Brussels, 31 August 2018

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EBF position paper on the European Commission proposal for a Regulation on the establishment of a framework to facilitate sustainable investment

Key points:

The EBF supports the Commission's legislative proposals on sustainable finance based on its Action Plan for Financing Sustainable Growth[1]. We welcome the choice of Regulation as the legislative vehicle for delivering these results. Establishing the key definitions that will shape our understanding of what is a sustainable economic activity and the steps that should logically follow need to happen within both a global context and the legal framework of an appropriate harmonization process at EU level.

The major issues that we would like to highlight are:

- It is essential that the Commission defines and bolsters sustainable finance as part of the Capital Markets Union and takes into consideration banks' voice given their valuable role in the investment and financing process.
- Sustainable finance, as referenced in the Commission's Action Plan appears a wider term than Sustainable Investment when thinking about a taxonomy that will embrace economic activities based on investment and lending. We understand that the current focus on sustainable 'investment' aims to inform investors' decision-making, although it risks being interpreted as more limited in scope than the

[1] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the establishment of a framework to facilitate sustainable investment (COM (2018) 353 final);
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (COM (2018) 354 final); and
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (COM (2028) 355 final).

Commission may have in mind, taking into account the broad definition given to Sustainable Finance in the first place.

- Given the role of banks on sustainable finance, we take the view that the banking sector should be much more involved than has been the case so far in the process of development of the taxonomy, ensuring to include all stakeholders.
- We would favour the extension of the scope of the Regulation to cover other sustainability objectives, in particular social objectives from the earliest possible stage subject to the availability of reliable data. Broadening the scope from the inception of the taxonomy would ensure avoiding risks of efficiency losses, as internal models of Financial Institutions would need to be adapted every time a change is adopted. However, we support the progressive approach on the broadening of the scope as to recognise the urgency of environmental and climate issues, including the support to those not-yet sustainable activities in their transition.
- We would also recommend not to commence the work on social (and governance) issues at a too late stage as social issues are also critical if we are to have a holistic approach to sustainable finance from the outset.
- Besides being open to regular updates in response to market evolutions and stakeholders' needs, the Taxonomy should be open to the possibility of being updated or to abide by a different (and better) set of rules subject to appropriate governance of the validation of such better set of rules. We believe that the proposals for regulation should elaborate on existing market practices where possible. Many of the existing market practices tap into the same sustainability data providers, which has contributed to some amount of consolidation in terms of what these taxonomies or sustainability frameworks look like. For an EU taxonomy to fit, an analysis of a shared common ground in existing market practices could benefit our common goals.

In light of the European Parliament Draft Report on disclosures relating to sustainable investments and sustainability risks[2], we would like to clarify the following issues when discussing the implications of mandatory disclosure against the framework:

- The Taxonomy should have sustainable finance and economic activities as its scope. Credit and lending activities are key to the financing of the economy, so the framework should be open to be used by banks in all their activities (e.g. using the Taxonomy as a reference when it comes to the definition of the high level credit allocation policies), while not becoming compulsory in its application. Credit institutions should only be in scope of the disclosures proposalwhen offering financial products as environmentally sustainable investments or related advisory services. This is the original approach of the Commission that we support, but having now the European Parliament report on the table, which includes credit institutions in Article 2 of the proposal, our request to consider the importance of other banking business in the taxonomy could be

2 European Parliament Draft Report on the proposal for a regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

misunderstood. The regulation of disclosures for banks should be done in a separate package, not in the disclosures regulation which is focused on the investment side.

General remarks:

The role of Banks

There is an increasing level of awareness within banks and other credit institutions of the need for a credible harmonised taxonomy for sustainable finance / investment as a pre-requisite for market expansion and the introduction of a governing legislative framework

Banks play an important intermediary role in the economy, they match the demand for capital with the supply, and in that sense, play a big role in achieving the objectives of sustainable finance, because they are crucial to the overall economy in terms of:

- Lending to companies
- Lending and microlending to households
- Lending and microlending to projects
- Partnering with MDBs
- Issuing bonds in their own name (which in turn generates sources of financing on their balance sheet), including green bonds
- Underwriting and placing companies' bonds and equities, and ensuring secondary market liquidity of such securities by holding inventories on their balance sheets.
- Providing hedging and risk mitigation solutions to clients and investors (e.g. instruments on indices, foreign exchange and derivatives instruments transactions).
- Executing trades with or on behalf of private investors
- Giving investment advice to clients
- Channelling investors' funds to productive and sustainable investments
- Granting guarantees to facilitate green investment and trade

