

## EUROPEANISSUERS POSITION ON THE COMMISSION PROPOSALS REGARDING SUSTAINABLE FINANCE

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### SUMMARY

The publication of the action plan for sustainable finance is a **landmark** in EU policy regarding ESG issues and climate change mitigation and adaptation.

**The challenge is not to make finance greener but to bring about a greener economy.** Banks and investors should provide financing resources **to support companies in their transition process rather than implement exclusion strategies.**

Therefore, companies call on the European Union to establish a framework which will enable progress on reporting regarding environmental topics and, more generally, non-financial issues **whilst creating the conditions for a constructive and balanced dialogue between investors and corporates.**

The Commission has published, in May 2018, three proposals for regulations currently discussed by the Parliament and the Council:

- The proposal for a regulation on the establishment of a framework to facilitate sustainable investment, also defined as the taxonomy regulation proposal<sup>1</sup> (the **Taxonomy Proposal**);
- The proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive EU 2016/2341<sup>2</sup> (the **Disclosure Proposal**);
- The proposal for a regulation amending regulation EU 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks<sup>3</sup> (the **Benchmarks Proposal**).

**EuropeanIssuers** has examined the three legislative proposals, focusing on the Taxonomy Proposal, and the reports and draft reports of the European Parliament and has taken the following position.

EuropeanIssuers follows also closely the work of the Technical Expert Group (TEG) on Sustainable Finance established by the Commission to provide input and share experience of companies. In this regard, EuropeanIssuers has commented on the report of the TEG sub-group on climate related disclosures insisting on the voluntary nature of the NFRD guidelines and the necessary convergence with internationally recognised standards such as ISO 14 064-1 on greenhouse gases reporting. A specific paper in view of the update of the NFRD guidelines is currently under preparation.

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<sup>1</sup> (COM(2018) 353)

<sup>2</sup> (COM(2018)354)

<sup>3</sup> (COM(2018)355)

## 1. Position on the Taxonomy Regulation

### 1.1 On the Commission Proposal

- **A better balance between level 1 requirements and level 2 forthcoming measures**
  - EuropeanIssuers considers that the process implemented by the Commission regarding Taxonomy and consisting of starting the work on level 2 measures before level 1 legislation is adopted, is very unusual and bears the risk of confusion regarding the hierarchy of norms.
  - The taxonomy can potentially have significant structuring impacts on the financing of the economy and of companies. Therefore, a better balance should be struck between level 1 and level 2 in order to ensure a transparent and democratic process in the definition of the taxonomy. In addition, the current process for drafting level 2 measures gives a disproportionate influence to the Technical Expert Group appointed by the Commission, where only two non-financial companies are represented. We believe that the taxonomy regulation should include more detailed methodologies or conditions in order to better frame the definition of the technical screening criteria to be developed by the Technical Expert Group.
  - The review clause contained in Article 17 should also concern these methodologies or conditions to ensure that the regulation can take into account the development of new technologies (e.g. low carbon technologies) and to be able to improve the technical criteria determination process, if deemed necessary.
- **Need for a clarification of the definition of “environmentally sustainable activities”:**
  - The definition of environmentally sustainable activities is key; it is of utmost importance not to exclude economic activities *per se*, but to analyse among each activity what are the best practices in terms of environment performance, taking examples on the benchmarks that were established for the EU greenhouse gases trading scheme (EU ETS Directive).
  - An economic activity is not necessarily “green” or “brown,” but the technologies used by companies belonging to this activity can be more or less environmentally efficient.
  - Therefore, it is important to establish an assessment not only at activity level, based on NACE and/or PRODCOM classification, but also on real performance indicators and possibly benchmarks at company level or even installation level, as it has been done with the EU ETS Directive.
  - When using technical screening criteria, the level of granularity to assess environmental performance should be better defined in the proposal for regulation. This would avoid a situation where an activity would not be qualified as environmentally sustainable while a company, active in this activity, does actually use environmentally sustainable technologies and would therefore be able to qualify as environmentally sustainable.

