

EFAMA POSITION ON EU TAXONOMY IN VIEW OF TRIALOGUES

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SUMMARY

The European asset management industry supports the EU's political objective to fight climate change and meet the Paris agreement goals. We recognise the urgency and we are committed to facilitate the capital flows needed to finance a transition to a sustainable economy. A well-designed EU taxonomy has the potential to bring clarity on what constitutes sustainable investments, enhance comparability for investors and prevent green washing.

Our **key recommendation** in view of the ongoing dialogues are:

- **Scope and purpose**
 - EU taxonomy regulation should serve as a **reference framework for disclosures**, without imposing any thresholds that would turn it into a label-providing regulation.
 - The scope, especially regarding disclosure obligations (Art. 4), should be confined to **sustainable investments contributing to an environmental objective** as per sustainability related disclosures regulation¹.
 - **Transition activities** should be properly included as they are key to enable a transition to a sustainable and circular economy.
 - The taxonomy should be **scientific and evidence-based**, without any *a priori* exclusion at level 1 and respect a strict technologically neutral approach.
- Ensure **effective supervision** without creating unnecessary delays, market disruptions or hampering product innovation.
- Appropriate governance, competences, role, resources, structure and composition of the **Platform on Sustainable Finance**.
- Appropriate **transition** period and **realistic implementation timelines**.

Meanwhile, we would like to emphasise that the success of the EU taxonomy depends on:

- **Robust, comparable, reliable and publicly available ESG data** at the investee company level
 - Examining companies' exposure to the activities described in the taxonomy requires data that very few companies disclose.

¹ Regulation on sustainability-related disclosures in the financial services sector (SFDR)

- During the review of the Non-Financial Information Directive (NFRD), a careful consideration should be given to ensure that investee companies publicly disclose all key data points and KPIs that financial market participants need to comply with the EU taxonomy and the sustainability disclosures regulation.
- As long as appropriate ESG data is not publicly available, there is a danger of an overdependence on few third party data providers, while there are concerns about comparability and reliability of the information, insufficient transparency regarding methodologies used, the consolidation of the industry and cost of data.
- Sufficient **market relevance** to facilitate economically viable, risk-diversified investment approaches based on the EU taxonomy. It should be also sufficiently **simple and user-friendly**. Overly prescriptive measures may prevent its market up-take and result in confusing disclosures towards investors.
- **Global cooperation** and international uptake of EU taxonomy and standardised ESG data disclosure.

FULL POSITION

PART 1 – KEY MESSAGES IN VIEW OF TRIALOGUES

1. Scope and consistency with sustainability disclosures regulation

Clarity on the scope and purpose is needed for the sustainable finance package to reach its ambitious objectives. Given the current insufficient availability and quality of ESG data, and noting that the screening criteria developed by TEG are so far confined to climate adaptation and climate mitigation objectives, we strongly believe that **only products with an environmentally sustainable investment objective** should be within the scope. This seems logical as the taxonomy classifies activities which contribute to certain environmental objectives.

Moreover, to ensure seamless implementation as regards the other pieces of the Sustainable Finance Action Plan, and to avoid duplicative disclosure confusing investors, the **link between the taxonomy and the definitions in the SFDR² needs to be clarified**. In this respect, we understand that the Council text intends to **link the taxonomy disclosure requirement to products described in Art. 2(17) and Art. 9 of SFDR**, which we believe is the **appropriate way forward**.

Further clarification of this intention might be useful, since the Council text includes a separate definition in Article 2(1)(a), even though the disclosure obligations under Article 4(2) reference to the definition of sustainable investments under the SFDR. However, the recitals 16 et seq. indicate that environmentally sustainable products under the Taxonomy shall be only a subset of sustainable investments with environmental objectives.

Our recommendation:

To avoid unnecessary over-complexity and properly align the different rules, we suggest to clarify that the EU taxonomy, and especially **the disclosure requirements in Art. 4 (2)** of this regulation, should apply to **sustainable investment products with an environmentally objective under the SFDR**. In that respect, we support the **Council's wording of Art. 4(2) of the taxonomy regulation**.