The draft regulation focuses on 'investment', as investment funds, insurers, pension funds and asset managers use the taxonomy to inform their decision-making. Banks act as investment intermediaries as well as undertaking other financing and related activities as exemplified above, and as such should make sure that their sustainable offerings to clients meet the taxonomy requirements. This taxonomy, therefore, also concerns banks about bank financing, which also include other activities besides investment intermediation that should be properly considered, avoiding possible unintended consequences. As such, banks must have a say in the taxonomy detailed criteria.

Since banks provide around 80% of the total financing of the European economy, whereas the rest is provided by a varied mix of investors and institutions, it is essential that banking products are given due consideration when establishing the taxonomy.

However, it is important to note that said framework towards a more sustainable finance impacts the European economy in its entirety.

Structure of this paper

This paper is structured according to three key areas in which we recommend attention from the Commission in order to foster and accomplish the goals envisaged with the proposal:

1. The role of the banking sector in sustainable finance. 'Sustainable finance' needs to be defined first. We need a framework that supports sustainability in the sense of a type of economic growth that has a reduced and controlled impact on the environment in terms of CO_2 emissions, pollution and environmental degradation, on top of having beneficial environmental, social and governance implications, or transition towards the aforementioned growth.
2. The acknowledgment of the differences between the 'sustainable finance' and 'sustainable investment' concepts and their respective implications in the outputs of the work to be conducted going forward, including ESG considerations, and acknowledging the importance of a common language; and
3. Practical concerns with the definition of sustainable (focusing on the *Chapter* I on *Subject matter, scope and definitions* and in *Chapter II* on *Environmentally sustainable economic activities* of the proposal on the establishment of a framework to facilitate sustainable investment).

We believe that the Commission's proposals are forward-looking in their approach and cover much ground in an unprecedented way, considering the work of any other legislator or regulator so far. However, it is critical to take into consideration banks' perspective in terms of engagement with all financial markets stakeholders that are investing in sustainable finance. This would ensure that the approach is all-encompassing and all views and levels of expertise are taken into account for achieving a positive impact framework that truly engages and finances sustainable growth.

We would be pleased to work with the Commission on the scope of the regulation on taxonomy, benchmark and disclosure, thus involving the banking sector in a way that can provide a wider reflection and contribute to a comprehensive analysis of such crucial items, considering banks' role, experience and core knowledge of multiple stakeholders.

1. The role of the banking sector in sustainable finance

The banking sector plays a crucial role of utmost importance in the EU financial system[3]. The European Commission States that the EU financial system is in need of additional financing to tackle the estimated investment gap of roughly €700 bn per year, and especially to bridge the inherent sustainability gap totalling €180 bn per year.[4]

The European Investment Bank (EIB) is already bridging the gap, by disbursing an average of €100 bn per year, but this is still not enough. The remainder needs to come from the private sector. Many **European Banks are committed to mitigating the risks and seizing the opportunities of a low-carbon, climate-resilient and circular economy** and with this purpose in mind, have launched an increasing number of initiatives in recent years to promote sustainability both on their own initiative and in coordination with international regulators and platforms (initiatives) such as the UNEP Finance Initiative, Green and Social Bonds principles, Green Loan principles, Principles for Responsible investment, etc. I**t is essential that the Commission defines and bolsters sustainable finance as part of the Capital Markets Union and takes into consideration the valuable contribution of the banking sector**. Banks not only substantially contribute to the shift to sustainable assets, but also make possible transformation processes, using dynamic capabilities that enable businesses and assets to become sustainable in the short and long-term.

As we advanced in the key points, it is possible to construe that **banks are not considered as major relevant entities in the legislative proposal** *on the establishment of a framework.*. Nevertheless, banks are direct lenders, intermediaries and fiduciaries, and as such play a key role in the move towards a sustainable and socially inclusive economy. As indicated earlier on, banks offer a diversity of solutions that may be oriented to sustainable finance for investors. This move towards more sustainable finance therefore cannot happen without the key intermediary role of banks and their ecosystem.

