at the numerator).

On the one hand, the European Supervisory Authorities (ESAs) consider that derivatives should be taken into account when calculating SFDR Principal Adverse Impacts (PAIs) at product and entity level because they constitute investment decisions. For this purpose, the authorities' view is that derivatives should be converted to their equivalent economic position. On the other hand, the EU authorities consider that derivatives can never have a positive impact, for instance to the taxonomy alignment proportion (whether at product (SFDR) or entity (Taxonomy regulation) level). If derivatives are not neutral because they can have negative impacts depending on their underlying, it should logically follow that they can also have a positive impact depending on the underlying, both in funds entity level disclosure and funds product level disclosures.

Logic and homogeneity should also be applied across entity and product indicators: the Taxonomy asset manager GIR is linear and is the aggregation of the SFDR Taxonomy product Taxonomy KPIs, so logically derivatives should be included in the KPIs if they are required to be reflected in the GIR.

The inconsistent treatment of derivatives in the EU's sustainable finance framework is highly confusing and could have detrimental consequences on the EU derivatives market (as well as the sustainable investment market) as follows:

[9] 2025 Platform report (pg. 31-32).

- Investors will likely reduce their derivatives activities to favour cash investments for the sake of achieving better Taxonomy or sustainable investment disclosures;
- It ignores the role of derivatives to foster investments by providing companies with a reduction in their cost of capital, tailoring market risk to end investor's appetite and profile, and opening access to wider markets and investment opportunities;
- It ignores the role that derivatives play for retail investors helping them participate to the equity and credit market via capital protected products. Retail appetite for sustainable products is likely to reduce as a consequence;
- The inconsistent treatment of derivatives in the numerator and the denominator of the relevant sustainability ratios could lead to mathematically inconsistent and asymmetrical sustainability ratios that would not provide any valuable information to investors (and may even provide misleading information);
- A misrepresentation of the role of derivatives in sustainable finance regulation would expose firms selling those products to unwarranted risks of litigation and reputation, as well as jeopardise their use by investors and corporates and ultimately the development of derivatives markets.

d. Regulatory Treatment of Structured Products

Derivatives have the potential to contribute positively to the channeling of capital to virtuous economic activities as they allow the tailoring of risk profile to investors' risk appetite by either providing full capital guarantee or soft protection (protection up to a certain downside). This is particularly achieved through guaranteed funds and structured products allowing retail investors to participate in the equity and credit markets.

The regulatory treatment of structured products across the sustainable finance framework is currently in flux. We thus recommend that structured products be fully integrated into the EU's sustainable finance legislation and their sustainable contribution recognised in an equivalent way to the sustainable contribution of funds products.

It is essential that structured products be included in the SFDR scope during the upcoming SFDR review to ensure an equal treatment with funds' products since all types of assets are currently eligible for consideration under MiFID sustainability preferences.

In addition, including structured products within the SFDR framework would **ensure consistent sustainability information for investors across all categorised instruments**. It would also **resolve the current regulatory inconsistency whereby MiFID II's ESG-related requirements**—particularly those related to target markets and client sustainability preferences—are being indirectly applied to structured products, despite their exclusion from SFDR. This misalignment creates legal uncertainty for firms and confusion for investors.

Moreover, **in line with the recommendations of the Draghi report, such inclusion should also contribute to greater simplification and harmonisation**. Rather than perpetuating 27 national frameworks and resulting on divergent EET[10] implementations, structured products

[10] The European ESG Template (EET) is a standardised data format developed by the European Working Group (FinDatEx) to facilitate the exchange of ESG-related information between product manufacturers and distributors. It enables compliance with ESG disclosure requirements under MiFID II, IDD, and SFDR by providing detailed, machine-readable data on the sustainability characteristics of financial products.

should be subject to a single, EU-wide set of rules for their sustainable claims. This is important to ensuring market clarity, and effective investor protection across Member States.

We would like to highlight the following welcomed supervisory signals to that effect:

- The ESMA fund naming report[11] suggests not to make any distinction between physical vs synthetic replication and considers extending the rules to structured products;
- The ESA's opinion on SFDR[12] recommends that the EC reflects on the inclusion of other products in SFDR to ensure harmonized disclosures, quoting structured products;
- The ESMA opinion on the EU Sustainable Finance Regulatory Framework[13] suggests "Sustainability disclosures for MiFID II financial instruments not captured by the SFDR" and "consideration to the ability of structured notes, derivatives to effectively contribute to channeling capital flows to sustainability objectives.
- The SMSG advice on ESMA's draft RTS on the Prospectus regulation[14] suggests that "ESG structured products are now part of the ecosystem of ESG solutions, and it is therefore important that their issuers provide full transparency on their two key components being their funding part, on the one side, and their (derivative) exposure to underlying instruments or indices, on the other side."