- **Integrate a forward-looking approach to enable “brown” activities to become environmentally sustainable activities:**
  - The major objective of sustainable finance is to enhance a transformation from “brown” to “green” activities in a continuous way.
  - Enhancing finance on already environmentally sustainable activities is interesting but will not reach the goal of transforming our economy towards greener activities.
  - Therefore, it is important to allow activities that are presently “brown,” but which can prove they plan environmentally sustainable investments to qualify for sustainable finance.
- **Integrate non-financial companies in the sustainable finance platform:**
  - It is key to enable the participation in balanced proportion of European non-financial companies in the sustainable platform so as to ensure that environmentally sustainable solutions can be conceived and/or handled by those companies in order to create a positive dynamic for the European economy.

## 1.2 Comments on the Parliament’s draft report

**EuropeanIssuers supports the amendments** to the Commission proposal aimed at:

- **Integrating a forward-looking approach** to enhance a transformation from “brown” to “green” activities in a continuous way.
- **Improving the functioning of the future platform on sustainable finance** (notification by the Commission of the request addressed by financial market participants for the use of the criteria). The review of technical screening criteria should be sufficiently frequent in order to integrate new available technologies. The conclusion **of the platform’s analysis regarding requests from stakeholders** should be made public and the platform should **carry out public consultations to gather views from all concerned stakeholders**.
- **Enabling the participation in balanced proportion of European non-financial companies in the sustainable platform** so as to ensure that environmentally sustainable solutions can be conceived and/or handled by those companies in order to create a positive dynamic for the European economy. Experts in the field of socially sustainable investment or from trade unions should not be represented as the taxonomy should not tackle social aspects at this stage.

**On the opposite, EuropeanIssuers is not in favour of:**

- **An extension of the scope of the proposal.** In line with the objectives of the Commission, the taxonomy should be applied only to financial products labelled or marketed as sustainable and to financial market participants offering these products. EuropeanIssuers is opposed to any scope extension and in particular to the application of the taxonomy to activities considered “harmful to the environment” and to the creation of a brown category: this could be counterproductive and will not foster implementation of transition strategies. Also, **the taxonomy should not apply to investee companies**.

- In addition, the taxonomy **should not yet seek to tackle the social impact of investments**. EuropeanIssuers supports article 13 provisions about minimum social safeguards, which ensure that all economic activities deemed environmentally sustainable have to be carried out complying with these safeguards. However, **it would be premature to include social criteria** immediately in the taxonomy. The social pillar of sustainable finance will require in-depth analysis and the identification of appropriate indicators, which can gather consensus. Therefore, it should not be rushed through.
- Requiring, at this stage, **third party verification of compliance** with the regulation. Such a requirement would be extremely burdensome and generate additional costs.
- Including in the proposal provisions regarding companies' **due diligence along the supply chain**.

## 2. Position on the Disclosure Proposal

The Commission proposal applies to financial market participants (insurance intermediaries which provide insurance advice with regard to Insurance based investment product, investment firms which provide investment advice, AIFM, UCITS management companies, managers of qualifying venture capital funds and qualifying social entrepreneurship funds) and requires the **integration of sustainability risks in investment decision-making processes or advisory processes** as well as the transparency of financial products that have, as targets, sustainable investments including the reduction in carbon emissions.

The Parliament adopted its report in November 2018 and the Council its general approach in December 2018. This file is now being discussed in trialogue and, in this regard:

- **EuropeanIssuers disagrees with the extension of the scope of market participants to investee companies.**
- Furthermore, the Parliament and the Council have introduced, in the definition of sustainable investments, a reference to the implementation by the investee companies of good governance practices, and in particular the existence of sound and transparent management structures and due diligence procedures, employee relations, transparent remuneration policies of relevant staff, and to tax compliance.

