

# EFAMA RESPONSE TO CALL FOR FEEDBACK ON THE PLATFORM ON SUSTAINABLE FINANCE's DRAFT PROPOSAL FOR AN EXTENDED TAXONOMY TO SUPPORT ECONOMIC TRANSITION

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## EXECUTIVE SUMMARY

EFAMA supports the extension of the taxonomy framework to significantly harmful activities and provides the Platform with the following five policy recommendations:

1. **A significantly harmful taxonomy should not blacklist companies but support their transition away from such activities.** By distinguishing significantly harmful activities that have the potential to improve to no longer cause harm, asset managers will be able to design better, bigger and safer decarbonisation financial products. The enlarged taxonomy-aligned investible universe would decrease risks associated with the current environmental taxonomy, such as overweighting of highly green assets or the emergence of green asset bubbles. Investee companies would benefit from more clarity about which environmental performance levels are no longer acceptable, thereby improving the credibility of their decarbonisation plans.
2. **A "blacklist" based approach to the extended taxonomy should be avoided.** If investors are asked to stop investing in some companies, this will disincentivise their existing transition efforts and ignore the benefits of engagement. Moreover, a "blacklist" may not only lead to decommissioning of significantly harmful activities and companies, but also drive their selling to non-European or less climate-conscious investors, potentially below value, without any positive impact on climate.
3. Paris-aligned reference trajectories for every relevant sector need to be developed to make firms' emission reduction strategies credible, comparable and science-based. The taxonomy extension should also act as a vehicle for introducing **quality standards and verification procedures to such forward-looking transition plans.**
4. To avoid "greenwashing", we encourage the Commission to set up a "**Transition Asset Ratio**" alongside the existing Green Asset Ratio. It would reward companies entering the transition and incentivise their access to financing without misrepresenting transitioning activities as green.
5. A legally binding "no significant impact" (NSI) taxonomy shouldn't be prioritised at this stage, given the marginal significance of such companies for the transition at a macro level. NSI activities could be covered in non-binding guidance, giving investors clarity on which activities are considered not critical in terms of environmental performance.

## YOUR OPINION

**Question 1. Which environmental performance levels should the taxonomy distinguish, with a view to help the environmental transition?**

Please select all of those that you would prioritise:

- Substantial contribution
- Intermediate performance
- Significantly harmful - but can improve to sustainability
- Significantly harmful - but can improve not to do significant harm
- Significantly harmful - but cannot improve sufficiently to avoid doing no significant harm
- No significant impact

**Question 2. How could policies ensure that recognising the transition from significantly harmful to intermediate performance will not slow down the transition to green activities (that evidence shows we need to accelerate)?**

Please select all that you agree with:

- Not relevant
- Distinguish different levels of environmental performance clearly throughout the taxonomy and in other instruments
- Recognise only improvements from and to a well-defined level of environmental performance, rather than recognising activities sitting in a given level of performance below substantial contribution
- Require continued improvement beyond the relevant investment plan
- Require associated entity level transition strategy to understand the credibility of the intermediate transition.
- Recognise multiple ways of transition depending on type of Technical Screening Criteria.
- Other safeguards would be needed

**Question 3. Do you consider that recognising/naming the significant harm performance level would be important?**

- Yes
- No
- Don't know / no opinion / not applicable

**Question 3.1 Please select the answer you agree with:**

- voluntary disclosures and guidance are sufficient
- voluntary reporting is not effective, the mandatory solution is needed urgently
- agree with the staged approach in the report to first work with voluntary disclosures/ guidance and in a later stage introduce mandatory reporting
- Don't know / no opinion / not applicable

**'Significantly harmful' taxonomy**

**Question 4. In your view what would be the advantages and disadvantages of a 'significantly harmful' taxonomy as designed by the Platform (i.e. accompanied by an assessment of the existing and needed EU policy and legislative initiatives aimed at incentivising finance for urgent transition away from significantly harmful activities, for building climate-resilience and to support greening of the whole economy)?**

