EBF feedback on the draft Taxonomy Delegated Act

17 December 2020

Together with UNEP FI , we are preparing an extensive report resulting from case studies of EU banks, which will also include number of recommendations how to operationalize the EU taxonomy and improve the applicability to banking products, reflecting the specificities of banking sectors. The report will be launched on 26 January 2021.

Before commenting on specific aspects of the Delegated Act related to buildings and the DNSH criteria for electricity generation developed with regard to climate adaptation objective, we would like to share some insight, comments and suggestions on issues of more general or operational nature which we believe need to be addressed .

Lack of data

A large number of operational issues are related to the lack of data. We will be happy to work with the Commission and the Platform on tools and solutions to improve the availability, usability, relevance and reliability of the data and on gaining proper understanding of what data are essential for evaluation of each of the EU Taxonomy TSCs.

This will require

1. proper definitions of percentage of revenues and associated Capex and Opex, underpinned by proper companies reporting and environmental accounting.

2. alignment with Environmental Accounts Reporting by EU members states and other countries (SEEA, https://seea.un.org/), used for sustainable trade and production monitoring worldwide. This system uses NACE activity codes but also codes at a deeper level (PRODCOM, Combined, Nomenclature, HS etc) as well as existing eco-labelling schemes. All member states already reach out to companies for business related sustainability data.

In addition, the **development of common reporting templates** will facilitate the structuring and design of the database as well as data collection. A proportionate and simplified solutions have to be developed for SMEs and small institutions. It is also important to align and harmonize definitions across financial regulations but also in other EU policy domains.

We support ESMA's recommendation to the EC to develop a **methodology to be used for those companies for which data is not available or only partially available** in order "to allow KPI calculation to cover also investments in companies not reporting under the Non-Financial Reporting Directive the extent of their Taxonomy-aligned activities. A possible way forward

is to assign coefficient for such activities derived on a sector-basis under a common methodology but such approach should be possible to 'override' should better information be available .

Proposal:

The assignment of a coefficient should be applied to those investments that lack minimum reporting. However, for all those that have a certain level of disclosures, a more thorough customized methodology based on proxies and estimations should apply. A mixed approach should be allowed.

This will allow a) for more accurate results; b) will help encourage non-NFRD companies to disclose and will encourage investors to ask for greater transparency; and c) will not undermine those companies that make the effort to disclose.

We recommend that the EC develop a standardized official methodology for both approaches – including when to use one or the other. The Platform should provide advice to the EC on the methodologies. This would mean that the TEG's recommendation on disclosures as "potentially aligned" would be replaced by "aligned based on companies or complete data" versus "estimated alignment" based on the methodology established by the EC. As ESMA recommends, financial actors should then disclose which % is estimated following the official methodology and which % is not. The breakdown provides the reader the necessary information to assess and interpret the resulting figures.

Use of NACE codes and the deeper levels of these codes

Having a clear sector and economic activity classification scheme is essential to form the basis for the taxonomy. The EU officially uses NACE. NACE and their equivalents like ISIC and NAICS are widely used, even by foreign actors, next to systems like GICS that are used by investors. These codes are not very suitable for the Taxonomy as most of the times a NACE code activity deserves to be split into two given their different environmental profile or the other way around. There are also sustainable activities for which a NACE code has not yet been created. For example NACE 35 Electricity, gas, steam and air conditioning supply: the underlying sectors do not distinguish between fossil fuel and renewable energy generation, transmission, distribution. While the TEG, and the Platform now, might have made specific proposals on how to navigate through these issues and even provided a mapping to additional classification systems, a permanent solution is needed. We encourage the EC to work alongside EUROSTAT to put in place a mechanism for:

- Updating the NACE codes to reflect market and environmental realities and needs. Since NACE is only 4 digits, this update will not to the job entirely
- Use the deeper level of these codes (up to 12 digits), such as CPA, PRODCOM and CN (combined Nomenclature) and the international HS codes which are widely used by market participants and EU member states. Since this is up to product group level this is also better aligned with other EU policy domains that use these codes.
- Developing **international and industry-based equivalences** to facilitate their application and use by EU and non-EU actors. International translation between

sector classification systems should be used to facilitate their use. As indicated, codes are international, as well as the entire coding around the Environmental Accounts/SEEA (https://seea.un.org/)