In view of the above, we firmly believe that derivatives' sustainable contribution should be recognised by setting out a clear and consistent methodological framework which accounts for derivatives in funds and structured products relevant sustainability reporting metrics.

e. Simplifying CSDDD

ISDA supports the changes proposed by the EC to address the challenges pertaining to the CSDDD application. However, in line with AFME's views on this matter[15], we believe that even with these changes, the Directive will create significant implementation challenges for companies. In particular, we remain concerned that the broad application to global business creates legal challenges and puts EU companies at a competitive disadvantage internationally, as this could discourage their regional competitors from doing business in the EU and limit the access of EU entities to the services that non-EU undertakings provide. We also question the purpose of not excluding non-EU passive financial investors that are holding companies which allocate capital and do not interfere in the operations of their portfolio. These entities do not exercise control over the supply chain of their portfolio companies. Including such entities within the scope of CSDDD, will only serve to create more burdens to the allocation of private capital in the EU.

We strongly support the proposed removal of the review of the potential extension of the Directive's scope to downstream provision of financial services. This is essential to avoid introducing additional highly costly and duplicative requirements which will have a significant impact on European companies seeking access to finance. EU financial undertakings already do

[11] ESMA34-472-440 Final Report on the Guidelines on funds names
[12] JC 2024 06 Joint ESAs Opinion on the assessment of the Sustainable Finance Disclosure Regulation (SFDR)
[13] ESMA36-1079078717-2587 Opinion on the functioning of the Sustainable Finance Framework
[14] SMSG advice on ESMA draft RTS on the Prospectus Regulation question 16
[15] https://www.afme.eu/Portals/0/DispatchFeaturedImages/Press%20release_SF%20Omnibus%20reaction_.docx.pdf

extensive due diligence on their counterparties for KYC / AML purposes, and applying CSDDD to downstream services would be another check that they have to carry out and potentially a barrier to entities receiving services.

ISDA would welcome clarification of the definition of plausible information and in particular of how the proposed limitation of due diligence to direct business partners would work in practice given that the proposed wording would still require companies to look to indirect business partners if there is "plausible information" to suggest adverse impacts.

There is a risk that where "plausible information" is identified (e.g., through the risk-mapping exercise) or received by a company, the Commission's proposal could undermine the provisions that allow for a risk-based approach to the due diligence obligations. The proposal to make the limitation unavailable where there is "plausible information that suggests that adverse impacts … may arise" sets too low a threshold and arguably could render the intended limitation in the scope of the due diligence obligation ineffective. If a firm needs to ensure that contractual commitments are obtained from all indirect business partners in order to avoid liability, the lack of clarity around who those indirect business partners might be is unhelpful. Moreover, as we know from other regulatory requirements to obtain contractual commitments (e.g., Art 55 BRRD), it is not easy to get these commitments from counterparties, let alone from unconnected entities. If EU financial institutions are unable to obtain the necessary information or the suggested contractual commitments from indirect business partners, they are likely to consider that there is significant risk attached to continuing to enter into contractual derivative relationships with the relevant counterparty. This may put EU and non-EU counterparties in a position where they are unable to enter into contractual derivative relationships (e.g., for hedging or risk management purposes) with EU financial institutions, meaning that they would need to obtain these services from entities that are not subject to the same requirements. This may thereby not be supportive of the EU's Savings and Investments Union objectives.

Even if a firm benefits from some protection where those indirect business partners refuse or are unable to provide the necessary information or commitments, firms would still need to contact all those indirect business partners in order to benefit from this protection – again, the lack of clarity around who constitutes an indirect business partner is unhelpful.

ISDA would also welcome confirmation from the EC that the guidance it is required to adopt under Article 18 will be purely guidance and that, while companies may take that guidance into account, they will still be permitted to use any contractual wording that they consider appropriate for compliance with their obligations under Articles 10 and 11.

ISDA supports the proposal to amend CSDDD to remove the requirement for a harmonised EU-wide civil liability regime, given the significant problems that would arise with implementing this in the form currently included in CSDDD. We would support a further amendment to remove the provision for joint and several liability as there is a risk that this may encourage speculative litigation against EU entities for impacts occurring in their supply chains, rather than directly against entities that are more closely linked to the cause of the potential adverse impact. Moreover, the concept of joint liability is unreasonable for non-EU passive financial investors that do not interfere in the management of their portfolio companies. They should not be held liable for the day-to-day management and business decisions of portfolio companies that they do not direct. This would risk pushing such investors away from investing in EU companies.

It may also be preferable to refer generally to principles for determining damages under the relevant Member State law, rather than seeking to go into detail in the Directive on the level of compensation or types of damages that might be covered (e.g., what does "full compensation" mean? Who would be responsible for assessing the level of compensation payable?).

Finally, it would be useful to clarify whether a company can contractually exclude any element of this liability, and what the impact would be on the contract if they do currently exclude this liability but the Directive provides that they are unable to do so (e.g., in some jurisdictions a contract that seeks to exclude certain liabilities may be void or unenforceable). It would be helpful to have clarification that companies are only required to comply with any requirements to obtain contractual commitments under CSDDD to the extent that this does not cause them to breach obligations under applicable law (whether this is the law of an EU Member State or of a relevant third country).

f. Simplifying CBAM and Integrating Voluntary and Compliance Carbon Frameworks

ISDA welcomes the EC's two-step revision of the CBAM Regulation including a) a simplification proposal with a focus on reducing administrative burdens on companies and their supply chains while continuing to incentivize global carbon pricing with a view to making CBAM more effective, and b) a broader assessment of the mechanism which may include an endorsement for the broadening of the CBAM scope to downstream sectors, anti-circumvention measures, as well as an assessment of the impact on exports on EU CBAM industries.