**EuropeanIssuers disagrees with these amendments.** The priorities should be, as put forward by the Commission, environmental and climate-related issues. Extending the scope and adding more conditions will complexify the regime, ultimately rendering it ineffective when there is climate emergency.

- EuropeanIssuers considers that the opportunity to lay down a definition of sustainability risks in a level 1 legislation should be carefully assessed. Especially, the interaction and the impact of the definition on other pieces of EU legislation where disclosures on risks are required should be examined.
- **EuropeanIssuers opposes the extension to listed and non-listed companies of the disclosure requirement in periodical reports** of sustainability risks and performance of investments. Information regarding sustainability performance and risks should be dealt with through the NFRD – and taking into account the outcome of the Fitness Check on public corporate reporting – and not in this proposal. Including such information in the financial statements and, in particular, in consolidated financial statements established under IFRS would be inappropriate.

### 3. Position on the Benchmarks Proposal

The aim of this proposal is to **enhance the transparency of ESG benchmark methodologies** and to put forward standards for the methodology of low-carbon benchmarks in the Union. The Commission proposal introduces in the Benchmark Regulation<sup>4</sup> the definition of low carbon and positive carbon impact benchmarks. The methodologies for these benchmarks will be established through delegated acts.

The Council and Parliament adopted their negotiating positions in December 2018 and the file is now being discussed in dialogue. In this regard:

- EuropeanIssuers considers that both **a definition of what alignment with the Paris Agreement means and an assessment of the main provisions of the draft report should be set up.**
- The Parliament introduces the obligation for benchmark providers and for their significant equity and bond benchmarks to publish a detailed benchmark statement on whether or not and to what extent an overall degree of alignment with the target of reducing carbon emissions and/or attaining the goals of the Paris Climate Agreement is ensured. By 1 January 2020, the Commission shall, based on an impact assessment, assess how it is possible to include for all benchmarks or families of benchmarks in the benchmark statement, a detailed explanation of how the target of the carbon emission and/or attaining the goals of the Paris Climate Agreement is ensured.

**EuropeanIssuers is opposed to this amendment.** The requirements mentioned above should be limited to benchmarks marketed as pursuing or taking into account ESG or climate objectives. Whilst we agree that ESG or climate benchmarks are needed and can be useful, all benchmarks should not take these factors into consideration. Corporates and financial markets participants need benchmarks that are not ESG-focused (monetary benchmarks for instance).

The Council and the Parliament have also both introduced a provision to **postpone the deadline for critical benchmarks to comply with the Benchmark Regulation** until 31 December 2021. **We support this amendment** to the Commission proposal but consider that a similar provision should be introduced for **third country benchmarks.**

Under the Benchmarks Regulation (BMR), 3rd country benchmarks administrators have until 31 December 2019 to have their benchmarks qualified for use in the EU via 3 routes namely: (i) equivalence, (ii) recognition and (iii) endorsement. Yet, the 3 routes appear to be impracticable and, as of today, no third country benchmark is present on ESMA's Register of qualified benchmarks. Given the significant use of third country benchmarks by a wide range of EU market participants, it is essential to extend the existing BMR transition period by 2 years for third country benchmarks. This extra time would allow the Commission to assess equivalence of currently pending 3<sup>rd</sup> country frameworks, EU policymakers to agree on changes to the 'recognition' process and a potential review of the scope of a regulation that is mostly intended for critical benchmarks.

In case BMR transition period is not extended for third country benchmarks, there would be severe consequences for EU market participants relying on these indices for lending to third countries including developing economies, hedging, accessing liquidity and capital in other currencies and for pure financial investment purposes. European firms act as contributors to third country benchmarks. In fact, firms and individuals would be denied access to financial instruments and contracts referencing third country benchmarks (derivatives, loans, bonds and mortgages) leading to liquidity, market access and contractual

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<sup>4</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016

issues in EU markets. Moreover, the cumulative size of trades underpinned by third country benchmarks which are not going to be qualified for use in the EU (currently impossible to estimate) may as well create potential financial stability concerns.

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