Furthermore, we believe that the original intention of the Commission, supported by the Council, to develop the EU taxonomy to serve as a dictionary to improve comparability, should prevail. Therefore, **EU taxonomy regulation should remain as a reference framework for disclosures, without imposing any thresholds that would turn it into a label-providing regulation**. To recall, there is a separate workstream on the EU Ecolabel which has such an aim.

Our recommendation:

We support the wording of the Council regarding Art. 1(2) and Art. 4.

² Regulation on sustainability-related disclosures in the financial services sector

Inclusion of transition and enabling activities is key to facilitate a transition to a sustainable and circular economy. Fighting against climate change entails investing broadly in all economic sectors, to finance any company willing to transition towards low-carbon activities. The objective should be to incentivise all companies to become more sustainable.

This will also help prevent a ‘green bubble’ which is likely to happen if transition and / or enabling activities are not included and / or the criteria are overly stringent. Sustainable finance framework has a strong role to play not only in financing sustainable activities, but also in assisting the entire real economy to transition towards sustainability.

Our recommendation:

We support the **Council’s wording of Art. 14 (1) (a)** with the following addition:

„identify the most relevant potential contributions to the given environmental objective, while respecting the principle of technological neutrality, considering both the short and long term impacts of a given economic activity, its planned transition and targets, **mitigation measures and enabling activities substantially contributing to a transition to a carbon neutral and sustainable economy; (...)**“

We would also like to warn against the Parliament’s amendment in Art. 1 (2) (ba) (new) (ii) (line 101) which could possibly lead to a **misleading classification**. We understand the taxonomy’s role is to identify positive economic activities contributing significantly to one or more environmental objectives while not significantly harming others. Hence, it is clear that it does not aspire to classify all activities in the economy. Thus, it would be misleading to say that any economic activity not listed in the taxonomy has a negative sustainability impact. Moreover, the SFDR already provides for disclosures regarding the adverse sustainability impact.

Our recommendation:

We object the Parliament’s wording of Art. 1 (2) (ba) (new) (ii) (line 101) that could, in our view, potentially lead to a misleading classification.

2. Market relevance and usability

To ensure the success of the EU taxonomy, its feasibility in terms of implementation is of paramount importance. EU taxonomy should be flexible and dynamic enough to allow for a diversity of responsible investment strategies and continuous product innovation. Overly prescriptive criteria may lead to directing a vast amount of investments into a very limited number of companies which would artificially inflate the share price potentially create a bubble. Moreover, climate science and ESG research are evolving fast and require an ‘enabling’ and evolving framework. Understanding of climate change continues to develop and flexibility is needed to enable and promote new investment solutions and better analysis.

One of the remaining challenges is **application of taxonomy to different asset classes**. Despite having been originally conceived for investments in listed equities and bonds, EU taxonomy is the most

appropriate and workable to evaluate project finance, and for lending products that allow to ring-fence the use of proceeds.

We believe it would be useful that an **impact assessment** of the rules (based on the proposed screening criteria) is conducted before their finalisation, as currently very few companies disclose taxonomy - relevant data. On the basis of the TEG technical report from June 2019, it is expected that environmentally sustainable economic activities are conducted by companies that would account for a very small share of the overall market. Therefore, it is key that the EU taxonomy remains a reference point and a goal that companies can aspire to.

Examples of over-complexity of the technical criteria comprise: a positive evaluation of e.g. the absolute thresholds for GHG emissions, and verification of the criteria for the “do not significant harm” assessment that also often imply absolute thresholds, e.g. for the recycling quote, or peer group comparisons. This complexity will be further increased if technologies and products used all along the entire industrial value-chain needed to be considered in the assessment as requested by the EU Parliament in the amendment to Art. 14(1)(f).