**Advantages – a 'significantly harmful' taxonomy would:**

- increase the transparency of environmental performance levels of activities
- improve the communication of transitions and transition plans on activity level
- help companies to develop strategies and investment plans for moving away from significantly harmful performance levels and meeting environmental objectives
- help markets define and develop instruments for financing the transition
- enhance risk management frameworks
- help policymakers to provide subsidies for decommissioning
- other

**Please elaborate on your answer on the advantages of a 'significantly harmful' taxonomy. Could advantages be further enhanced? If so how?**

**EFAMA is supportive of an extension of the Taxonomy to significantly harmful activities as long as its objective is to support the transition away from such activities.** In this context, distinguishing significantly harmful activities that can improve sufficiently is essential, allowing the markets to provide capital for the transition. In addition, this would motivate corporates to detail the extent to which their transition plan broken down by activities is in line with a relevant trajectory in an industry.

Currently, the sustainability status of activities is subject to constant and inherently subjective discussions between investors and companies and other stakeholders. A '**significantly harmful taxonomy would also help companies and investors to obtain more clarity about which performance levels are not acceptable** in the transition to a climate-neutral and sustainable economy and potentially which activities need to be ultimately abandoned or decommissioned. As such, a

“significantly harmful” taxonomy can improve the planning capabilities of undertakings and investors.

For investors, a “significantly harmful” taxonomy could play a key role **in emphasising the added value of shareholder engagement** and, more broadly, of investment strategies aiming at the improvement of the environmental performance of investee companies. Influence by investors can be instrumental to reshaping entrepreneurial strategies to adapt manufacturing processes and business operations of companies and facilitate the transition to more sustainable business models.

From an asset managers’ perspective, expanding the taxonomy framework is key for **designing better, bigger and safer decarbonisation financial products**. On its own, the current environmental taxonomy may result in overweighting highly green assets, leading to economic instability or potential green bubbles.

### Disadvantages – a ‘significantly harmful’ taxonomy would:

*Please select as many answers as you like*

- be a departure from the positive spirit of the green taxonomy
- negatively impact the ability of companies to raise finance for transition
- accelerate transition risks and risks creating “stranded asset by legislation”
- negatively impact banks with high shares of lending to certain companies both among retail customers and on the wholesale markets
- disadvantage EU companies vs non-EU jurisdiction
- increase complexity, reporting burden and affect usability of the taxonomy
- other

### **Please elaborate on your answer on the disadvantages of a ‘significantly harmful’ taxonomy. How could they be addressed?**

To keep the positive spirit of the taxonomy and accelerate decarbonisation, the extension to significantly harmful activities should not be done to recognise harmful activities per se, but to show the pathway towards sustainable/intermediate levels and help in reality the transition. **It is key to favour and incentivise a company to transition rather than blacklist it.**

The level playing field is a crucial issue. **Indeed, EU companies will be subject to complex and heavy regulatory requirements (CSRD reporting) compared to other companies, and this could damage the competitiveness of the EU economy.** For example, such activities might be not only be decommissioned, but also spun off and sold to non-European investors, potentially below value, with detrimental effects for Europe’s energy security and without any positive impact on climate. For example, in many parts of the world, the production of energy from coal and lignite is still being expanded, and such expansion is likely to continue as long as such activities remain profitable. Therefore, determining activities as “significantly harmful” under any circumstances cannot occur without corresponding policy measures coordinated at the international level that would provide a just

pricing mechanism for carbon emissions and render highly emitting activities uneconomical.

Furthermore, some “significantly harmful” taxonomy economic activities might be immediately considered unsustainable and lose access to market financing, even when EU’s Member States remain highly reliant on them from the perspective of tax revenues, energy supply and energy affordability. Judging by the experience related to the political discussion around agriculture and nuclear energy technical screening criteria in the environmental taxonomy, a significantly harmful taxonomy could lead to very divisive debates amongst the Member States.

