

# EU SUSTAINABLE FINANCE TAXONOMY IMPLEMENTATION

## 1. The EU sustainable finance policy agenda

### 1.1 Sustainable Finance at the forefront of the policy agenda

A policy decision maker remarked that the delegated act regarding the taxonomy is expected to appear within weeks and proposals on the Non-Financial Reporting Directive are also expected.

A policymaker stated that back in 2018, when the first action plan on sustainable finance was submitted, the subject was somewhat exotic and marginal. Three years later, it is at the centre of the debate and at the heart of the European and global financial system reforms.

### 1.2 The EU sustainable taxonomy is a bedrock of the EU sustainable finance policy

A policymaker noted that the EU taxonomy is at the heart of the proposed reforms. It is a classification system for environmentally sustainable economic activities. The desire is to create a trustworthy tool that helps to translate environmental objectives into clear criteria for investment purposes, and to define which activities are in line with the 2050 net neutrality objective. Sustainable activities are explained, so investors can be guided if they want to invest green and sustainably. The other goal of the taxonomy is to give guidance regarding the journey to sustainable economies. The policymaker (Marcel Haag) stated that while firms and the financial sector must transition, they cannot do so all at once. The move is from less sustainable to more sustainable.

### 1.3 Complementary legislative pieces and the renewing of the EU sustainable finance strategy

A policymaker explained that the intention is to submit the (first) delegated act on the Taxonomy later in April. There is also work on the data challenges. A review of the Non-Financial Reporting Directive will be submitted before the summer. Another delegated act on the taxonomy-related information companies will have to publish will be submitted. How to consolidate and further develop the Sustainable Finance Framework will also be considered. The intention is for a renewed sustainable finance strategy to be submitted before the summer.

A policymaker stated that the desire is to converge towards the taxonomy. The European Parliament and the Commission have a very important job, and a great deal of power in defining where a large amount of investment is going to go in the next few years. They must continue to be as rigorous as they have been because that will become the standard globally.

### 1.4 Making consistent green bond principles with the EU taxonomy is also necessary to further foster sustainable investment

A policymaker stated that the Commission is joining the ICMA Green Bond Principles, but given the programme is structural the taxonomy is something to converge with. The sooner the delegated acts are published and the clearer and more user friendly the taxonomy is, the

easier it will be for sovereign issuers and sub-sovereign issuers to engage in this investment.

### 1.5 Investor protection is essential for sustainable finance to succeed

A regulator emphasised that the tool must be powerful enough to protect investors from greenwashing. Were there to be an accident involving inappropriate use of green labels, trust may disappear very rapidly.

### 1.6 EU public institutions are on track

A regulator confirmed that there are real challenges. At the European level, thanks to the European Parliament, the Commission and the EU Council of Ministers, agreements at level one and to some extent level two, have been reached for a rather comprehensive framework, which is very ambitious. It is the most comprehensive framework existing worldwide, supported by all co-legislators on a consensus basis.

### 1.7 Challenges faced by the definition of the regulation

A regulator warned that however the devil is in the detail. Regarding implementation challenges, the framework at the European level is very impressive. At the legislative level two, the choices made at level one, must be implemented. Each member state needs to be on board. In his jurisdiction, appropriate external communication was launched. Sustainable finance at the European level there is a step-by-step approach and attention also must be paid to avoiding a one-size-fits-all approach.

### 1.8 Pragmatism is required to combine the EU and global sustainable finance agendas

A regulator stated that, on the link with the worldwide agenda, when the discussion at the International Organization of Securities Commissions (IOSCO) level started regarding non-financial information standards, it was asked who needed to be in the first line and the answer was the International Financial Reporting Standards Foundation. They have experience with due process as well as technical legitimacy and can address the agenda.

A very ambitious but prudent agenda is being set up by the Commission. There will not be competition between Europe and the global agenda. However, the speed may not be the same.

In addition, EU political decision makers are paying attention to the social aspect and human rights dimension. The starting point at the worldwide level is the classical aspect relating to sustainable finance. At the end of March 2021, the Financial Stability Board (FSB) stressed that it welcomed the steps being taken by the trustees of the International Financial Reporting Standards (IFRS) Foundation, supported by IOSCO, to accelerate convergence in sustainability reporting. It must be understood who is best placed to come with additional regulation. For some aspects it will be the Europeans. For some extensions it could be at national

level. For other aspects, finding consensus will require a opting for a building block approach. Europe cannot achieve the green transition alone.