With regards to the entities identified in the disclosures proposal, that directly link to the taxonomy, we argue that credit institutions should not be in scope of the disclosures proposal. They should only be included when offering financial products as environmentally sustainable investments or related advisory services. This is the original approach of the Commission that we support, but having now the European Parliament report on the table, which includes credit institutions in Article 2 of the proposal, our request to consider the importance of other banking business in the taxonomy could be misunderstood.

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[3] Due to different historical and economic factors, banks in Europe finance around 80% of the EU economy, in contrast with other developed economies like the US, where the percentage takes a very different shape. According to the EIB Investment Survey 2017 "bank loans account for the highest share of external finance (56%)" of companies in all different sectors, be they large companies or SMEs, and together with other means of bank financing, make banks the main financier of the real economy in the EU.

[4] As stated by Werner Hoyer in several occasions - http://www.euronews.com/2017/01/31/can-we-fill-the-investment-gap.

With regards to the proposal on the framework, we argue that **banks should be more closely involved in the development of the Taxonomy and its practical implementation.** Taking into account our considerations on disclosures above, banks' activities are key to the financing of the economy, so the framework should be open to be used by banks in all their activities, while not becoming compulsory in its application.

So far banks are **only mentioned once** in the proposal, pointing out that EU taxonomies can allow the analysis of risk differences between bank and insurance assets/exposures and will analyse such differences and their possible incorporation into prudential regulation[5].We understand that to the extent that banks are not mentioned, the impact assessment accompanying the legislative package does not identify bank's current actions as the problematic ones that should be addressed, contrary to the lack of incentives these 'relevant entities' have to consider ESG factors in their investment and advisory processes. Our core issue is with the fact that the proposal for a framework that will set the core definitions of what sustainable activities (and thus sustainable finance) are, **will be affecting a much wider spectrum of financial market participants (including banks) than those included as 'relevant entities'**.

As such, it is important to avoid inconsistencies or incompatibilities with banking approaches to the evaluation of sustainable criteria, and avoid their inclusion in the disclosures proposal, which is not in line with what the scope of the taxonomy should be.

2. The differences between 'sustainable finance' and 'sustainable investment'

Given the fact that the aim is to fully embed sustainability in the EU financial system, all market participants and their respective roles need to be considered when building key legislative proposals that will set not only an EU approach to sustainability, but also contribute to global standards with regards to defining sustainable finance (as the EU is often an example to follow for many other jurisdictions)[6].

As we understand, the Action Plan seeks to build a taxonomy that will set out uniform criteria for determining whether an economic activity is environmentally sustainable (or not), thus guiding how economic activities are financed through the financial markets.

It is realistic to expect that **whatever taxonomy is set, it will have a direct impact on the activities financed and investment solutions offered by banks – as it does on the entire economy**. Next to that, one of the main challenges banks are likely to face with regard to the implementation and follow-up of the Taxonomy may be related to absence (or insufficient presence) of in-house scientific or/and environmental knowledge.

[5] Which is surprising due to the Commission explicitly stating that the ESAs, **in particular EBA** and EIOPA, will have an important role to play in ensuring that taxonomies are developed in such a way that they are useable for climate scenario analysis and, at a later stage, for climate stress testing, and will contribute to the development of methodologies for such scenario analysis and stress testing based on EU taxonomies (page 39 of the legislative proposal on a framework).

[6] In this sense we reiterate our understanding on the leading role that the EU has on the topic and especially with regards to defining a sustainability pathway up until 2050 to align long-term sustainable finance developments with political objectives. Financial and environmental policies and the relevant regulatory framework must be coordinated across government agencies and departments to ensure that financing reaches the intended goals.

This might create a dependency of the industry or certain players on information delivered from either competitors or third parties.

2.1 The importance of a common language

The question of which actions should be classified as sustainable is common for capital markets and credit markets. The possible applications for the taxonomy are many, thus it should be the common language for all relevant parties, and banks should be involved in its development and updating, bearing in mind the need to simplify and ensure consistency in the use of new, or already used, terms and nomenclatures. Many European banks have already invested in considerable research and development for sustainable product innovation, distribution and risk management, and therefore are keen to contribute to the process with their experience of different asset types, data issues, customers' needs as well as with educational efforts.