It is also unclear how a negative taxonomy will stop investors from investing in activities without investing in certain companies. Investors invest in companies, not economic activities. With a negative list (i.e. backlist) of activities, asset managers will be required to stop investing in certain companies which are in greatest need of transitioning investments. Moreover, those companies generally perform not only one activity, but several, such as a combination of renewables and oil and gas production. Furthermore, there are dramatic differences between oil and gas companies regarding their Co2 footprint per barrel produced. Should all these companies be categorised as environmentally harmful, one would disincentivise their energy efficiency or decommissioning investments applicable to the existing significantly harmful activities and the underlying infrastructure. Put simply, if investors are asked to stop investing in some companies, this will disincentivise the transition efforts of these companies and would also ignore the benefits of engagement.

Finally, such a taxonomy would add more complexity (in terms of company reporting, eligibility, screening, alignment etc.) to the already sophisticated taxonomy framework and might become an unsustainable bureaucratic data burden resulting in a tick-the-box exercise. Therefore, before adopting such a significantly harmful taxonomy, we call on the Platform to run consumer testing to ensure an investor centric view and straightforward implementation, given that even the current green taxonomy is not sufficiently comprehended by retail investors.

We also insist that direct fiscal (Co2 taxation) and energy policies (renewables subsidies, combustion engine vehicle phase outs, bans on most harmful activities) have a far more effective transitional impact, and this is where the EU and its Member States need to focus most of their efforts and political capital.

## Two types of significantly harmful activities

The report distinguishes two types of significantly harmful activities

- those that are ‘always significantly harmful’ (no technical option to transition to an environmental performance not causing significant harm)
- and those that can transition out of causing significant harm

### Question 5. Do you agree with the following statements?

Please check all boxes that you agree with:

*Please select as many answers as you like*

- Always significantly harmful activities should be distinguished** from those activities that have a potential to transition out of significant harm

- Criteria should be added under the green taxonomy to **recognise as green the closure / decommissioning** for such always significantly harmful activities
- Mandatory reporting** on turnover from and capex/opex related to always significantly harmful activities should be introduced

**Question 6. Do you consider recognising/naming the intermediate performance level useful to encourage mitigating significant harm?**

- Yes
- No
- Don't know / no opinion / not applicable

**Please explain your answer to question 6:**

While the adoption of intermediate performance level adds a lot of complexity, we would consider it helpful in setting the threshold of a minimum level of transformation and encouraging transforming activities out of the “significant harm” space. Furthermore, recognising the intermediate performance level is a prerequisite to defining the “intermediate transition” concept, which would help reward transition efforts of corporates under the Taxonomy framework, thus reducing the “binary” dimension of the current Taxonomy.

The introduction of different performance levels and the planned review of the “do not significant harm” approach should be seen as the opportunity to reduce the complexity of the current DNSH criteria that are considered a significant hindrance to practicability. Data for the DNSH assessment are almost entirely lacking, and even in the future, they can be expected only for EU companies or some non-EU issuers active in the EU markets. Without such data and with only a limited possibility to use estimates, however, the taxonomy will not be able to exploit its potential for steering investments towards sustainable activities.

**Question 7. For activities that are in the intermediate performance space (in between significant harm and substantial contribution):**

**a) should all turnover from such activities be recognised as intermediate turnover, and all opex as intermediate opex?**

- Yes
- No
- Don't know / no opinion / not applicable

**b) should all capex be recognised as ‘intermediate capex’ irrespective of whether or not it improves environmental performance of the activity and by how much?**

- Yes
- No

- Don't know / no opinion / not applicable

**Please explain your answer to question 7. b):**

We would welcome a more differentiated treatment of capex depending on the specific improvement targets and measures facilitating the transition as outlined in the company's transition plan. In case a company has a verifiable, comparable and robust time-bound transition plan for improvement of the environmental performance to a level that would qualify as "significant contribution" and such plan adheres to certain quality standards, capex related to investments in transition should be recognised as green, at least after first intermediate targets have been met and the overall feasibility of the transition plan demonstrated in practice.

A second alternative would be **setting up a specific ratio for transitioning activities** alongside the Green Asset Ratio (e.g. the transition asset ratio). Such a ratio would reward companies entering the transition and incentivise their access to financing without misrepresenting transitioning activities as green.

### Intermediate transition

The report recommends to recognise 'intermediate transition', differentiated from green transition.

