

Swiss Sustainable Finance consultation response to EU Commission's 1st round climate mitigation activities and Usability of the Taxonomy

1. Introduction and background

On 7 December 2018, the EU Commission published the "1st round climate change mitigation activities". This is the first of the 4 elements outlined within the Commission's legislative proposals of May 2018¹.

The four elements are:

- ***An EU classification system – the so-called taxonomy – to determine whether an economic activity is environmentally sustainable***
- An EU Green Bond Standard
- Benchmarks for low-carbon investment strategies
- Guidance to improve corporate disclosure of climate-related information

The current feedback round is based on the work of the Technical Expert Group on Sustainable Finance (TEG), made up of representatives of organisations, individuals appointed in a personal capacity or representatives of European entities.² The TEG is tasked to recommend by June 2019³ a first list of economic activities delivering substantially on climate change mitigation and adaptation objectives (while not significantly harming any of the other environmental objectives).

For this consultation, the work of the TEG focused on defining a taxonomy to help meet the EU energy and climate targets for 2030, and to transition to a low carbon and more environmentally sustainable economic model. As there are not yet commonly agreed principles and metrics for assessing if economic activities can be considered environmentally sustainable for investment purposes, the EU feels that the redirection of capital towards more sustainable economic activities is hampered. This is due to the fact that investors often find it too burdensome to check and compare different information for different financial products. The published taxonomy is an attempt to address this issue. It identifies climate mitigation activities based on the NACE industrial classification system and produced corresponding "activity sheets" including information on (1) mitigation criteria, (2) do no significant harm assessment and (3) rationale.

The current consultation asks specifically for feedback on:

- 1st round climate mitigation activities and
- Usability of the taxonomy

SSF has drafted a response and is asking for feedback from its members by **Friday, 15 February** in order to be able to incorporate your feedback and meet the EU's deadline of 22 February 2019 cob.

¹ https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

² <http://ec.europa.eu/transparency/regexpert/index.cfm?do=faq.faq&aide=2>

³ The mandate can be extended until December 2019

2. SSF feedback on 1st round climate mitigation activities

SSF refrains from giving feedback to this point as the feedback must be specific to the various selected NACE Macro sectors chosen within the first sub-set of “economic activities expected to make a substantial contribution to climate mitigation under the EU Commission’s Taxonomy proposal”. SSF does not represent the listed Macro Sectors and therefore does not have any expertise on individual sectors and associated rationales. Instead, it has the expertise to judge if the taxonomy can be utilized by the financial industry.

We encourage those members with expertise in the individual activities to directly provide feedback to the EU Commission.

3. SSF feedback on Usability of the Taxonomy

Below are SSF’s responses to the consultation on the usability of the taxonomy. Responses per question are limited to 2000 characters (including spaces).

1. **Referring to the Activity Sheets, do you believe the Taxonomy will provide a clear indication of what economic activities should be considered environmentally sustainable? [YES/NO/DON’T KNOW]. Please explain your answer. Response limited to 2000 characters.**

SSF response: NO

- Although it may be clear as to what exact activities should be considered environmentally sustainable, it is unclear what is meant by “Activity”. Do users of the taxonomy need to link this to sale of products and services? In the “Spotlight on Taxonomy” example we see the term TO (turnover) used within the illustrated portfolios. In order for the Taxonomy to be used coherently, it should better define where investors are expected to look within the balance sheet or financial statements in order to assess what % of a company/investment can be considered EU taxonomy compliant.

2. **Do you expect any practical challenges within your organisation to classify an economic activity according to the taxonomy? [YES/NO/DON’T KNOW]. Please explain your answer. Response limited to 2000 characters.**

SSF Response: YES

- In the context of investments, practical challenges will be met when trying to assess the share of a green activity of a single company, as companies do not usually report on their activities in such detail.
- Practical challenges will further be met when dealing with SME and small loans. The consumers of these loans normally do not have the resources or capability to report on the level suggested in the taxonomy. Therefore the burden lies with the lending company.