DNSH reference to EU Regulation

We understand and support the use of EU regulation as a reference for "Do No Significant Harm" criteria. Companies and other economic actors are expected to comply with EU regulation when operating in Europe - financial actors and intermediaries, in return, will consider that an activity complies with the specified regulation if, after having conducted proper due diligence no breach of the regulation is found.
While the intention is not to lower any environmental standard, we recognise the difficulty for any economic actor operating outside of the EU, especially for non-EU players and smaller companies or public actors, to interpret complex EU regulation. We recommend the EC to:

- Include in the Delegated Acts a reference to **a future equivalence framework of international and/or national standards** to facilitate the adoption and application of the EU Taxonomy by non-EU actors as well as the development of other national or regional taxonomies. In particular, the (future) integration of the DNSH criteria with the IFC Performance Standards could strengthen the application of the EU Taxonomy at a global level.
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- **Collaborate with other countries** – for example, as part of the **International Platform on Sustainable Finance** – to develop such equivalences.
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Qualitative criteria for DNSH and for minimum safeguards

Companies and other issuers disclosing against the Taxonomy will need to assess their compliance with minimum safeguards. We agree with the TEG that compliance to minimum safeguards as well as qualitative DNSH ought to be done through due diligence. As the OECD Guidelines state and the TEG restates, the principle of proportionality should prevail when conducting due diligence:
"The nature and extent of due diligence, such as the specific steps to be taken, should be appropriate to a particular situation and will be affected by factors such as the size of the enterprise, context of its operations, the specific recommendations in the OECD Guidelines, and the severity of its adverse impacts". The size and nature of the financial institution will also affect the nature and extent of due diligence. For example, if an asset owner appoints an asset manager, the role of the former is to ensure that the latter has implemented the policies and procedures necessary to conduct due diligence.
The principle of proportionality enforces a risk-based approach to due diligence when assessing minimum safeguards. The principle of proportionality should apply to both companies and other issuers as well as to financial actors and different financial products. We recommend to the EC to:

- **Clearly enshrine the principle of proportionality in the regulation** – especially when applied to SMEs and to the different financial products.

- **Provide clarity on how to conduct such due diligence and regulators' expectations** on financial actors and intermediaries – especially verifiers – when assessing compliance by companies or other economic actors.

DNSH climate Change Adaptation to mitigation

The Commission has made the DNSH criteria for mitigation activities less strict by removing the obligation to reduce 'all' risks and requiring new activities to have a plan to implement the adaptation solutions within the next 5 years (rather than having them implemented from the start). We welcome the amendment as it reflects better where the market is at present. Nevertheless, and without intending to undermine the urgency to foster climate adaptation, we believe the **criteria should apply only for new investments and financing projects** (in line with the capex accounting for adaptation activities and not on the revenue side). It should also **take into account the specific context** in which it is applied by including the principles of proportionality, principal agent and a risk-based approach, e.g. for a green mortgage it makes little sense that a household would have to conduct the evaluation, which should fall under the responsibility of the municipality.

Assessing compliance regarding research, development and innovation

We welcome the inclusion of R&D&I as stated above and encourage the Commission, through the Platform, to provide **more clarity on how compliance should be evaluated and to specify the disclosures needed for granting alignment**. For instance, it is not clear how something that is being researched, innovated or developed has at the same time the obligation to have calculated, quantified and third-party verified a life-cycle GHG emissions analysis to be Taxonomy aligned.

Alignment and consistency with EU ETS and EU policies

The value of the Taxonomy resides to a large extend in its consistency and alignment with EU policies and goals.

Recital (40) states that in order to ensure that the application of Regulation (EU) 2020/852 evolves with technological, market and policy developments, the Regulation should be regularly reviewed and, where appropriate, amended as regards the activities considered to be contributing substantially to climate change mitigation or climate change adaptation and the corresponding technical screening criteria.

We urge the EC to work **towards a coordinated update of both the EU ETS benchmarks and the thresholds for those activities in transition**. Not only should the thresholds be aligned wherever possible to send an unambiguous message to economic actors and to provide clarity and visibility to financial actors as well as to maximise effectiveness, but also they should be revised **with the same frequency and at the same time.**

Lifespan of investment plans

We welcome the TEG suggestion that for both environmental objectives, a non-financial undertaking should be able to count CapEx when it is part of a plan to meet the technical screening criteria for a substantial contribution to climate change mitigation / adaptation and relevant DNSH criteria. CapEx can be counted if the plan to which it relates aims to make the economic activity in question Taxonomy-aligned within a maximum period of five years. While we agree with the 5-year span as a general rule, we recommend that **the EC makes an exception for large infrastructure projects whose proven *financing and/or construction* timespan largely exceeds the timeframe.**

Timeline issues for financial product alignment

The draft Delegated Acts contain criteria which will be reviewed on a schedule, either set out in the design of the criteria (e.g. transport) or every third year by virtue of being a "transitional" activity. This predictability for the reviewing of criteria is welcome.