Financial and economic activities should be reflected upon as a whole and not in a compartmented way, thus avoiding fragmentation, as well as posing risks to the common understandings of which stakeholders are affected by which proposals. The definition of a taxonomy is challenging and, as in any effort of this kind, **a common accepted language among all market participants is required,** including industry codes which should be aligned to enable potential reporting on sustainable finance strategies and exposures based on the taxonomy to be consistent across stakeholders.

A common language needs however, to be set within a global context, taking into account the role that banks play financing a substantial part of the European economy, it is key to obtain their view and input at the most early stage, as to get the maximum reach and impact when defining sustainable activities. Banks are engaged in both day-to-day and long term relations with their clients, they are aware of sustainability concerns from different angles and can provide the extra expertise from their internal models into the technical discussion of the Commission.

We widely welcomed and praised the Action Plan for Financing Sustainable Growth as a document in which all relevant parties, including banks, were fully included in the way forward, and the actions proposed were following a clear logic already devised in the HLEG. To our view, this has accounted for having common understandings of what sustainable finance means.

2.2 Sustainable Finance vs. Sustainable Investment

At the very early stage already, **Sustainable Finance was the umbrella term that was used for describing the goal the Commission sets itself to achieve**.

In the first place, the role of finance is defined as […]*support[ing] the economy by providing **funding** for economic activities and ultimately jobs and growth". in a sustainable manner.* This is followed by an explanation of what we understand by 'Sustainable Finance', while mentioning investment decision-making as the key action for environmental, social and governance considerations.

It does not take banks out of the equation, as the definitions included in the taxonomy and disclosure proposals do. Finally, the last remarks on the goal of the Action Plan complete the financing picture: *This Action Plan on* ***sustainable finance*** *is part of broader efforts to connect* ***finance*** *with the specific needs of the European and global economy for the benefit of the planet and our society.*

We have not seen, so far, the reference to Sustainable Investment as an umbrella concept under which all economic activities fall, but just as one of the main components that should shift its way of acting when involved in a framework of sustainable finance as the one the Commission proposes. We understand and welcome the rationale for the commission to follow this step by step approach starting with a taxonomy used for investment purpose. Therein this vein, it appears to exist a disparity between the scope of the proposal (considering the explanatory note) and the proposed scope of the regulation. The proposal refers to sustainable finance, which includes institutions other than those mentioned in the definitions in Article 2 – referring to sustainable investment. The Commission should clarify whether issuing banks and credit institutions are also in scope of the regulation proposal and clarify why this step by step approach starting with a taxonomy used for investment purpose was retained.

Sustainable finance, as referenced in the Commission's Action Plan[7] is a more appropriate term than Sustainable Investment[8] to refer to when mentioning a taxonomy that will be embracing all economic activities based on all available sources of funding, given the fact that the main goal is to fully embed sustainability in the EU financial system.

Action 1 of the Action Plan explicitly states that the focus of the taxonomy is to shift **capital flows** (financing, including investment) towards more sustainable economic activities.

This is underpinned by a shared understanding by all market participants of what 'sustainable' means.

Our insistence on Sustainable Finance as an umbrella definition for the proposals referenced is built on our understanding that financing - the provision of funds- is a wider concept that covers investment and comparable destined uses (of the received funds). As

7 European Commission: COMMUNICATION FROM THE COMMISSION: Action Plan: Financing Sustainable Growth
8 Proposal on disclosures and sustainability risks, Article 2:
"(o*) 'sustainable investments' mean any of the following or a combination of any of the following:*

> *(i) investments in an economic activity that contributes to an environmental objective, including an environmentally sustainable investment as defined in Article 2 of [PO: Please insert reference to Regulation on the establishment of a framework to facilitate sustainable investment];*
> *(ii) investments in an economic activity that contributes to a social objective, and in particular an investment that contributes to tackling inequality, an investment fostering social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities;*
> *(iii) investments in companies following good governance practices, and in particular companies with sound management structures, employee relations, remuneration of relevant staff and tax compliance;"*

such the provision of funds can be also used to business activities or for making purchases in addition to investing.

