

FEEDBACK ON THE DEVELOPMENT OF DELEGATED REGULATION ON CLIMATE CHANGE MITIGATION AND ADAPTATION

27 April 2020

Introduction

As the voice of the European asset management industry, we renew our continuous support for the EU's fight against climate change, the ambition to meet the Paris Agreement commitments and the objectives of the EU Green Deal.

We welcome efforts by the Commission and the TEG to develop a European Taxonomy to provide clarity on what constitutes environmentally sustainable investments, enhance comparability for investors and prevent green washing. Only a well-balanced and clear taxonomy, which can be practically applied by market participants can deliver on the ambition of "shifting the trillions" towards environmentally sustainable investments.

Many of our members need more time to fully comprehend and test the screening criteria for climate adaptation and mitigation, and DNSH as proposed in the final TEG report. They are also trying to understand how the different pieces of the regulatory puzzle fit together, especially in the context of preparing for the implementation of the Sustainability-Related Financial Disclosures Regulation, which in the meantime has already been amended by the EU Taxonomy Regulation. The timeline for application of different provisions and their respective sequencing is challenging.

The situation is further exacerbated through the issue created by COVID-19, which diverted a lot of resources from our members into crisis management.

We fully understand the urgency to push forward measures to drive forward the sustainable transition and we acknowledge that we need to start where we can. However, to make sustainable finance work in practice, we call on European and national authorities to show and exercise the necessary support and flexibility to the industry in the implementation and enforcement of these new rules and requirements.

Nevertheless, taking opportunity of this consultation, we would like to share our preliminary feedback on the main challenges identified regarding the implementation of the EU Taxonomy and the related screening criteria as proposed by TEG. We are also providing some recommendations for the way forward.

Meanwhile, we will continue to gather members' input, especially on the operational challenges and / or where further clarification is needed. We need to discuss some points with our members in more detail before we can ensure that our proposals properly reflect our members' views. We hope to share our further feedback in the weeks to come.

We also remain at your disposal to discuss and explain any of the below made points further.

KEY HIGHLIGHTS

1. The **insufficient availability, quality and reliability of publicly available ESG** data on investee companies, remains a key challenge for the screening against the EU taxonomy criteria.
2. Given the ESG data challenge, which is very likely to persist for a while, the **current timeline for the application of new rules poses a serious challenge**.
3. A public **EU central database or a single access point** has a potential to alleviate to some extent the challenges to be faced by the financial market participants in the short-term as well as in the long-term.
4. The revision of **NFRD should be given priority within the Sustainable Finance strategy** and should not be delayed despite the current challenging circumstances.
5. **More clarity** and further work is needed on certain aspects of the TEG proposals to ensure that the EU Taxonomy can be applied and work in practice.
6. The **Platform on Sustainable Finance** will play an important role in addressing the issues arising from the implementation of the EU Taxonomy. Its **governance, composition and resources** should reflect this.
7. We suggest to increase the **international relevance of the EU Taxonomy** to the extent possible. The role of the International Platform on Sustainable Finance is key in this respect.
8. The industry would welcome **additional support and guidance** regarding how to use the EU Taxonomy as well as the expectations of the regulators in the short- and long-term regarding the level of accuracy.
9. We suggest to consider strong inter-dependencies between the EU taxonomy and the **EU Ecolabel**.

1. Availability & reliability of ESG data

The insufficient availability of quality, reliable and public ESG data on investee companies remains a key challenge for the screening against the EU taxonomy criteria, making it difficult to check which companies and what percentage of their activities are Taxonomy-compliant.

This is reflected in the Financial Impact Assessment of the EU [Taxonomy](#)¹ performed by the JRC, confirming that: “*We can identify companies involved in activities covered by the Taxonomy. However, understanding the relative share of activities aligned with it is much harder.*”

We therefore very much **welcome the Commission’s intention to perform a thorough impact assessment** before finalising the draft Delegated Acts to have a proper picture to what extent EU Taxonomy is currently implementable given the availability and reliability of ESG data.

In some areas, the TEG recommends that the criteria should be assessed by a third party to ensure that the technical screening criteria have been met. Greater reliance on **third party verification** to ensure the reliability of the information, as has also been suggested by the TEG in relation to the EU GBS, could help reassure investors that the information provided is reliable.