A challenge that arises for companies and financial market participants arises when a financial instrument or product has a different investment timeframe to the revision of the technical screening criteria. Investors may judge that investing in an activity that is currently Taxonomy-aligned is problematic where the Taxonomy-alignment of the investment may be removed during the course of the investment. This is particularly the case for green bonds, loans and mortgages but may affect all green or use of proceeds debt products. This challenge necessarily arises when technical screening criteria are likely to tighten over time, but the implications for companies and financial products must be addressed.

We encourage the EC to establish appropriate practice for accounting for Taxonomy-alignment with different financial instruments, in particular where the timeframe for the underlying investment or project is considerably longer than the timeframe for revision of the technical screening criteria. Such practice could consist of Taxonomy "grandfathering" whereby the Taxonomy rules at the time of issuance of the financial product or instrument would apply for either all of the duration of the financial instrument or for a sufficient period to mitigate concerns of future divergence.

Operational Expenditures

The original taxonomy regulatory text rightly considered "capex and, if relevant, OpEx". The interest in that "if relevant" is to allow accounting for operational expenditures inherently linked to a project for example. The inclusion as a mandatory disclosure across the board, while well-intentioned, translates into an unsurmountable barrier for companies given the extremely highly accounting difficulties to allocate operational expenditures to specific economic activities following the NACE codes and to adjust internal accounts to such a classification. ESMA concluded that it is uncertain how in practice OpEx could be calculated and recognised the complexity of the exercise.

Further, the inclusion of OpEx as a financial metric to measure portfolio-alignment provides no value to the regulator or to institutional investors.

We highly recommend to the EC to revert back to the original text: "capex and, if/when relevant opex" which will ensure its inclusion at project financing level and in those cases where and when is appropriate and meaningful.

Broadening the selection of activities

While we share the spirit of recital (6) to focus first on those economic activities and sectors that have the greatest potential to achieve the climate goals, we believe that in a second phase, the EC through the Platform should consider expanding the scope to include those activities that play **a key role in the value chain** in **creating the necessary demand**. Their inclusion can create significant positive spillovers as they accelerate the transformation of manufacturing activities while building a strong demand for sustainable products and services, e.g. in the provision of public transport services – when run only by vehicles or when acquiring a fleet that meets the technical criteria. At times, the same company might conduct these activities and therefore it will be difficult to disassociate expenditures and revenues from both of them.

We encourage the EC through the Platform to broaden the scope by examining in detail **the supply chains for manufacturing activities - upstream and downstream** – to further foster the transition and transformation efforts needed across economic sectors and services, and not just the most polluting production sectors

Comments on buildings and the DNSH criteria for electricity generation developed with regard to climate adaptation objective,

Leaving the operational issues aside, we would like to share with you some feedback on the draft Delegated Act in particular in relations to (i) the buildings which is key in the banking sector as well for development of green covered bonds and potential for green securitization, and (ii) the DNSH criteria for electricity generation developed with regard to climate adaptation objective, which could preempt the debate over the brown taxonomy.

Buildings

7.7 Acquisition and ownership of buildings

With regards to substantial contribution to climate change mitigation and the activity 7.7 (Acquisition and ownership of buildings) the criteria for buildings built before 31 December 2020 is set to be "at least Energy Performance Certificate (EPC) class A". This is a substantial change from the last TEG-report, where TEG suggested that the criteria should be set at a level reflecting the top 15 % in terms of energy demand. This is also a substantial change from the prior TEG reports, where EPC class A and B was suggested.

In some countries A label is close to 15% (like in Netherlands around 16%) but in other countries the market share of the A label can be as low as 1% %, as for example in Sweden and other Nordic countries, 2 % for residential properties in Germany, 5% of in Ireland and.

Furthermore, in the commercial sector, which accounts for more than 50% of the CO_2 emission in the real estate sector in Germany – there are no EPC classifications at all.