2.3 Taking stock of all ESG considerations

As stated before, to our understanding, the definition targets specific sectors which have issues integrating ESG factors in their decision-making. However, even if they do not plan to do so, the proposals would affect the inner workings of all the financial sector, not only specific sectors. . **A siloed approach does not contain the almost certain spill-over effect that the taxonomy would have in all economic and finance activities, including banking.**

The EBF considers that it is crucial to define the three component parts of ESG subject to the availability of reliable data, hence we need a common definition of what is meant by environmental criteria, what is meant by social progress and what is meant by improvements in governance. The financial sector is linked to all other economic sectors. Therefore, we need to speak the same language which we can only do once we have the same concepts and common definitions, not just throughout the financial sector but also in the wider economy at large. We believe that the banking sector's approach to ESG and sustainable finance is very much in line with both the need for funding of the European real economy and the words by Vice-President Dombrovskis: "*sustainable finance is no longer a niche - it is going mainstream*", which we truly believe will be a key component of the new operating system in finance.

Practical concerns with the definition of what is sustainable

The EBF considers the taxonomy as **a positive example of the public sector acting as enabler of sustainable projects and unlocking the potential of private financing**. It will allow the financial sector to count with a sound and reliable basis for setting their high-level policies for credit and investment allocation. In this regard, effective public-private cooperation and an alignment of public strategies and policies with the needs of the private sector, including the financial industry, is imperative if we are to accelerate sustainable development and its financing.

Regarding the taxonomy per se, we agree that it should focus on defining which economic activities can be considered as sustainable and under which conditions, instead of trying to identify sustainable companies or/and assets. And this focus should be maintained with no further precision related with its application only to what are defined as 'financial market participants' (not banks), and investment as the narrow definition contained in the proposal on disclosures and referenced in the footnote above.

In any case we would like to note that the perimeter of the economic activities should not be limited at the EU boundaries, as sustainable opportunities for EU companies acting in third countries, as for example emerging markets (or financial entities represented/having businesses on these markets), would not be valued. These sustainable opportunities should be evaluated taking into account adequate ESG criteria.

Enlarging the scope beyond the EU, where relevant, would also be consistent with the European commitment on UN Sustainable Development Goals, with its ambition to be at the forefront of the development of Sustainable Finance at the international level, and would allow the EU to "export" its best practices to other regions.

To be holistic, the taxonomy should leverage not only on current taxonomies developed by Multilateral Development Banks (MDBs), but also on any existing taxonomies developed by banks in their sustainability frameworks (using them as a basis on which to build upon), taxonomies developed by international Sustainable Finance initiatives, taxonomies used for "traditional" economic sectors and taxonomies based on activities contributing to the achievement of the UN SDGs. Such taxonomies are likely to cover a broader spectrum of financing activities (sectors and types of instruments) than MDB taxonomies, given the specific mandates of MDBs. Such broader taxonomies are necessary to enable credit institutions to assess the degree of sustainability of their outstanding portfolios towards the transition to a low carbon standard. We believe that this kind of link could be useful in order to integrate the sustainable taxonomy in the macro-financial policies that are based on economic sectors taxonomies and (forward looking) steer the credit and capital flows towards sustainable and social activities/projects. **Some banks may also wish to link their sustainability commitments (such as those communicated at the occasion of the COP 21 or the recent Climate Finance day) to the EU taxonomy, for transparency and comparability purposes.** With regards to the activities defined under Article 3 and specified in Articles 5-13 **we very much welcome the precise clarifications and their alignment with agreed international standards and financial actors possessing high standards as recognised by the market** (i.e. MDBs). Going forward, further clarity will however be needed on how the taxonomy should relate to other existing, established market standards such as green, social and sustainability principles.

3.1 Criteria, compliance and organisation-level measures

In Article 14, the Commission should make reference to the cost of implementation of the technical screening criteria. Definitions are likely to be based on measurable criteria. But not all market participants have access to the same type of data in order to evaluate the economic activities being financed. Therefore, to minimize costs, measurable criteria should rely on open access and open source data. Taking the example of buildings, criteria based the value of Energy Performance Certificates could be more easily implemented by banks as EPC could be accessed from customers or public data repositories.

In Article 14 (c) we think it would be useful if multiple measurable criteria were used for a single definition. For example in defining whether a building is sustainable (or more sustainable than before), measurable criteria could include the building emission intensity or amount of energy saved (through its energy performance, carbon certificate or other internationally accepted or recognized standards) as well as any additional metrics. While this may create some issue of comparability, it could be better suited to a variety of market participants having access to different types of data. The more the screening criteria are in the public domain and the same approach is used by all, the less costly its implementation and the less ambiguous the interpretation.