3. **For financial market participants: will the proposed structure and format of the Taxonomy enable you to comply with potential future disclosure obligations? [YES/NO/DON’T KNOW]. If not, what changes would you propose? Response limited to 2000 characters.**

SSF response: DON’T KNOW

- We feel that the structure and format of the Taxonomy will enable market players to comply with potential future disclosure obligations ONLY IF the data is provided from investee companies. Generally, it will be challenging to find a reasonable form of aggregation to a total share of green activities of a

portfolio, due to the different nature of the positive contribution and level of environmental sustainability. The TEG may need to consider creating different categories also within activities to help investors determine also the level of “greenness”. Using the example sheet: Energy Production (Geothermal), it would also be relevant to know, not just those companies that meet the threshold of 125gCO₂e/kwh, but also if portfolios contain companies that achieve a far better efficiency due to innovative, state-of-the art techniques.

- In addition, the NACE may be comprehensive in its coverage of the EU Economy, but the financial industry often operates on a global level. Therefore, it may be helpful to financial players, if the TEG also aligned the taxonomy to other widely used international classification systems, such as ICB or GICS. This may be in the form of a mapping of classifications available to all users.

4. Is the proposed taxonomy approach sufficiently clear and usable for investment purposes? [YES/NO/DON'T KNOW]. If not, what changes would you propose? Response limited to 2000 characters.

SSF response: NO

- There industry is faced with a lack of data due to limited reporting on the share of activities by investee companies.
- Investors invest globally, but the taxonomy will, at most, be mandatory for European companies. We see that issues can arise when aggregating data over a global portfolio.
- It is unclear from the example in the document “Spotlight on Taxonomy” how “green” a fund must be in order to achieve the green label. Will products that achieve only a very low “green” level (i.e. less than 15%) also have the use of the label?

5. Would the use of the taxonomy require any additional resources (for example in human resources or information technology)? [YES/NO/DON'T KNOW]. If yes, please specify and if possible, give an indication of the expected costs (e.g. as a % of turnover or operating costs). Response limited to 2000 characters.

SSF response: YES

- In general, investors will need additional resources to be able to gain and aggregate the information on green activities of their investee companies. SSF has heard feedback particularly from market players with a lending business that they will need to invest more resources in collecting data from small lenders if they want to identify areas that are EU Taxonomy compliant. For banks, assuming clients can actually deliver data aligned with EU Taxonomy, there is still a need to analyse data. If clients are very small, investors would likely need to invest additional resources to help investees/borrowers consistently report the necessary data.

6. Please provide any additional comments on the design and/or usability of the taxonomy, including proposals for improvement. Response limited to 2000 characters.

SSF response:

- SSF commends the work of the TEG, which it sees as a necessary starting point to help bring clarity, transparency and accountability to the field of sustainable finance, especially to help products become more comparable and understandable for end investors.
- We do however feel that the limitations of the approach must be made transparent to end consumers. These limitations include:
 - The need to constantly update the taxonomy based on new innovative technologies being developed while existing solutions might no longer be considered environmentally sustainable.

Therefore, at any given time-point, the taxonomy might be out of date compared to technological developments.

- Not considering the very negative companies within portfolios may lead to the case of having two very similar portfolios with regard to the EU taxonomy compliant activities, however, they may differ dramatically with respect to the non EU taxonomy compliant activities.
- The label or “green” calculation is based on ex-post data (i.e. year-end data provided in annual reports). If company activities change during the year (i.e. sale of coal operations, purchase of renewable energy plant), it can be that the distribution of green vs. non- green is slightly different in the portfolio than reported.
- The taxonomy is focused on specific products and activities contributing to environmental sustainability and improvement of production processes in high emitting sectors. In order to achieve a low carbon economy, it is equally important that companies of all sectors improve their environmental sustainability in their production process and product development, be it based on circular economy approaches or increasing energy efficiency. This aspect is currently not covered in the taxonomy and we consider it important to complement this in a future version. Therefore it should be communicated to users that this current EU Taxonomy is not an exhaustive and exclusive classification system for sustainable finance.

4. Further information

Links to important documents

Documents linked to the consultation can be found at: https://ec.europa.eu/info/publications/sustainable-finance-taxonomy_en

- Technical expert group on sustainable finance: Taxonomy pack for feedback and workshops invitations: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-feedback-and-workshops_en.pdf
- Technical expert group on sustainable finance: Spotlight on taxonomy: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-spotlight_en.pdf

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