

## Feedback on the Platform on Sustainable Finance's draft proposal for an extended taxonomy to support economic transition

6 September 2021

### INTRODUCTION

AFME welcomes the opportunity to comment on the Platform on Sustainable Finance's draft report on the extension of the EU Taxonomy Regulation. With the figures for yearly estimated investment needed to meet the 2030 emission-reduction target revised to EUR 480 billion in the Strategy for Financing the Transition to a Sustainable Economy, up from EUR 180 billion according to the 2018 action plan, the need for an effective framework to shift capital towards the economic transition is needed now more than ever.

We firmly believe that the EU Taxonomy Regulation is a key pillar of such framework and we have, earlier this year, offered our recommendations on how to embed transition finance in the Taxonomy and better recognise transition activities on a credible pathway towards sustainability<sup>1</sup>. We find that a more supportive framework is needed to address the challenge of financing interim steps in the urgent transition of companies towards the EU's climate neutrality and environmental objectives, and therefore welcome the European Commission's initiative to extend the application of the existing climate and environmental Taxonomy to facilitate access to transition finance, building on the proposal by the Platform on Sustainable Finance.

The key objective for this extension, we believe, is providing a tool to better recognise companies' transition efforts. An extended taxonomy should be firmly focused on supporting greater recognition of transition plans, for companies currently below 'substantial contribution' (SC) performance levels. We welcome that the Commission's 'Strategy for Financing the Transition to a Sustainable Economy' makes a priority of this objective, by committing to develop a more comprehensive framework and help the financing of intermediary steps towards sustainability.

An extended Taxonomy could help support this goal by providing a framework to recognise transition from significant harm or performance improvements without the need for specific detailed taxonomies for each performance level.

However, this task presents several challenges which need to be carefully considered, including:

- ensuring that it supports a positive, dynamic framework to incentivise and recognise improvements in environmental performance and avoids creating an overly negative perception of activities in non-green economic sectors which nevertheless have the credible ambition and capacity to improve their performance; and
- avoiding creating a disproportionately complex taxonomy framework which is difficult to use and/or overly burdensome in practice.

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<sup>1</sup> [AFME – Embedding transition finance into the European Taxonomy framework \(12 March 2021\)](#)

In order to address these challenges, we recommend:

- the introduction of a ‘Significantly Harmful’ taxonomy focused on defining economic activities for which there is no possibility of improving their environmental performance to avoid significant harm;
- focusing on supporting the design and recognition of Paris-aligned transition plans for the improvement of performance levels; and
- not prioritising the development of a ‘no significant impact’ taxonomy.

We expand upon our recommendations below.

### ***Development of a ‘Significantly Harmful’ taxonomy***

We consider that, if it is decided to introduce a ‘Significantly Harmful’ taxonomy, the focus should be to define economic activities for which there is no possibility of improving their environmental performance to avoid significant harm. This would aid investors’ understanding of such activities, allow companies to track the turnover obtained from these activities, and recognise as “transition eligible” any capital expenditure for their closure or decommissioning.

It is very important when developing such framework to ensure that it does not discourage investment towards companies operating in highly-emitting sectors which demonstrate a credible ambition and capacity to improve their environmental performance, as these sectors urgently require capital in order to transform to achieve the transition to Net Zero. We are concerned that classifying under a Significantly Harmful taxonomy activities which do have the capability to improve their environmental performance away from significant harmful levels risks stigmatising such activities and deterring investments into companies that wish to transition those activities. It is important to avoid a Significantly Harmful taxonomy becoming, or being perceived as, a tool to *name and shame* companies in dire need of transition investment, causing a direct negative impact not only on their ability to improve their environmental performance, but also unintended consequences for social and employment matters as well as international competitiveness.

We therefore strongly believe that a distinction should be made between activities for which no possibility of improving their environmental performance to avoid significant harm exists, and those which do have the possibility to improve their environmental performance. As the Platform recognises, there is a high risk of misunderstanding and misinterpretation with the introduction of a significantly harmful taxonomy, so any extension will need to be clearly explained to avoid confusion in the market. Technological developments in high-emitting industry sectors are also rapid, highly dynamic and hence difficult to predict. Locking in activities as “significantly harmful” today might not be an adequate characterization in the near future, adding to the risk that such sectors are effectively starved of much needed innovation and investment for transition.