In Article 14 (j) more clarification should be given on how the Commission intends to facilitate the verification of compliance. Here again, this element could render the cost of implementation quite high, compromising the objective stated in recital 29 of the Regulation Proposal *"To avoid overly burdensome compliance costs on economic operators, the Commission should establish technical screening criteria (…) with which compliance can be verified within reasonable cost-of-compliance boundaries"*.

Article 6 to 11, the Commission should mention the importance of organisation level measures. For example, making reference to system-wide enabling economic activities or cross-sector business models in Article 6. In Article 9, such system-wide economic activity could include measures of recycling optimisation – taking into account, as an input, the formerly approved EU's landmark Circular Economy Package. The issue is the collection and recycling optimisation through the organisation. The innovation and the performance is not only equipments or technologies but also how the system is organised.

3.2 Scope, flexibility and dynamism of the taxonomy

When looking into the topic of the **flexibility** of the taxonomy, we understand that it has been widely discussed, and that there will be the possibility to amend the meaning of sustainability, as evidence and science evolves and changes over time. The area of sustainable finance is – and should be - dynamic, being thus reflected in the functioning of the taxonomy. Also, there are technical and regional differences which may need to be taken into account in the practical application of the taxonomy. Ideally, the taxonomy should ensure a high standard and, on the other hand, be flexible enough in further developments towards increased sustainability.

The banking industry is more than ready to take on this effort and to go forward promoting best practices, always taking into account that extending of the scope of the Regulation to cover other sustainability objectives, in particular social objectives, instead of using a review clause, would improve clarity for investors, from the earliest possible stage subject to the availability of reliable data, regarding what defines environment and social sustainable economic activities. Broadening the scope from the inception of the taxonomy would ensure avoiding risks of efficiency losses, as internal models of Financial Institutions would need to be adapted every time a change is adopted. However, we support the progressive approach on the broadening of the scope as to recognise the urgency of environmental and climate issues.

We recommend clarifying the scope of application of the taxonomy. The taxonomy appears to only apply to economic activities within the EU. If this is the case, this will restrict the EU green bond market as well as it might ignore environmentally sustainable finance / investment opportunities in other markets. Consideration therefore needs to be given to geographical scope and the means by which the global activity of EU Head-Quartered firms can be captured in an appropriate way, while geographically bounding to the EU the activities of inbound firms. This provides further grounds for wanting to ensure that the EU approach aligns to the developing global framework. However, this should not create negative unintended cross-border implications for firms. While it is indeed useful to have the option of using the taxonomy in order to dispose from "green" assets from outside of

the EU, making it a requirement could result in competitive distortions for EU banks. Indeed, should such obligations be imposed on EU banks regardless of the location of their customers, they may end up having to impose a number of conditions or requests for information on their non-EU customers – conditions or requests that non-EU banks would not be subject to. As a result, EU banks would be at a competitive disadvantage as non-EU customers would have incentives to favour non-EU competitors."
Article 17 of the proposal envisages a three-year time horizon for reviewing the taxonomy. We consider this may be too long as business models and technology can evolve considerably within the mentioned timeframe. It could result in situations where the market is ready to finance sustainable activities but these are not recognised by the existing taxonomy. Instead, it is important to include a mechanism in the taxonomy proposal which will facilitate regular updates of the taxonomy in response to the evolution of industry sectors and new business models. Furthermore it will be very important to set up proper governance structure in the delegated acts making sure there will be public consultations with adequate deadlines and involvement of the financial sector. Accordingly, the taxonomy should be sufficiently flexible as to allow taking into account such evolutions between reviews.

The Taxonomy should be sufficiently open to be able to fit into other already existing standards and any taxonomies used by financial institutions. In practice, some financial participants already use their own criteria about what they consider defined as 'green' and 'social' and are often shared with stakeholders and shareholders. Sustainability data providers, which have contributed to some amount of consolidation in terms of what these taxonomies look like, play a crucial role. The EBF agrees that setting a standard with a taxonomy helps to be able to better compare various approaches to 'what is green and what is not' and that this is a key goal of the taxonomy. The right balance has to be found between recognition, harmonisation and setting a minimum standard which institutions can 'top up'. Practical lessons could be learned from previous market initiatives such as the - Green Bond Principles & Climate Bonds Standard.