Timeline challenge

We realise that the situation regarding ESG data availability should improve over time, given certain provisions in the EU Taxonomy Regulation and the upcoming review of the Non-Financial Information

¹ <https://publications.jrc.ec.europa.eu/repository/handle/JRC118663>

Directive. However, the resulting public disclosures by investee companies can only be reasonably expected in a couple years' time. The **current timeline for the application of new rules creates a serious challenge**.

1 January 2022 marks the application date of the provisions on financial market participants to disclose the proportion of their portfolios aligned with the climate mitigation and adaptation objectives specified in the EU Taxonomy. However, the obligation on the large investee companies² to disclose the corresponding information needed by market participants to prepare their own disclosures, shall apply as from the same date. Our understanding is that following the logic and rules followed by the NFRD (reviewing the accounting directives), the first reports by investee companies can be only expected in the course of 2023 (for the financial year 2022). This results in a very problematic **gap of more than one year during which financial participants will not have the data** they need to comply with the legal requirements.

Even if the disclosure by investee companies were to be expected to be **published in the course of 2022**, this **still creates a difficult situation** as financial market participants need such disclosures before they can produce their own.

Furthermore, any disclosures resulting from the upcoming NFRD review are most likely to become effective even much later. A Commission proposal to review NFRD is expected towards the end of 2020. Even if the review goes swiftly, the disclosures cannot be reasonably expected before 2024.

We understand, that a re-adjustment of the timelines from when different provisions apply to ensure a logical and practical sequencing may not be legally feasible at this stage. Therefore, we propose the following solutions.

Our recommendations:

- The revision of NFRD should be given the priority within the Sustainable Finance strategy and should not be delayed even in the current challenging circumstances. The scope of NFRD should be enlarged. We will provide specific suggestions in our response to the on-going Commission's consultation on the NFRD review.
- To address the challenges especially in the short- to mid-term we suggest to:
 - Clarify **when first disclosures by the reporting entities and by financial participants** respectively **are expected** in view of entry into application of the EU Taxonomy disclosure obligations on 1 January 2022.
 - Find an appropriate solution for phasing-in of disclosure obligations during the initial period of when EU Taxonomy applies.

A possible solution could be to **clarify that reasonable estimations of the EU Taxonomy-compliance are accepted as a transitional solution while promoting swifter implementation by companies**. We suggest that this is **clarified in the level 2 measures** to ensure legal certainty for market participants.

DNSH and minimum safeguards due diligence

Amongst others, our members have flagged **great difficulties in screening against DNSH criteria as well as against minimum safeguards**. As acknowledged by the JRC, most companies do not disclose such information. Moreover, it is difficult or impossible to check whether the information, if provided by the company, is correct and whether it applies to the activities or assets involved.

² The obligation introduced in Art. 8 of the EU Taxonomy regulation requiring companies within the scope of NFRD (currently undertakings with more than 500 employees) to disclose the proportion of their EU Taxonomy-compliant economic activities

Asset managers already have some tools to be able to assess adverse impact, including: through due-diligence whereby the asset manager assesses whether the appropriate policies and procedures are in place by the companies to ensure that adverse impacts are assessed and mitigated (such issues are likely to also be reflected in ESG scores provide by third party ESG ratings); and through the use of ESG controversy screens. In both instances, these assessments rely to a great extent on information reported by the companies and take place at the level of the company rather than the underlying economic activity.

As fund managers, especially in the initial years, will not be able to rely on corporate disclosures to evaluate alignment of their portfolios with the EU Taxonomy criteria, use of **estimations prepared by way of due diligence in-house or performed by ESG data and rating providers** will be key. This is also a solution proposed by the TEG.

Furthermore, a **proportionate approach should be envisaged for investments in companies** that fall **outside the scope of the NFRD and EU Taxonomy** reporting obligations, since access to the necessary information to undertake the required due-diligence will be lacking.

However, it remains unclear **whether due diligence will be accepted by regulators to assess compliance** when referring to qualitative criteria for substantial contribution, minimum safeguards and for DNSH.

While this will not solve all of the above mentioned challenges, to at least to alleviate them to an extent, we suggest **to clarify to what extent: 1) participants can rely on estimates based on due diligence produced in-house, and 2) to what extent asset managers can rely on due diligence assessment performed by a third-party**, i.e. an ESG rating agency.

Many small and middle-sized asset managers do not have the resources necessary to perform an extensive in-house due diligence on the EU Taxonomy or to systematically validate the plausibility of third party assessments. It would be of help, and for some the only solution, to rely on estimations provided by a recognised service provider.