We therefore agree with the Platform that “In order to fully realise the potential contribution that an SH Taxonomy can make to environmental objectives and to the Renewed Sustainable Finance Strategy, it needs to be presented in a way that highlights and favours the orderly and managed exit of economic activities from harmful levels of performance.” To that end, we believe that it is important to carefully assess what would be the coverage and related impact of a ‘Significantly Harmful’ taxonomy before any decision is taken. As the Platform’s report mentions, estimates and early testing of the climate Taxonomy criteria show a low overall

Taxonomy alignment today in companies' activities and investment portfolios (between 1% and 5%). It follows that a great majority of existing activities would fall under the amber (intermediate performance) or red (significant harm) categories - where red, in the traffic light colour system adopted by the Platform, is meant to be universally understood with the meaning of "Stop". When used to screen companies' KPIs, we fear that market participants could interpret a Significantly Harmful taxonomy as a tool to create a blacklist of issuers that should not be considered eligible for transition investment. With our feedback we aim to prevent the risk of an increase in the cost of capital to support companies' transition efforts. As the Platform finalises its report and the Commission considers how to take any extension forward, it is essential that these challenges are carefully considered. It is also important to avoid an overly complex approach and to minimise the reporting burden on companies and financial institutions.

### ***Traffic light classification of activities***

To reduce the risk of misinterpretation identified by the Platform and ensure that the extended taxonomy achieves the goal of incentivising and recognising improvements in environmental performance, we believe it is important that the traffic light (red/amber/green) classification envisaged by the Platform should not be based on a static classification of significantly harmful economic activities but be done in a dynamic, forward-looking way and be regularly reviewed to take into account technological and scientific progress.

We propose that in this framework, the 'red' classification should only apply to those activities that cannot improve sufficiently to avoid doing significant harm, allowing companies to track the turnover obtained from these activities, and recognise as "transition eligible" any capital expenditure for their closure or decommissioning. Activities that can transition out of causing significant harm, on the other hand, should not be included in a "red" category where accompanied by proven capacity and appropriate climate transition plans built following Commission's guidelines using forward looking metrics (i.e. capex) to follow companies' path towards climate neutrality.

To that end, we would welcome a Taxonomy extension conceived as a tool to support public and private entities, investors and lenders design a credible, realistic and verifiable strategy to meet the 2030 emission-reduction targets, closely aligned with the sectoral legislation introduced by the Commission's "Fit for 55" package. It should also take into consideration the transition pathways for industrial ecosystems to be co-created by policymakers and the private sector as announced in the European Commission's updated Industrial Strategy.

The extended Taxonomy framework could include criteria or provide guidance to help assess the feasibility of companies' commitments to transition their economic activities, including guidance on the role and impact of technological innovations to assess specific economic activities or entities. This approach would address the challenges that our members encounter when trying to screen companies' transition plans for specific sectors, each with different technologies, timelines and overall transition paths. Credible transition plans should therefore embed science-based strategies for building decarbonization trajectories (such as, for example, those based on internationally adopted PACTA methodologies or Science Based Targets (SBTi), ideally accompanied by further Commission guidance on screening companies' business models, in addition to their activities. They should also take into account, when relevant, countries' Nationally Determined Contribution to demonstrate the alignment between private sector financing and government objectives.

## ***No Significant Impact Taxonomy***

Finally, while we see the benefit of an extension of the Taxonomy to better recognise companies' transition efforts, we do not find sufficient merits, at this stage, for the creation of a "No\_Significant (environmental) Impact" (NSI) taxonomy. The benefits introduced by an additional tool to identify NSI activities (as per the definition proposed by the Platform) are likely to be outweighed by the additional regulatory and administrative burdens and complexities for both policymakers and market participants.

## **QUESTIONNAIRE**

### **Questions on the draft report:**

- 1. Which *environmental performance levels* should the taxonomy distinguish, with a view to help the environmental transition? Choose all of those that you would prioritise:**
  - a. Substantial contribution
  - b. Intermediate performance
  - c. Significantly harmful - but can improve to sustainability
  - d. Significantly harmful – but can improve not to do significant harm
  - e. Significantly harmful - but cannot improve sufficiently to avoid doing no significant harm
  - f. No significant impact
  
- 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)? Check all that you agree with.**
  - a. Not relevant
  - b. Distinguish different levels of environmental performance clearly throughout the taxonomy and in other instruments
  - c. 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
  - d. Require continued improvement beyond the relevant investment plan
  - e. Require associated entity level transition strategy to understand the credibility of the intermediate transition.
  - f. Recognise multiple ways of transition depending on type of Technical Screening Criteria.
  - g. Other safeguards would be needed

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

- ☐ Yes
- ☒ No

Follow-up question: If yes, 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

### **'Significantly harmful' taxonomy**

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)? Check all that apply.

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. Could advantages be further enhanced? If so, how?

Please see our introductory remarks above.

Disadvantages – a 'significantly harmful' taxonomy would:

- 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. How could disadvantages be addressed?

