POSITION PAPER

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Sustainable Finance EU Action Plan: the "Taxonomy" proposal

KEY MESSAGES

1 European industry is at the core of the environmental and energy transformation. Access to investments will be of critical importance to make it successful. The European business community is therefore supportive of the objective of the Sustainable Finance Action Plan to further mobilise investments in the EU in view of achieving sustainable growth, job creation and prosperity.

2 We support the idea of creating a level playing field for so-called "green" financial products and to provide greater clarity to the markets through a more coordinated EU approach. A well-designed taxonomy could contribute to these goals and help to establish a common language for Sustainable Finance.

3 Therefore, the taxonomy should

- harmonise existing standards rather than establishing new standards.
- keep a flexible approach that prevents prescriptive categories which do not take the dynamic evolution of technology into account.
- not lead to additional bureaucratic burden.
- be accompanied by mechanisms that ensure it will not be misused as punitive instrument.

The link between the taxonomy and other EU legislations must be strictly defined in the proposal to avoid future ill-conceived initiatives.

4 We suggest in line with the better regulation principles to have a rigorous discussion with all stakeholders, including representatives from the real economy in order to set up a comprehensive regulation. Main criteria should be clarified in the regulation itself and not in delegated acts. This is essential to set up a balanced and easily applicable taxonomy that will be accepted by market participants.

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I. Mobilising "green" investments for sustainable growth

Environmental degradation is a major challenge that societies and economies across the globe need to address very seriously. There will be hardly any sustainable paths without overcoming these challenges. Meeting Europe's 2030 Climate Goals and Paris Agreement commitments will require huge transformative investments by both the public and private sectors. According to the European Investment Bank, around €180 billion of annual investments will be needed to achieve the EU's climate and energy goals.

European industry is at the core of the environmental and energy transformation. Access to investments will be of critical importance to make it successful. The European business community is therefore supportive of the objective of the 'Sustainable Finance Action Plan' to further mobilise investments in the EU in view of achieving sustainable growth, job creation and prosperity.

To get broad support from the European business community and ultimately to have a greater impact, it is essential that EU initiatives lead to mobilisation of more investments in support of economic, environmental, societal and governance goals, without undermining initiatives that contribute to this end. It is equally important that the scope and nature of actions accommodate the requirements and needs of both the financial markets as well as the real economy. The two are deeply intertwined and approaching them separately risks undermining the objective.

This position paper gives BusinessEurope's views on the European Commission's proposal for a regulation on the establishment of a framework to facilitate sustainable investment i.e. the "Taxonomy" proposal, as this is one of the core legislative instruments of the Action Plan.

II. The "Taxonomy" proposal

The proposal primarily targets the financial market actors (e.g. issuers, banks, pension funds, insurers, etc.). It attempts to increase the transparency and reliability of sustainable investors and investments by offering clearer criteria for these actors to assess whether an investment is environmentally sustainable or not. However, the proposal will also impact the real economy by encouraging investment in certain areas. It is crucial that the proposal facilitates access to finance rather than making it more difficult.

The proposed taxonomy has the potential to contribute to the development of sustainable finance by creating a level playing field for so-called "green" financial products through a more transparent and coordinated EU approach. However, it raises some questions that should be clarified before proposals are progressed. In particular the following critical points must be carefully addressed:

Scope and definition

- There are existing rules and criteria in the EU that define the environmental profiles of products. A new set of criteria targeting the financial sector must (a) add value and (b) be aligned and consistent with existing EU-regulations, that already showed good applicability in practice and (c) should be underpinned by credible scientific evidence and reflect the latest, relevant technological developments.

- There is a lack of coherence in parts of the proposal. For example, whereas the stated aim of the proposal is to set out uniform criteria for determining whether an economic activity is environmentally sustainable and to assess the possible coverage of social aspects only as part of the review clause, social aspects are in fact already covered, including in the criteria.

- While the European Commission's proposal seems to be carefully defined in its scope (i.e. making more transparent and reliable how financial market actors assess and communicate), the risk of (mis)using it as a punitive instrument cannot be underestimated (e.g. prescribing market actors what to invest in, classifying assets or companies and hence basically result in a "negative-list"). It could be particularly harmful if current or future legislative initiatives (e.g. in the areas of disclosure, reporting, risk management, product labelling, corporate governance and company law) are linked to or based on a taxonomy designed under different preconditions. This could lead to potentially ill-conceived initiatives which could have far-reaching consequences on access to finance, bureaucratic burden and additional costs for the real economy.