Moreover, we believe that the taxonomy should be **scientific and evidence-based** to enable a proper transition towards sustainability. Thus, the list of eligible activities under the EU taxonomy should be developed by the Technical Expert Group or the future Platform on Sustainable Investments. Consequently, we would oppose the EP’s text Article 14 paragraphs 2(a) to 2(c) and **support Article 14 of the Council’s text referring to transition to carbon neutrality, enabling activities, and technological neutrality.**

Our recommendations:

- The taxonomy should be **scientific and evidence-based** to enable a proper transition towards sustainability. We oppose the EP’s text Article 14 paragraphs 2(a) to 2(c) and **support Article 14 of the Council’s text referring to transition to carbon neutrality, enabling activities, and technological neutrality**
- **Avoid overcomplexity** while designing the taxonomy. Also, in the context of the scarcity of the relevant information disclosed by the investee companies, it is premature to require an assessment of technologies and products used all along the whole industrial value-chain. Therefore, we oppose the Parliament’s amendment to Art. 14(1)(f).
- An **impact assessment** of the rules (based on the proposed screening criteria) should be conducted before their finalisation, as currently very few companies disclose taxonomy - relevant data.

3. Supervision

The European Parliament elaborates on supervision in Art. 4 para 2a and Art. 4(a).

Art. 4 provides that financial market participants (FMP) would have to report on each product to the national competent authority which would subsequently report to ESMA. Both NCA and ESMA would then assess the information and if they disagree, FMP would need to review the information disclosed.

This is quite a complicated and burdensome process; moreover the text does not provide for a timeline. Neither is it clear whether the evaluation is done ex ante or ex post. This raises questions possible delays and lack of clarity in case NCA and ESMA come up with a different judgement. Furthermore, it is unclear what the consequences would be in case of a negative judgement affecting products that are already sold, not in the least in combination with a completed suitability assessment.

Art. 4(a) introduces product intervention/ban powers on the basis of “incorrect” disclosure which interferes and goes beyond the framework set in MiFID or PRIIPs, in addition to the regime described in Art. 4(2a).

Both requirements would result in what can be described as a “dual regulatory regime”, allowing ESMA to “second guess” NCAs’ decisions. We would like to emphasise that this was contested by the co-legislators during the ESAs review.

To sum up, the revisions suggested by the Parliament in Art. 4 para 2a and Art. 4a would result in:

- Unclear and very impractical supervisory procedures;
- Product bans on the basis of disclosure requirements that unproportionally exceed the current framework;
- Dual regulatory regime (ESMA “second guessing” NCAs).

Our recommendation:

We believe that the Council’s text regarding Art. 4 para 2a and Art. 4(a) will result in a more effective enforcement without creating unnecessary delays, market disruptions or hampering product innovation.

4. Timeline & transition

To ensure a smooth and proper implementation of the new rules, a **realistic and well sequenced application timeline** is needed, especially regarding disclosure obligations in Art. 4. It means ensuring there is sufficient time between the publication of the final technical measures (the so called “level 2”) and the application date of the regulation. Otherwise, we risk changes in disclosures within a couple of months that may confuse investors and result in unclear consequences on products already sold. Moreover, the disclosure requirements on the financial market participants should be **clearly linked to the availability of standardised and publicly accessible ESG data**.

We would also welcome a “**transition period**” or regulatory forbearance to allow the new disclosures to bed in, which has been very helpful during the application of Article 173 in France. It is of high importance given:

- the novelty of the provisions, meaning that industry needs to develop appropriate measures and processes to ensure meaningful disclosures;
- insufficient availability and quality of ESG data by the investee companies which is necessary for asset managers to comply with the disclosure requirements.

It should be also clarified that the level and quality of disclosures done based on Art. 4 is dependent on the availability and quality of ESG data disclosed by investee companies. Transition period is key to ensure that the EU taxonomy is used from the beginning.

Proper guidelines on how to report in view of the current data availability, reliability and accessibility are also very much needed.