Please see our introductory remarks above. The extended framework could include criteria or provide guidance helping assess the feasibility of companies’ commitments to transition their economic activities, including guidance on the role and impact of technological innovations to assess specific economic activities or entities. This approach would address the challenges that our members encounter when trying to screen companies’ transition plans for specific sectors, each with different technologies, timelines and overall transition paths. Such transition plans should therefore embed science-based strategies to building decarbonization trajectories (such as, for example, those built based on internationally adopted PACTA methodologies or Science Based Targets (SBTi), ideally accompanied by additional Commission guidance on screening companies’ business models, in addition to their activities, to provide a more vertical perspective to the framework’s usability. They should also take into account, when relevant, countries’ Nationally Determined Contribution to demonstrate the alignment between private sector financing and government objectives.

## Two types of significantly harmful activities

5. 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.

**Do you agree with the following statements? (Please check all boxes that you agree with)**

- ***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

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

- ☐ Yes
- ☐ No

Please explain your answer to question 6:

Please see our introductory remarks above. While we support expanding the Taxonomy to recognise transitional performance which does not reach substantial contribution levels, we believe that it is crucial that this would be accompanied by clear guidance to avoid confusion in the market. To that end, we would welcome a Taxonomy extension conceived as a tool to support public and private entities, investors and lenders design a credible, realistic and verifiable strategy to meet the 2030 emission-reduction targets, closely aligned with the sectoral legislation introduced by the Commission's "Fit for 55" package. The extended framework could include criteria or provide guidance to help assess the feasibility of companies' commitments to transition their economic activities, including guidance on the role and impact of technological innovations to assess specific economic activities or entities.

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

- a. All turnover from such activities should be recognised as *intermediate turnover*, and all opex as *intermediate opex*?
- b. All capex should be recognised as '*intermediate capex*' irrespective of whether or not it improves environmental performance of the activity and by how much.

## Intermediate transition

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

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:**

- 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.

If this answer is selected, follow-up question: The criteria for ensuring that the activity will improve to reach substantial contribution should include to (check all boxes that apply):

- 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

C. in addition, that the activity continues to improve its environmental performance in order to reach substantial contribution (green) in the future

If this answer is selected, follow-up question: The criteria for ensuring that the activity will improve to reach substantial contribution should include to (check all boxes that apply):

- 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

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)

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

To reduce the risk of misinterpretation and ensure that the extended taxonomy achieves the goal of incentivising and recognising improvements in environmental performance, we believe it is important that the classification envisaged by the Platform should not be based on a static classification of 'significantly harmful' economic activities but be done in a dynamic, forward-looking way and be regularly reviewed to take into account technological and scientific progress. We propose that in this framework, 'red' classification should only apply to those activities that cannot improve sufficiently to avoid doing no significant harm, allowing companies to track the turnover obtained from these activities, and recognise as "transition eligible" any capital expenditure for their closure or decommissioning. Activities that can transition out of causing significant harm, on the other hand, should not be included in a 'red' category where accompanied by



appropriate transition plans built following Commission's guidelines using forward-looking metrics (i.e. CapEx) to follow companies' path towards climate neutrality.

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

**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:**

- a. help the ESG analysis
- b. be beneficial for SME's to access finance
- c. 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)
- d. ensure banks can report green lending to SMEs and continue to develop these markets
- e. allow easier access to finance for larger companies in these sectors
- f. other (please specify)

Please, elaborate on your answer. Could advantages be further enhanced? If so how?

Some players in the market that fall within the NSI category may be underrepresented in a taxonomy that does not recognize activities that neither significantly contribute to environmental objectives nor do significant harm.

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

- a. be too complex to manage, as a framework
- b. imply burdensome reporting obligations
- c. risk disadvantaging 'no significant impact activities' vis-à-vis intermediate contribution activities that are likely to be more polluting
- d. other (please specify)

Please, elaborate on your answer. How could disadvantages be addressed?

We recommend that the Commission prioritises the implementation of the EU Taxonomy Regulation and its extension to significantly harmful and intermediate impact activities.

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

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**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

**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

**Follow-up question to those who select Yes:** If you agree, what should be the scope of such guidance, for instance in relation to minimum standards of environmental performance?

**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

We recommend that the Commission prioritises the implementation of the EU Taxonomy Regulation.

**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

We do not see merits in the inclusion of a generic category of NSI activities in the taxonomy at this stage. Activities without significant impact can be identified by exclusion.

## AFME contacts

Oliver Moullin, Managing Director, Sustainable Finance, General Counsel and Company Secretary

[Oliver.Moullin@afme.eu](mailto:Oliver.Moullin@afme.eu)

Giorgio Botta, Senior Associate, Sustainable Finance

[Giorgio.Botta@afme.eu](mailto:Giorgio.Botta@afme.eu)

Pablo Portugal, Managing Director, Advocacy

[Pablo.Portugal@afme.eu](mailto:Pablo.Portugal@afme.eu)

## 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](http://www.afme.eu)