## 2. Key success factors of the EU taxonomy

### 2.1 To be conducive to transition the taxonomy must evolve continuously

An industry representative stated that the obvious goal is net zero, and protecting the environment, the climate, and the planet. Europe is leading now and will continue to lead with regard to this challenge. However, certification of the taxonomy must be based on transition. Companies that are at present brown but have every intention to become green need to get exposure to capital to fund that transition. If this transition is not managed properly and effectively, incumbent companies that have every intention of being part of the solution could be stifled, which would be cataclysmic. Europe can also export the technologies, the skills, and the services.

A policymaker stated that the taxonomy already provides for transitional activities. The feedback on the delegated act indicated that more clarity is necessary, along with more sophistication when it comes to transitional activities.

However, more can be done to support companies on this transition, and the expert platform on sustainable finance has been asked to help develop the transition framework further.

An industry representative noted that the taxonomy gives the targets but it is not a tool for transition. He explained that they have developed a an internal tool to assess the transition of clients through a kind of colour or rating on the way the company is organising and progressing on its transition to the net zero target. However, this tool is not taxonomy compatible as it is a tool while the taxonomy gives the landing zone.

### 2.2 Implementing the taxonomy is a huge challenge which requires gathering beforehand some key success factors which will prevent any taxonomy-washing

An industry representative suggested that Europe should leverage the work on the taxonomy and come to the implementation phase as soon as possible, while maintaining the consistency of the taxonomy, including its science-based foundation.

There are important caveats for starting the implementation. There is the data issue, as was mentioned. To apply the taxonomy first, at the company level, a granular analysis of each activity is needed, in a context where the data to perform this analysis is hardly available. Thus, the conditions for a safe implementation must be thought about. This includes starting quickly to benefit from the learning curve as the implementation of the taxonomy will take time. In parallel it is necessary to build what is missing in terms of reporting tools, guidelines, completing the taxonomy, etc. There should be a transition period where companies can test, so when eventually official numbers are disclosed, they

are actually reliable. Otherwise, publishing unreliable numbers could lead to what could be called taxonomy washing.

## 3. Sustainability data stakes, challenges, and success factors

### 3.1 Transparency is a precondition to accessing funding, cheaper funding

An industry representative noted that what works everywhere in the world is data transparency, to the extent good and granular data can be used to provide comparability. The interest an entity has can completely change the dynamic of the conversation related to sustainable finance.

An industry representative stated that there is the underlying issue that for the issuer, equity or debt, there is a prize for being on the right side versus a stick for being on the wrong side of the taxonomy, namely access to funding and to cheaper funding. That provides a reason to disclose more, better, and clearer data but also an incentive to manipulate data for the best numbers possible. It is therefore important for investors in these businesses to have some level of standardisation and accountability on the information being provided. If Europe does not get this disclosure part right with auditable, standardised data at corporate issuer level, then the risk is that, as this topic flows out of Europe, control will be lost over what is material.

### 3.2 Aligning bank reporting with the EU taxonomy is prevented by SMEs not reporting such information

An industry representative favoured taking a progressive approach, because there is a 'big wall' to contend with: the green asset ratio.<sup>1</sup> Currently it is only a 'wall' because the data is not there to assess the size of the green part of the outstanding of the bank. According to the EBA, the data from SMEs should be included in the reporting of the bank, but SMEs have no regulatory obligation to publish the information regarding the alignment of their activities with the taxonomy.

The taxonomy is not a tool for supporting, encouraging, and recognising the transition to a low carbon economy. The risk is not being seen as the pioneer of sustainable finance in Europe, and instead being the bad student of sustainable finance in the world due to not being able to issue the right level of green outstanding. The way the taxonomy is designed is somewhat opposed to how companies are financed. The taxonomy has an activity approach, while banks assess their counterparties by considering the company rather than the various activities it encompasses.

### 3.3 Technical and regulatory requisites for producing much-needed data

An industry representative stated that a key success factor is creating an EU data repository for SMEs. On the other side is leveraging technology much more. The problem lacks borders, so there is a need for a common perspective. Artificial intelligence and machine learning can do much to support the needs of the financial

1.The Green Asset Ratio (GAR) shows the proportion of assets that are environmentally sustainable (Green Asset) used to identify whether banks are financing sustainable activities. The GAR is based on the EU Sustainable Finance Taxonomy and is "Paris agreement" aligned.

industry in meeting the objectives. This can make for a much more global approach. Without a global approach the level of financing will be reduced. If the level of financing for the transition is reduced it will never be possible to get to where is needed.

