

AFME comments on European Parliament's Report on Taxonomy Regulation

25 March 2019

The EU Taxonomy Regulation ("Regulation") is a foundational proposal of the European Commission's Action Plan on Financing Sustainable Growth ("Action Plan"). We consider that the identification of sustainable economic activities and their degree of sustainability is a significant positive step in an orderly transition towards a low-carbon and climate resilient economy, to which AFME is fully committed.

We agree that lack of clarity as to what constitutes "sustainability" is a key obstacle for increasing and directing capital flows towards sustainable investments. Therefore, we welcome the current proposal as we support both the ambitious objectives of the Action Plan and its proposed "step-by-step" approach.

AFME thus welcomes a series of amendments proposed in the *Report on the proposal for a regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment*¹ ("Report") as of the 13th of March 2019. We would also like to contribute to the thinking of the European Parliament on some of the proposed aspects of the Regulation in pursuit of assisting the negotiating parties to make further progress towards reaching agreement on this important file.

Creating a "green" taxonomy

We agree that "the taxonomy should be based on harmonised, comparable and uniform criteria and indicators" taking into consideration the principles of proportionality and progressivity in its application as well as aim to avoid any overlaps in regulation and unnecessary burden of authorities and financial institutions. We therefore welcome the fact that the Report focuses on creating a taxonomy for sustainable activities and that expanding the Regulation with the criteria for economic activities with a significant negative environmental impact would be subject to separate impact assessment by the Commission and that any further expansion would be "conditional to an outcome of the impact assessment that states that such an expansion is proportionate, feasible and desirable". However, we are concerned that such impact assessment would be expected to be completed by 31 December 2021, which, in our view, will not be long-term enough to adequately reflect on the state and developments of industries' transition towards a more sustainable, low-carbon economy and would divert resources from achieving more immediate objectives (i.e. establishing and implementing the "green" taxonomy, which is already a complex task).

AFME stresses that most economic activities, companies and industries are currently at different stages of their transition journey towards low-carbon standards and the transition is expected to extend beyond the end of 2021. Therefore, we believe that creation of a taxonomy for activities with negative environmental impact in the short term would not take into consideration products that might not necessarily comply with the "green" criteria in the nearest future, but which would still contribute to or would be in transition to a more sustainable investing. We think that incorporating the criteria for economic activities with a significant negative environmental impact in the short term could lead to large scale divestments especially for activities where alternative technologies are not yet developed (with reference to amended Recital 30, which we support), which may jeopardise an orderly transition of the EU economy towards low carbon activities. We also believe that a taxonomy on "brown" activities would generate financially punitive effects for all companies performing those activities. These firms would be equally financially discriminated regardless of their benefits brought to society otherwise and regardless of their internal practices and policies (including those to progressively reduce negative impact on the environment).

¹ http://www.europarl.europa.eu/doceo/document/A-8-2019-0175_EN.pdf

Scope of Regulation

We are supportive of the fact the Regulation is targeted only at products marketed as environmentally sustainable investments or as investments having similar characteristics. We believe it is consistent with the Commission's objective set out in its *Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment*, which was to "address the divergence of existing national taxonomies and market-based initiatives at national level, in order to tackle the risk of "greenwashing". We believe that providing additional clarity and transparency for product offerings in relation to their sustainability would only be pertinent for products that are marketed as environmentally sustainable or having similar characteristics as these are the products subject to "greenwashing risk".

Activities in transition

AFME welcomes the proposed amendments as per Recital 26 a (new) and Article 14 noting that the technical screening criteria should consider the nature and the scale of economic activity taking into account activities in transitions. We believe that this approach would give credit to market participants for measures taken in transitioning to more sustainable activities and would encourage further progress. We also support that the technical screening criteria should be "easy to apply and avoid unnecessary administrative burden from a compliance perspective" as noted in Article 14 (ha).

Establishing minimum social safeguards

AFME welcomes the proposed amendments to Article 13 of the Regulation stating that any further expansion of the minimum safeguards to be observed by firms in order to establish that economic activity as environmentally sustainable would be subject to further impact assessment by the Commission. We believe it is important to establish safeguards that would be applicable globally and to smaller companies first. However, consistent with our comment above, we think that the timeframe set for the impact assessment would be too ambitious to reach a meaningful conclusion on the need to expand the Regulation.

Definition of "financial products"

AFME is concerned that the definition of "financial products" was expanded to include "issuances" according to Directive 2003/71/EC and Regulation (EU)2017/1129). We stress that banking institutions distributing products issued by the corporate sector might not be able to adequately assess and disclose whether such products comply with the Regulation. This is due to the fact that corporates are not included in the definition of a financial market participant per the Regulation and thus would not be obliged to disclose the same level of information necessary for banks to perform the required detailed assessment.

Disclosure of holdings in companies carrying out environmentally sustainable economic activities

Article 4, paragraph 3(a) presumes that financial market participants will be required to disclose the percentage of holdings in different companies carrying out environmentally sustainable economic activities. AFME is concerned that complying with this requirement might not be feasible in the short term due to the lack of exploitable data, especially on non-listed investees. Therefore, we recommend that this requirement should be contingent to data availability and therefore a "comply or explain" approach could be a solution.

Other considerations

With regard to Recital 27, referencing NACE sectors for economic activities to which the technical screening criteria should apply, we would urge the European Parliament to consider that the TEG taxonomy workshops have not yet concluded on the scope of economic activities, and we note that the input of technical experts would be crucial.

With reference to Article 4 (a), whilst we understand this measure is aimed at preventing "greenwashing", we would highlight to the European Parliament that the individual ESAs might not have sufficient resources or appropriate level of expertise to monitor the market for financial products in scope. We therefore recommend

a pan-European approach to market monitoring. Similarly, we note that Article 12 sets a very ambitious and complex proposal requiring the “ environmental impacts of the activity itself, as well as of the products and services provided by that activity throughout **their entire life cycle** and, if necessary, throughout **the value chain**, shall be taken into consideration” when assessing the economic activity. We recommend that it is important that this requirement allow for a progressive, phased approach taking into account that certain sectors might lack the resources and expertise to comply in the short term.

We would be pleased, of course, to discuss the content of this paper or to provide any further clarity with regard to the statements made.

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About AFME

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe’s wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.