3.2.1 Social and Governance considerations

We understand the decision to focus first on environmental concerns as stated in the Action Plan (divided between climate change adaptation and climate change mitigation) and we are supportive of the possibility of including social elements at a future point (already contained in the definition of sustainable investments referenced above and remarking the possibility to include governance considerations), we would like to voice our concerns with regards to timing and possible extra inclusions.

In article 17 of the proposal it is mentioned that only from December 2021 *the appropriateness of extending the scope of this regulation to cover other sustainability objectives, in particular social objectives should be considered*. Market standards, which today comprise green, social as well as broader sustainability principles already acknowledge that the different aspects are related and that there are co-benefits from different projects. The different objectives should not be decoupled, since they are part of the same, broader concept of sustainability.

We believe that the framework should allow flexibility to incorporate social and governance aspects from the outset at least at a level of principle, and especially when more and better data is available. This would encourage a holistic approach from the beginning to sustainable finance. This would reflect the fact that social factors are in some cases less defined while at the same time providing a clear statement of intent on the part of the Commission and encourage firms to be forward-looking in their approaches on these issues. However we agree that differences on time schedule between the different ESGs might exist (reflecting the priority given to climate-related issues).

That being said, when considering Governance issues, thus having the complete ESG picture, we would like to reiterate that subject to the availability of reliable data, this would enable opportunities of working on social inclusion of vulnerable groups, greatly impacting the effects on Human Rights considerations and the levels of connectedness or disconnectedness that financial institutions can demonstrate regarding the behaviour of the economic actors they finance.

Finally, with regards to banks' clients preferences for environmental, social and good governance factors and to implement such factors in the product governance and suitability assessment processes, the taxonomy is an important tool to let the market develop more "sustainable investment products" in the future, that are key for financial intermediaries such as banks to adequately respond to investors' needs taking into account their ESG preferences or demands.

Therefore, we welcome in principle that ESG criteria end up becoming an integral part of investment advice. However, it is worth noting that the regulatory proposal amending Regulation (EU) 2017/565 supplementing MIFID II lacks of a clear and precise definition of ESG investments and only in the case of "environmentally sustainable investment" it refers to the taxonomy regulation, which does not include yet Social or Governance considerations. Such definition should reference the EU taxonomy, for obvious consistency reasons, and therefore the amendment of MIFID II comes in crucial moment. In addition, banks and financial institutions are just in the process of digesting the implementation of MIFID II in January 2018, and are not today in a position to revisit again their client relationship framework in such a shorter time. Therefore, we urge the Commission to delay this amendment until such point when the taxonomy will be fully and smoothly operational.

3.2.2 Economic sectors considerations: Innovation and Transition

In the review clause proposed with article 17, the Commission envisages a three-year time horizon for evaluation and reporting. This timeframe could be definitely too long for some growing economic sectors which are characterised by a quick (sometimes exponential) evolution. We believe that it should be beneficial to include the possibility of regular updates of the taxonomy in response to the evolution of industry sectors and new business models.

Importantly, the taxonomy should also provide a framework to assess the transition to sustainable finance. We understand that the goal is to support those economic activities already sustainable and, in the meantime, support the not-yet-sustainable activities in their transition., as the financial world and the real economy will need time to evolve, and will likely never be 100% green. Many corporates (e.g. Utilities) operate and are interested in different economic activities which are financed as a whole. Taxonomies that focus on green assets may be adequate for green bonds, but such instruments are only adapted for the financing of specific capital expenditure by corporates, with explicit "Use of Proceeds" clauses to allocate the green bonds to a dedicated asset or portfolio of asset. Such approach is not viable for other financing that are not Capex related, which represent a large proportion of the financing of the economy. In order to provide the right incentives to corporate to progressively improve their carbon footprint, a mechanism must be designed that capture transitional evolutions at company level, rather than specific assets. Therefore we would like to understand better how the taxonomy will treat "transition" investments made by those companies or companies operating in carbon-intensive activities but willing to minimise their negative impact within the financeable investment products universe.

Furthermore, sustainable finance needs to embrace products dedicated to financing of research and development from corporates which are investing significant amounts in research to develop new low carbon technologies and products. Loans to corporates which have a strategy in line with TCFD recommendations or have adopted science based targets-like metrics should also be eligible to be categorized as sustainable/green financing. In addition, "investment in innovation and technology" will allow for incremental improvements at company level and make a case for "transition" investments which may incentivise corporates to move surely towards more sustainable business models.