Our recommendation:

Adjust Art. 18 to ensure **realistic and well sequenced application timelines:**

- Final technical measures (the so called “level 2”) should be **published well before** the related provisions apply.
- A “**transition period**” allowing the new rules to bed-in should be provided for.
- It should be also clarified in the regulation that the level and quality of disclosures done based on Art. 4 is dependent on the availability and quality of ESG data disclosed by investee companies.
- Provide for **guidelines** on how to report in view of the current data availability, reliability and accessibility.

PART II – GENERAL CONSIDERATIONS & SUCCESS FACTORS FOR EU TAXONOMY

1. Availability and quality of ESG data

To categorise an investment according to its economic activities, **asset managers need robust, standardised, quantitative and reliable data that is publicly available.** Existing practices and /or rules do not provide sufficient quality, granularity nor consistency to meet the expectations of the taxonomy implementation.

Investee companies’³ ESG disclosures require a significant reform to meet the requirements of the Taxonomy. As long as investee companies do not disclose such data, there is a risk of asset managers and investors becoming **overly reliant on few third party data providers.** Their models/estimates often lack transparency, are not comparable, do not necessarily reflect the reality on the ground and tend to charge very high fees. This would add another layer to the wider concern over the availability and cost of market data.

We would suggest that the Commission looks into ways of making data freely available and accessible via for instance data platform, as well as on looking into the impact that the **current market concentration of data providers will have regarding costs and overall quality of data.**

As announced by the Executive Vice-President Dombrovskis, the Commission intends to **review the Non-Financial Information Directive (NFRD).** During this exercise a careful attention should be given to **all key data points and KPIs that investors need to apply the taxonomy and the sustainability**

³ By investee company we mean all issuers including sovereign issuers.

disclosures regulation. In other words, investee companies should report in compliance with the revised NFRD all data points and KPIs that investors need to meet the requirements of new sustainable finance rules, including the taxonomy and sustainability disclosures regulation.

Regarding the inclusion of transition activities in the EU taxonomy, we suggest to look into the existing industry initiatives already exist which could be relied upon, such as the Science-Based Target Initiative. To make those initiatives even more impactful and helpful, through more homogeneous, reliable and widely available data, the publication of those targets, pathways and milestone by issuers would be very helpful. They should be assessed against market references, such as the Paris Agreement for GHG emissions for instance.

Our recommendations:

- During the **review of the Non-Financial Information Directive (NFRD)**, a careful consideration should be given to ensure that investee companies publicly disclose **all key data points and KPIs** that financial market participants need to comply with the **EU taxonomy** and the **sustainability disclosures regulation**.
- Existing industry initiatives and frameworks should be considered in term of what information investee companies could provide to inform investors on their efforts regarding the transition towards sustainable economy.
- We suggest that the Commission looks into ways of making data freely available and accessible via for instance data platform, as well as on looking into the **impact that the current market concentration of data providers will have regarding costs and overall quality of data**.

5. Platform on Sustainable Finance & global cooperation

Governance, competences, role, resources, structure and composition of the Platform on Sustainable Finance is of crucial importance. The platform should be in charge of expanding and updating the taxonomy, but also it should oversee it, helping to make it a globally accepted and used taxonomy. The platform should actively engage with the industry and with the investment community, it should improve the tools to help companies and investors implement it. It would be useful that the platform is also involved in the update of the climate benchmarks or green bonds.

We applaud the Commission's efforts to lead cooperation regarding Sustainable Finance at the global level. It is vital to the success of the Sustainable Finance Action plan. While the EU taxonomy applies to European investment managers, the industry invests globally and disclosure issues are even greater outside of Europe where even the most basic ESG information may be missing. There, investment managers would have to make approximations to decipher compliance with the Taxonomy.

It is important to aim at creating a level-playing field and avoid markets' fragmentation. Therefore, the **EU International Platform on Sustainable Finance** should be leveraged to give consideration to **how the EU Taxonomy could serve as a template for other markets**.