Methodology and implementation

- The "Taxonomy" proposal intends to define in a very detailed way - first based on general criteria in the regulation itself and subsequently with more detailed and/or quantifiable sub-criteria implemented via delegated acts - what can be considered as so-called "green" or "non-green" activities.

- While it will be in several cases already quite challenging to evaluate the sustainability of a single activity, it will be extremely difficult to assess the degree of environmental sustainability of a given company, as the proposal suggests. Companies often conduct multiple activities with their relative shares being unknown. The results of such an exercise is therefore likely not to be informative, i.e. if the taxonomy does not cover the entire range of company activities.

- Companies do not only engage in different activities but, when it comes to materials' production, several companies can also be part of different steps in the production cycle. For this reason, to be able to compare sustainability performance between companies in the same sector, each step of production must be evaluated.

- It is crucial to keep a flexible approach that prevents prescriptive categories which do not take the dynamic evolution of technology into account. Experience teaches that the innovation rate cannot be entangled in a fixed definition and/or category, especially in fields such as energy production and emission reduction. It is also a huge challenge to capture the extensive range of economic activities, their broad interactions with the environment and the need of an integrated approach that also looks at potential trade-offs and risks-exposure.

- It is questionable if the proposed taxonomy enables to assess the ties of the industrial value chain correctly. For example, “Green products” are made of indispensable raw materials like minerals, metals or chemicals. While life cycle analysis shows the positive impact of such energy- and emission intensively produced raw materials, the proposed taxonomy could lead to misguiding results that the production of raw materials as such may not be sustainable.

- The suggested approach to determine the degree of sustainability is excessively based on the past by taking only former investment decisions into account. Qualitative and future-oriented factors should also be included, such as development or innovation potential.

- It is important to ensure that the taxonomy remains a tool for use when raising new finance for a new activity or a future project. We therefore recommend to include a grandfathering clause. The taxonomy shall not be applicable for already agreed investments to prevent burdensome bureaucratic duties. A classification of existing instruments will clearly not lead to additional sustainable investments and is therefore not necessary.

- The taxonomy should not lead to any direct or indirect additional reporting duties nor disproportionate cost increases as companies already disclose a wide range of information in the scope of their financial and non-financial reporting. This is particularly true for SMEs and midcaps up to 3,000 employees. Due to limited capacities, these companies already have less stringent reporting duties. And it has to be ensured that the lower availability of information to evaluate the environmental sustainability of SMEs and midcaps must not become a barrier for their economic activities to be classified as environmentally sustainable. All in all, the present legislative proposal has to ensure that SMEs and midcaps are not put at a disadvantage and their peculiarities are taken into account.

Governance

- We suggest in line with the better regulation principles to have a rigorous discussion with all stakeholders, including representatives from the real economy in order to set up a comprehensive regulation. This is essential to set up a balanced and easily applicable taxonomy that will be accepted by market participants. The taxonomy should also consider the non-EU regulatory framework addressing any impacts on the EU competitiveness. This process might take more time than the initial approach. All in all, while agreeing with the need for actions, speed should not be at the expense of better regulation principles and quality.

- The process implemented by the European Commission raises some questions. Firstly, concerning the composition of the Technical Expert Group, there is an underrepresentation of the manufacturing. Secondly, very rapid progress has been made with the Technical Expert Group while the co-decision process on the framework regulation is still at a very early stage, without any political guidance from the co-legislators. Thirdly, there is the proposal to legislate via delegated acts the detailed, but crucial, sub-criteria of the taxonomy. This would delegate highly political decisions with very far-reaching impacts on a range of economic actors, such as the classification of energy sources, to purely technical work**.** Therefore, more details of the objectives and criteria have to be clarified in the regulation itself and not via delegated acts.

- The legislative proposal sets out the establishment of a Platform on Sustainable Finance. The role of the members will be to advise the Commission on the technical screening criteria, and the possible need to update those criteria. In view of the objective of the legislative proposal, this platform will need a much better balance between representatives from the real economy, financial sectors, civil society and the public institutional bodies than the initial composition of the technical expert group. In order to come up with applicable and viable criteria, we suggest to add representatives of the manufacturing industries with expertise in environmentally sustainable economic activity. This group shall represent a wide range of industries and account for at least one quarter of the Platform's members.

- Once the taxonomy has been established, further measures of the Action Plan on Sustainable Finance can then be taken. Before a common language has been agreed upon, however, next steps would be premature. The legislative proposals on prospectuses for green bonds, features of benchmarks, and investor duties should only be addressed subsequently in order to guarantee clarity and legal certainty. These measures will only succeed if the classification established is workable and industry-oriented.

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