The further development of carbon markets will be integral to meeting the EU's net zero emissions target by 2050. This will require both scaling up voluntary carbon markets (VCMs), where companies can buy verified carbon credits (i.e. carbon reduction, carbon removal, and carbon offsets) to advance their decarbonisation and maximise the reach and impact of the EU's Emissions Trading System, where companies pay a price to pollute.

ISDA believes that a robust international VCM plays an important role in delivering a reliable, market-based approach for investment opportunities that reduce greenhouse gas emissions and remove carbon from the atmosphere. We have a strong interest in the development of a robust VCM that will strengthen the functioning of the carbon derivatives markets and enable the continued development of liquidity in derivatives products so that market participants can appropriately manage their business risks. In turn, facilitating trading in carbon derivatives would contribute to market liquidity and uptake of carbon credits, which would support much needed financing for climate mitigation projects.

There are five key areas where urgent action is needed to enable the international VCM to reach its full potential:

1. First, we must have a globally consistent definition of a ton of carbon that is adopted by all market participants to avert trade friction and transition to CBAM without disruption. That definition should be compatible with UN Article 6.4 carbon credits with existing market standards for VCMs to mitigate market fragmentation. This goes hand-in-hand

with an independent, science-based system to verify and audit a) the soundness and integrity of voluntary carbon credits (VCCs) and b) the veracity of third countries' local carbon prices that EU importers would be able to deduct to calculate their net CBAM liability.

2. Second, we need a sound legal framework to create greater certainty and confidence. This includes standardisation of documentation and consistent definitions of products.
3. Third, we need clarity on the accounting treatment for VCCs.
4. Fourth, we need to develop a liquid forward market, which will provide valuable price signals as the market evolves. This will be built on standardized, common units of larger carbon projects that are fungible and benefit from market pricing.
5. Finally, we need a globally interoperable regulatory framework for this market to offer the certainty companies need in order to be able to commit investment to decarbonisation. This must be considered in the context not only of the implementation of the EU's CBAM, but also crucially in the upcoming review of the EU's ETS.

ISDA strongly supports the work of the EC's Task Force for International Carbon Pricing and Markets Diplomacy, which aims to promote the development of global carbon markets and to ensure high integrity in voluntary carbon markets. We also welcome the EU's Carbon Removals Certification Framework (CRCF) and its potential future alignment with the Article 6 Crediting Mechanism but caution against limiting the eligibility of carbon removals to activities that take place in the EU. It will be critical to ensure that non-EU firms, particularly in emerging markets and developing economies, have the ability to develop projects for carbon removal that could result in a credit that can be offered in the EU, allowing EU companies and financial institutions to contribute to decarbonisation globally".

The VCMs could play an important role in the implementation of the EU CBAM and a revised future EU ETS. Importers will need to show they have paid an equivalent carbon price to sell their products in the EU. But for carbon credits to be considered as a potential recognized carbon cost, there is no question that setting sufficiently robust minimum standards and transparency are minimum pre-conditions. It is critical to ensure that compliance and voluntary carbon markets complement each other to achieve that goal.

The EU CBAM does not currently envisage use of VCCs in contrast to other jurisdictions' carbon tax regimes where VCCs are used to offset up to a certain amount of their taxable emissions. The EU CBAM and the EU ETS should be no different.

We thus encourage the EU to consider the utility of international VCCs for purposes of the EU ETS and the EU's CBAM, alongside establishing a regulatory framework which addresses potential VCC issues such as a lack of consistency, comparability and clarity and to the extent a common framework can be developed that accommodates the gaps between the two markets.

Moreover, in the context of the EU's Green Claims Directive, it is important to avoid limiting the use of carbon credits in compensation claims to only residual emissions and rather encourage the scaling up of high-quality, high-integrity removal credits, certified under the EU CRCF and independent and/or under international crediting programmes. Such a limitation would be inconsistent with the EU greenhouse gas mitigation hierarchy and would significantly lower the economic incentive for corporates to reduce emissions at lower cost. This, in turn, may drastically reduce investment into carbon markets, including the future market for EU CRCF credits, and thereby dampen corporate climate ambition.[16]

Finally, it is important to note that there are various EU private sector carbon initiatives underway in certain EU member states which are exploring, inter alia, the use of securitization as a liquidity, capital management and risk transfer tool to promote the scalability of these projects. Such European projects could promote financial innovation as well as the competitiveness of European companies provided that there is a well-functioning trading market of high quality VCCs in place.

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[16] IETA's position paper on the use of carbon credits in the EU Green Claims Directive