To align efforts and build on the EU Taxonomy for those jurisdictions inclined to take the same regulatory approach as the EU, we suggest to discuss with global economic governance and steering bodies.

Our recommendations:

- We support efforts to increase the **global cooperation and international uptake of EU taxonomy** and of the **standardised ESG data disclosure**.
- We emphasise the need for the appropriate governance, competences, role, resources, structure and composition of the **Platform on Sustainable Finance**.

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Annex: Overview of our detailed recommendations

1. Scope and consistency with sustainability disclosures regulation

- To avoid unnecessary over-complexity and properly align the different rules, we suggest to clarify that the EU taxonomy, and especially **the disclosure requirements in Art. 4 (2)** of this regulation, should apply to **sustainable investment products with an environmentally objective under the SFDR**. In that respect, we support the **Council's wording of Art. 4(2) of the taxonomy regulation**.
- We support the wording of the **Council regarding Art. 1(2) and Art. 4. EU taxonomy regulation should remain as a reference framework for disclosures**, without imposing any thresholds that would turn it into a label-providing regulation. To recall, there is a separate workstream on the EU Ecolabel which has such an aim.
- **Inclusion of transition and enabling activities** is key to facilitate a transition to a sustainable and circular economy. We thus support the **Council's wording of Art. 14 (1) (a)** with the following addition:
 „identify the most relevant potential contributions to the given environmental objective, while respecting the principle of technological neutrality, considering both the short and long term impacts of a given economic activity, its planned transition and targets, **mitigation measures and enabling activities substantially contributing to transition to a carbon neutral and sustainable economy;**“
- To avoid any potential misleading classification we **object the Parliament's wording of Art. 1 (2) (ba) (new) (ii) (line 101)**.

2. Market relevance and usability

- The taxonomy should be scientific and evidence-based to enable a proper transition towards sustainability. We oppose the EP's text Article 14 paragraphs 2(a) to 2(c) and support Article 14 of the Council's text referring to transition to carbon neutrality, enabling activities, and technological neutrality
- Avoid overcomplexity while designing the taxonomy. Also, in the context of the scarcity of the relevant information disclosed by the investee companies, it is premature to require assessment of technologies and products used all along the whole industrial value-chain. Therefore, we oppose the Parliament's amendment to Art. 14(1)(f).
- An impact assessment of the rules (based on the proposed screening criteria) should be conducted before their finalisation, as currently very few companies disclose taxonomy - relevant data.

3. Supervision

- We believe that the Council's text regarding Art. 4 para 2a and Art. 4(a) will result in a more effective enforcement without creating unnecessary delays, market disruptions or hampering product innovation.

4. Timeline & transition

Adjust Art. 18 to ensure **realistic and well sequenced application timelines**:

- Final technical measures (the so called “level 2”) should be published well before the related provisions apply.
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- It should be also clarified in the regulation that the level and quality of disclosures done based on Art. 4 is dependent on the availability and quality of ESG data disclosed by investee companies.
- Provide for guidelines on how to report in view of the current data availability, reliability and accessibility.

5. Availability and quality of ESG data

- During the review of the Non-Financial Information Directive (NFRD), a careful consideration should be given to ensure that investee companies publicly disclose all key data points and KPIs that financial market participants need to comply with the EU taxonomy and the sustainability disclosures regulation.
- Existing industry initiatives and frameworks should be considered in term of what information investee companies could provide to inform investors on their efforts regarding the transition towards sustainable economy.
- We suggest that the Commission looks into ways of making data freely available and accessible via for instance data platform, as well as on looking into the impact that the current market concentration of data providers will have regarding costs and overall quality of data.

6. Platform on Sustainable Finance & global cooperation

- We support efforts to increase the **global cooperation and international uptake of EU taxonomy** and of the **standardised ESG data disclosure**.
- We emphasise the need for the appropriate governance, competences, role, resources, structure and composition of the **Platform on Sustainable Finance**.