An industry representative remarked that both data accessibility and the numeric format are important, and hence probably a European single access point (ESAP) also. There are many data requirements. The role of the non-financial reporting standard should be to define this data or make precise the data already required.

#### **4. The ever-growing demand of investors regarding ESG information globally**

##### **4.1 Investors and asset managers have increasing expectations regarding EGS information although reliability and comparability of data remains challenging**

An industry representative noted that their firm has been able to go out to financial institutions, particularly asset owners and asset managers. On a global basis, 75% really want to use environmental, social and governance (ESG) criteria, integrating these factors in their investment decisions. This is very positive compared to the current number. However, regarding securities investments, the comparability, and reliability of ESG data are real issues to be addressed.

A regulator stated that one challenge is how to go from many interesting initiatives and self-regulation to regulation. There are many labels in all jurisdictions. Usually, they are very successful, but they are very fragmented. EU investors should not have the impression that the labels on financial products, which are usually self-regulated, are not interesting or that there is no capacity to believe in the sustainable aspect of them.

It must be very clearly stated, especially from the European side, that the taxonomy, if developed in isolation, could lead to greater fragmentation of practices, and could even inhibit the growth of global sustainable finance. What is needed is one standard that considers some specificities at a regional level.

##### **4.2 The priority focus may differ across regions in the world, which raises consistency issues**

An industry representative stated that Europe is much more advanced than any other region on ESG, particularly on the climate agenda. In the US there would be more discussions about E and S. In Asia it is probably more on the Social and Corporate Governance aspects.

A consistent theme is the need to make things simple. Europe can be at the forefront of any conversation on this topic because of the splendid work that has been done so far. Maintaining that science-based approach and the simplification for looking at the taxonomy would probably be best for maximising the results in terms of international co-ordination.

An industry representative stated that Europe's leadership in net zero targeting is exciting. Key to European success is that European investors want financial security, but also with a strong element of sustainability. Europe has created a regulatory framework and is putting the taxonomy as the basis of certification. An industry representative (Hideaki Takase)

appreciated that much progress has been made by the EU, which is a frontrunner in the discussion. To achieve the goal the global economy must work together.

The new prime minister of Japan declared that the country aims to achieve net zero by 2050. The banking industry and companies in Japan need to work together to contribute to that target. Multiple taxonomy frameworks complicate bank operations across multiple jurisdictions. Investment in the green area is important, but more important is the necessity of the transition from high-emitting sectors to more sustainable and energy efficient solutions.

The question is how to leverage the EU taxonomy, adding the global context and creating a consistent framework. A good example of global co-ordination is the International Platform on Sustainable Finance (IPSF). Many companies from the private sector joined this body to discuss how to coordinate. Due to new technologies and ongoing business, the taxonomy needs to be dynamic and flexible, not a static framework.

#### **5. Challenges posed by the global convergence of sustainable finance standards**

##### **5.1 The current European leadership should benefit from the involvement of the EU in several international fora**

A policymaker stated that Europe has a chance to remain a leader in sustainable finance. The priority is to do what it has been committed to and to do it right. There is engagement internationally in several fora. The G20 has started a working group on sustainable finance that will be led by the US and China. There is the G7, COP26 and so forth. There is no contradiction between having an ambitious European agenda and the international conversation. Efforts must be made to align internationally and then allow for regions and nations to go beyond the internationally agreed standards.

##### **5.2 An effective transition toward economic sustainability should not be watered down by seeking convergence at the global level**

An industry representative stated that as the leader in this area the EU should not leave everyone behind. This is a global standard and a very important global challenge. The hope is that good global coordination will accelerate.

However, a policymaker believed that the world will converge towards where it sees more rigour, and the taxonomy has the potential to provide that. 'Rigour' is not something static, but a mutually exclusive, collectively exhaustive list of differently classified activities with a dynamic sense. This is very similar to what is happening with data protection. The regulatory power of Europe can attract others because it is seen as more rigorous. Ambition should not be lost. It can be designed to be more user friendly, and with non-financial disclosures it can be made possible for small and medium-sized enterprises (SME) to provide data, but it should not be less rigorous for the sake of universality.