Our recommendation:

We suggest that the Commission clarifies to what extent and in which conditions market participants can rely on estimates based on due diligence produced in-house and acquired from the external data providers. This would provide more clarity and legal certainty for market participants.

ESG database

The insufficient availability of ESG data is very likely to remain a challenge even after the initial years of the application of the EU taxonomy and after the revision of NFRD. The reporting obligation is confined to the scope of application of NFRD. Currently NFRD applies only to large listed companies, insurance companies and banks (in each case entities with more than 500 employees). However, the obligation on financial market participants to provide the disclosures is not confined to those companies.

Even if the scope of NFRD is to be enlarged, **it will remain a challenge for companies that are based outside the EU**. That creates a great problem for asset managers investing globally on behalf of European investors.

To help understand the magnitude of the issue, around **67% of UCITS assets were invested outside the EU-27** at the end of 2019. UCITS, with net assets worth EUR 11 trillion and representing 62% of all European funds³, represent most of the funds targeted to retail investors.

A public **EU central database / public register or a single access point**, allowing access to ESG data reported by companies, **has a potential to alleviate this challenge both in the short-term as well as in the long-term**.

Besides including information reported in line with the regulatory requirements (EU Taxonomy, NFRD and other sectorial and environmental legislation providing for ESG disclosures), such database **should include ESG information filed by companies** from outside the scope of the legal requirements **on voluntary basis**. Companies should be encouraged to do so.

Such database / public register / access point would be amongst others helpful for accessing ESG information before application of the EU Taxonomy-related disclosures and the provisions of the reviewed NFRD. It would very much **facilitate access to ESG data** not only for investors, but also **many other stakeholders (including civil society and academics) and various European and national authorities**.

In this context, the **Transparency Directive**, as revised in 2013, has **already provided for** establishing a **European Electronic Access Point**. The Directive provided for ESMA to:

- interconnect the national Officially Appointed Mechanisms (OAMs), responsible for compiling information disclosed by issuers having shares admitted for trading on regulated markets;
- provide a single access to such an inter-connected European-wide database.

We understand that at the time this initiative was put aside due to what was believed to be excessive implementation costs. However, especially in the current situation, we believe that it is **high time to reconsider this initiative or to provide for an alternative**, even more appropriate **solution**, which should be extensively discussed with ESG data users.

Our recommendation:

We suggest to provide for a public **EU central database, public register or a single access point** allowing to access ESG data reported by companies. It should include regulated information as well as ESG information provided by companies on voluntary basis. Besides addressing the needs of investors and EU and national regulators, such database would play an important public accountability role.

2. Reactions on the TEG recommendations & further work to be done

Revenues vs CapEx/OpEx

While in many cases it may be quite straight-forward whether to take revenues or CapEx/OpEx as a metric to evaluate EU Taxonomy compliant activities, more clarification would be helpful especially regarding construction and real estate.

Our recommendation:

We suggest that TEG clarifies which metric (revenues vs Capex/ Opex) is recommended to be used to evaluate EU Taxonomy compliant activities in the construction and real estate business.

³ Data at end of 2019 covering 29 countries representing the EFAMA membership (including UK, CH, NO and TK but excluding EE, LV and LT).

Sustainability-related disclosure

The TEG made some recommendations regarding disclosures within the scope of the Sustainability-related Financial Disclosures Regulation (SFDR). We understand that these disclosures at the level of financial products shall be further specified by the level 2 measures to be developed by the ESAs (cf. Article 25 of the Taxonomy Regulation). Consequently, we understand they will not be dealt with by the Delegated Regulation to be prepared by the Commission on the basis of the TEG report.

The TEG recommends that such disclosures be very detailed. In addition to specifications on transition and enabling activities as foreseen in the level 1, the TEG recommends to provide disclosures separately for each environmental objective. This seems reasonable for products offered as environmentally sustainable investments under Article 9 Disclosure Regulation, given that they commit to pursue dedicated environmental objectives and should be measured against them. However, we do not think this should be required for other products.

Our recommendation:

We suggest to require **separate disclosures** for each environmental objective **only for products offered as environmentally sustainable investments under Article 9 Disclosure Regulation**.

Addressing cliff-edge effects

The EU Taxonomy is designed as a dynamic framework, particularly in relation to the transition activities where the criteria are set to be reviewed every 5 years. However, many investments in environmentally sustainable activities will be long-term in nature, potentially beyond the 5-year review clause, creating uncertainty for investors and a potential barrier to such long-term investments.