**Question 8. What do you think are the essential conditions for recognising such intermediate transitions for activities that can make a substantial contribution to the given environmental objective:**

*Please select as many answers as you like*

- a) that the activity reaches the intermediate performance level, in other words does not do significant harm to that particular environmental objective
- b) in addition, that the activity continues to improve its environmental performance in order to stay in that intermediate performance level and not to do significant harm even if in the future the criteria are tightened.
- c) in addition, that the activity continues to improve its environmental performance in order to reach substantial contribution (green) in the future
- d) in addition, that the activity does no significant harm to other environmental objectives
- e) in addition, that the activity does no significant harm to any of the other environmental objectives, with the exception of adaptation (because failing to meet the do no significant harm criteria to adaptation means only a harm on the activity itself)

**You selected option b) in question 8:**

**The criteria for ensuring that the activity will improve to reach substantial contribution should include to:**

- have a transition plan in place set a deadline for the transition
- have the transition plan validated by the Board publish the transition plan

- audit the transition plan
- disclose how the intermediate transition fits within the entity level transition strategy
- other

**Please specify to what else should the criteria include, in relation with option in question 8.:**

From an investor's perspective, it is more relevant to set clear intermediate targets and disclose a transition pathway and governance measures in place to oversee the transition. Companies should also define a fallback scenario if the transition plan fails and regularly report on their progress in implementing it. We believe that an audit of the plan might be "nice to have" for large companies but would be a burden for smaller corporates.

The question of the timeframe allowed for the intermediate transition is also crucial. For example, the Taxonomy Article 8 Delegated Act currently provides the possibility to have a transition plan for a maximum of 10 years, while corporates argue such a period is not sufficient for certain sectors.

The criteria could also include targets relating to the 2 degrees decarbonisation scenario, in order to measure ambition.

**You selected option c) in question 8.**

**The criteria for ensuring that the activity will improve to reach substantial contribution should include to:**

- have a transition plan in place
- set a deadline for the transition
- have the transition plan validated by the Board
- publish the transition plan
- audit the transition plan
- other

**Question 9. Do you have other suggestions for extending the taxonomy framework for significantly harmful activities, intermediate performance, intermediate transition?**

We are convinced that only indisputably harmful activities incapable of transitioning should be marked as significantly harmful. These activities should be clearly distinguished from other activities that might currently be at the "significantly harmful" performance level, but that can improve their environmental performance and transition out of the "significantly harmful" space. An extended taxonomy should provide a positive label for investments to move activities out of "significantly harmful" performance to incentivise such transitioning efforts.

Corporate disclosures of robust and credible targets and transition plans informing on core business transformation are indispensable for investors to assess companies holistically, including a forward-looking perspective. Against this background, we would like to highlight that the climate-related metrics proposed by the TCFD (Taskforce on climate-related financial disclosures) in its recent consultation (July 2021) provide a useful basis for assessing how companies plan to achieve climate-related targets. Relying on SBTI (Science Based Target Initiative) is also strongly encouraged in this context.

Lastly, we would like to highlight that consistency between the definition and principles laid down in each piece of the Taxonomy framework (Social Taxonomy, Green Taxonomy) and the EU sustainable finance toolbox more broadly (e.g. CSRD, SFDR) and its implementing rules should be ensured with the foreseen “significant harm” taxonomy elements.

## **'No significant (environmental) impact' taxonomy**

**Question 10. In your view what would be the advantages and disadvantages of a 'no significant (environmental) impact' taxonomy? Check all that apply and add anything you think is missing:**

*Advantages – a 'no significant environmental impact' taxonomy would:*

- help the ESG analysis
- be beneficial for SME's to access finance
- be beneficial for SME's to access green finance (if it can allow for / incentivise greening even within the NSI space, where there is such possibility)
- ensure banks can report green lending to SMEs and continue to develop these markets
- allow easier access to finance for larger companies in these sectors other

**Please elaborate on your answer on the advantages of a 'no significant (environmental) impact' taxonomy. Could advantages be further enhanced? If so how?**

A non-binding NSI guidance would be helpful for portfolio analysis and construction by bringing clarity about which activities are considered not critical in terms of environmental performance and can be thus included in a portfolio or a lending book.