3.3 Greenwashing and Transparency

In addition to the above, an EU classification system (taxonomy), including carbon-related assets, green assets, and a set of minimum standards will also be important in mitigating the risk of 'greenwashing', ring to the practice of gaining an unfair competitive advantage by marketing a financial product and/or service as environmental-friendly or socially acceptable, whereas it does not meet such standards. Against this backdrop, the specific reference on the greenwashing market practices in recital 9 on the legislative proposal pertaining to the establishment of a framework to facilitate sustainable investment is welcomed.

With regards to transparency, we would like to mention the importance that it has in the sector, and the consequences of inaction both for the environment and for investors. For example, investors that invest in a venture that is not environmentally sustainable, risk losing money because the companies they have invested in could be fined or face risks to their business models.

3.4 Easy to Use taxonomy and disclosures that work for all, individuals, professionals, SMEs and other economic actors

The Commission should also embed a **clear and unambiguous definition, that is easy to use across the economy and society**. A taxonomy that is specific enough, but that it is also easily understandable and appropriately manageable for SMEs or other local market participants that should be able to better align their actions with sustainable practices -in order to achieve better financing options in the long run- without having to spend a lot of time and resources to do so.

This would be facilitated by **increased clarity on the disclosure proposal and labelling**, as in the Commission's proposal regarding disclosures we ask for more clarity around the scope.[9] Under Article 3, financial market participants are required to publish written policies on the integration of sustainability risks in investment decision making process. The financial market participants are required to publish them on their websites and maintain the policies up-to-date. This obligation also extends to financial advisors.

With regards to article 5 (1, 2, 3), where a financial product targets sustainable investments or investments with similar characteristics and no index has been designated as a reference benchmark, the information shall include an explanation on how that target is reached, as the majority of investment products currently doesn't target sustainable investments specifically while the proposals aim to increase investments in these products.

3.5 The relevance of a sequential approach

Last but not least, the EBF considers that having a solid sustainable framework is a necessary condition before introducing any other legislative proposals. It is our understanding that no legislative proposals should be implemented before having a fully-fledged robust framework (taxonomy), being thus very much in line with EBA's approach:

We need to follow a sequential approach, first regarding taxonomy and an appropriate disclosure as it will clearly define what do we understand as sustainable; and second, evaluate the convenience to work on prudential requirements. This will ensure that both borrowers and lenders know where they stand when taking decisions.[10]

<u>Conclusion</u>

We would like to remark that the Commission's proposals are forward-looking in their approach and cover a lot of ground in a way that is unprecedented by the work of any other regulator so far. We would be pleased to work with the Commission on the definition of the regulation on taxonomy, benchmark and disclosure, thus including the banking sector in a way that truly reflects its role in sustainability.

[9] REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

[10] As commented by Adam Farkas (EBA) in the first in-person meeting of the Central Banks and Supervisors Network for Greening the Financial System (NGFS) organized in Amsterdam 6th of April 2018.

As concluding remarks we would like to reiterate our main points:

- We welcome the reach and policy option chosen for the proposals. However, we would like to emphasise the important role of the banking sector in implementing the Sustainable Finance Agenda. Banks should be, thus, more closely involved in the development of the Taxonomy and its practical implementation, while balancing the possible negative implications that their inclusion in the disclosures proposal would have.

- We are supportive of the original path set out in the HLEG report and in the Action Plan of the Commission, taking Sustainable Finance as the umbrella concept under which to build the way forward to sustainable growth. However, we understand that the current cautious approach can be a good first set of steps that will avoid unnecessary mistakes in making sustainability the new mainstream.

- With regards to the core elements of the taxonomy, we would like to see social aspects considered the earliest possible stage subject to the availability of reliable data and we would like a clear and unambiguous final definition that adequately identifies all risks and opportunities that sustainable finance offers in terms of economic sectors, greenwashing and transparency allowing even to be used by smaller companies to improve their sustainable actions. All of this also considering that a step by step approach should be the one to follow.

- Additionally, a sequential approach needs to be followed, first regarding taxonomy and an appropriate disclosure as it will clearly define what it is understood as sustainable; and second, evaluate the convenience to work on prudential requirements.

- Finally, we consider important to promote the possibility of regular updates of the taxonomy, when necessary in response to the evolution of market’s needs and developments.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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