This issue has rightly been highlighted by the TEG in relation to the EU GBS, where they state that the EU Taxonomy compliance is assessed at the date of issue, regardless of any subsequent changes to the Taxonomy criteria. However, this problem will be also faced in case of corporate bond and equity investments, where the issue of a potential cliff-edge effect has not been taken into account. This is because the EU Taxonomy alignment for such investments is assessed in relation to the revenues, CapEx or OpEx of the company issuing the asset and as such, a grandfathering approach is more complex.

Our recommendation:

We believe that **any changes to the criteria must be consulted on widely and include a long phase-in period** to allow any funds targeting a certain level of EU Taxonomy-compliance to be brought back into compliance with their targets in the event of a criteria change. **More clarity on potential cliff-edge effects will be appreciated.**

Expansion of cross-cutting activities

The TEG concluded that many more sectors and activities should be looked at in the future. They also reminded that even when the EU Taxonomy is finalised, not all sectors will have technical screening criteria as they do not make a substantial contribution. While indeed not all sectors can make a substantial contribution, as it is now the case for buildings, there are other activities that are cross-cutting and should be regarded and included as such. A **consideration could be given to expanding cross-cutting issues to sectors such as transportation and ICT and on adaptation overall.**

Our recommendation:

A consideration could be given to expanding cross-cutting issues to sectors such as transportation and ICT and on adaptation as a whole.

Forestry and real estate

There are many existing environmental standards, both European and international, that can be built on. We would suggest to make greater use of these existing standards not to reinvent the wheel and to swiftly operationalise the EU Taxonomy. This can be particularly helpful in areas where the TEG notes that their proposed solution cannot currently be operationalised because the necessary data doesn't exist. Examples include forestry and real estate. Please refer to the responses by our members BVI and Invesco for specific examples and possible ways forward.

Biofuels

While we understand that the TEG tried to align its recommendations with the EU Green Deal, our members spotted an inconsistency regarding biofuels.

The TEG recommends that only biofuels produced from feedstock listed in Part A of Annex IX of Directive (EU) 2018/2001 would be eligible, omitting Part B which refers to waste from used cooking oil and animal fats. Meanwhile, the latter are frequently used to generate biodiesel that would contribute to the EU Green Deal objective of reducing emissions from transportation. We suggest to consider this while finalizing the screening criteria.

Nuclear energy

We support the TEG recommendation that further work by experts should be done to examine whether nuclear energy should be considered as a taxonomy compliant transitioning activity, given the important contribution of this energy for the transition towards a low-carbon economy. We would like to highlight the importance of following a robust and science-based approach. We would suggest that this evaluation is carried out swiftly and we would welcome clarification about the process.

3. Guidance and support needed

Given the level of complexity of the EU Taxonomy and challenges related to its application especially at the beginning, we suggest to provide as much support as possible to the industry. This could include an **additional guidance** further explaining **how to practically apply the EU Taxonomy and clarifying** expectations in terms of accuracy of the disclosures, especially in the short and mid-term given insufficient availability of ESG data.

We also suggest that **webinars** practically explaining how to use the EU Taxonomy should be organised. An **on-line tool** and a **support line** which market participants could call to get support and clarity if needed would be also very helpful.

4. Platform on Sustainable Finance

We would also like to stress the important role to be played by the **Platform on Sustainable Finance** succeeding the TEG. It is important to ensure its **proper governance, composition** as well as **sufficient resources** so that the platform can properly address the challenges of not only developing the remaining screening criteria but also to be able to do the on-going adjustments based on feedback from market participants. In terms of the composition, the platform should provide for a balanced representation of experts, industry and other stakeholders.

5. Links with EU Ecolabel

The EU Taxonomy is to be used in the context of the EU Ecolabel, criteria of which are currently being developed. The EU Ecolabel directly links the investment criteria to the EU Taxonomy. However, the proposed thresholds, in line with the Taxonomy would result in a too-narrow pool of qualifying investments and funds that are suitable for the retail market. This risks undermining the success of the EU Ecolabel, reducing its capacity to raise funds for the transition, and increases the risks faced by the end-investors. We invite the Commission to consult our [comments](#) on the latest JRC proposals for further details.

We thank the Commission for this opportunity to provide feedback on the roadmap to implement the EU Taxonomy and we look forward to further contributing to a development of a well-balanced and user-friendly EU Taxonomy. We remain available to discuss and provide clarification on our comments and recommendations.