*Disadvantages – a 'no significant environmental impact' taxonomy would:*

- be too complex to manage, as a framework
- imply burdensome reporting obligations
- risk disadvantaging 'no significant impact activities' vis-à-vis intermediate contribution activities that are likely to be more polluting
- other

**Please elaborate on your answer on the disadvantages of a ‘no significant (environmental) impact’ taxonomy. How could they be addressed?**

The codification of NSI activities would add significant complexity to the taxonomies and increase the reporting burden for companies and investors. In addition, with the existence of “significant contribution” and “significant harm” taxonomies, an NSI would be redundant. Moreover, the costs of implementing it are likely to outweigh the benefits.

Therefore, **EFAMA is convinced that an NSI taxonomy with a binding legal status should not be developed at this stage**. In view of the urgency of distinguishing performance levels that are significantly harmful to the environmental objectives as well as measures to incentivise an orderly transition, a binding taxonomy for NSI activities should not be considered a priority. **The effect of the NSI activities on the environment is not impactful enough and therefore does not justify the development of a corresponding, legally binding taxonomy.**

**Question 11. Can you give examples of activities which you think would be considered as NSI?**

It will be hard to comprehensively codify (and update) all activities falling into this category but consulting, media, law firms, marketing, digital, healthcare, sports could all fall under this category. We believe it would be more practical to set clear lines between significant harm and substantial contribution and leave an uncodified list of activities in between.

**Question 12. If there was to be an extension of the taxonomy to address NSI activities, should it be a requirement for companies or investors wishing to report activities under the NSI taxonomy to first participate in an environmental labelling or certification scheme (such as EMAS) to validate minimum levels of environmental performance?**

- Yes, reporting of activities should stay voluntary but conditional upon such a certification/labelling
- No, reporting of activities should stay voluntary but there should not be any certification/labelling as a condition
- Don't know / no opinion / not applicable

**Please explain your answer to question 12:**

The suggestion of having a certification scheme to ensure minimum performance is interesting, but might be of limited benefit if it remains based on EU legislation/applicable to EU companies only.

**Question 13. Do you consider it would be helpful if the Platform prepared non-binding guidance on NSI activities which could be published by the Commission for voluntary use by taxonomy users?**

- Yes

- No
- Don't know / no opinion / not applicable

**Question 13.1 If you consider it would be helpful, what should be the scope of such guidance, for instance in relation to minimum standards of environmental performance?**

Setting minimum standards and best in class standards that are linked as much as possible to existing industry standards/best practice frameworks.

**Please explain your answer to question 13:**

**Investors would generally welcome more clarity about which activities are considered not critical in terms of environmental performance.** In addition, further non-binding guidance on sectors and activities where no significant impact could be assumed would be helpful for portfolio analysis and construction, as well as for communication with clients.

**Question 14. Are you in favour of a phased approach where NSI could be recognised as a generic category (through guidance) without L1 change?**

- Yes, it is a priority
- Yes but it should be done in future only
- No
- Don't know / no opinion / not applicable

**Please explain your answer to question 14:**

Non-binding guidance on sectors and activities where no significant impact or substantial contribution could be assumed would be helpful for portfolio analysis and construction, and communication with clients.

On the other hand, the development of a detailed "no significant impact" taxonomy with a binding legal status would be largely redundant and overly burdensome. In view of the urgency of distinguishing performance levels that are significantly harmful to the environmental objectives, a binding taxonomy for NSI activities should not be considered a priority.

The Taxonomy framework is already very complex, and the constantly increasing number of categories and sectors could lead to confusion and undue reporting burden for companies and investors.

**Question 15. Prior to any L1 change (if at all), do you consider that the Platform should recommend to include some NSI activities in the taxonomy by e.g. creating a generic category for 'green' service providers under the adaptation or other objectives?**

- Yes
- No
- Don't know / no opinion / not applicable

**Please explain your answer to question 15:**

We believe this is not the right timing given the marginal significance of such companies for the transition at a macro level.

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## About EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 27 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

More information is available at [www.efama.org](http://www.efama.org).

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