Most banks and real estate companies use the top 15% in their green bond frameworks. There are various good and practical reasons. One is that energy certificates are not public in many countries, so banks use building years as a proxy for building codes, to determine top 15%. Second, and more serious, reason is that the systems for energy labelling have different criteria's in various countries. An EPC A label doesn't give any insight about the energy performance of a single country. Neither can EPC labels be used to compare the „greeness" of building European wide, e.g. Residential EPC B in Germany is at 50-75, Belgian 100-200, Poland 60-120 kwh/sqm. Therefore, the proposed A label requirement would not bring consistency across EU, and would in many countries substantially reduce the volumes of eligible buildings compared to a 15% requirement.

Most investments in green buildings are not direct, but via other instruments such as loans, equity and large scale refinancing instruments like bonds, that will fund large portfolios or pools of green buildings.

Over the last years, a market in Green covered bonds emerged, and banks have been issuing green covered bonds based on green mortgages. A convergence with the EU green bond standard and the taxonomy criteria is a natural next step for this market. However, with the criteria as set in the" draft of the delegated act, there will be a large reduction in the volume of eligible green buildings and linked mortgages, resulting in a setback to green covered bonds developments. Such a limitation would have a negative impact on financing of green buildings (i.e. reducing the intended consequences of the taxonomy as new origination via green mortgages will be negligible), reducing the amount of green investments as the volumes are with certainty far too low to provide (covered) bonds to investors (via mortgage pools) . and reducing the relevance and volume of the EU green bond standard in this market.

We suggest that the criteria should be kept at a level reflecting the top 15 % in terms of energy demand.

In addition (reference to page 202), please note building codes are a moving target, and investment portfolios of buildings move in sync with that. As said most funding instruments are based on portfolios, and not on selection of individual buildings like "real asset" portfolio managers do. A top 15% criterion is just a practical way to achieve harmonization of the market and includes both NZEB-20% and A label. It is also more flexible: in the Netherlands for example A label exceeds 15% and is not strict enough, and will be totally outdated in a few years. The Energy Index of buildings can be used to narrow down the selection to bring green portfolios within top 15% again. Very efficient buildings that are better than what the law requires will always be part of a larger pool, and it should be stimulated to disclose how big the part is that is better than the building codes require.

While we do not support the replacement of 15 % criteria by A label for the reasons explained above, should the Commission not reverse its decision, transition period for the top 15%

approach should be evisaged. Existing building certificates (BREEAM, LEED, DGNB, HQE) should also be granted a transition period.

Construction of new buildings :

7.1. Construction of new buildings NZEB-20%.

Eligibility criteria for new buildings (i.e. built after December 2020) are based on an Primary Energy Demand 20% lower than the NZEB requirements. In many EU countries, the NZEB requirements are already very ambitious. For instance in France, starting from mid 2021 all new buildings will be at "positive energy", i.e. producing more energy than they are consuming. The proposed wording doesn't specify how the extra 20% of energy performance criteria would be calculated when buildings already have a negative net energy consumption. The TEG recommended in its final report no additional requirement where the local regulation is already net-zero carbon aligned: "Where net-zero carbon is already mandated by regulation (as may be the case for some building types in some Member States), the taxonomy should not require better performance, since net zero carbon can be considered sufficient (from the side of new constructions) to allow the entire building stock to be climate-neutral by 2050" (p372, Technical appendix).

Also, for banks (with large portfolios), it is not possible to know the NZEB-20% technical criterion (=near zero energy building minus 20%). It cannot be determined in the systems (even finding out entirely manual or downloading from databases is difficult).

In addition, in each EU country the NZEB definition is different, it is a relative cost effectiveness (calculated) measure. Next to that, the market share of the NZEB is already low (like <3%) and NZEB-20% is close to zero (<<1%).

We would recommend adding the TEG recommendation to the NZEB-20% criterion, whereby this criterion would not apply to member states that applies a zero-carbon standard. A list of which Member States would then be subject to the -20% criterion would be very helpful.

In addition, the draft Delegated Act mentions A label for existing buildings and refers to 7.1 for new buildings. 7.7 must be an exact mirror of 7.1 and 7.1. criteria must also refer to 7.2, otherwise banks and investors cannot include refurbished buildings unless they have A label.

7.2. Renovation of existing buildings

The renovation of the existing building stock is key to transition the building sector to become more energy efficient. For example, this renovation is important to drive securing upgrading EPC levels if we consider that only the buildings sold or rented after 2010 have an EPC certification which means that in a large part of the market the buildings do not have yet any EPC. This will in turn support financial stability by making banks portfolios more resilient to real economy shocks. With this in mind, we would like to stress the importance of ensuring

that the entirety of loans for the purchase and renovation of buildings should be categorized as eligible 'transition or green activities' depending on the result of the renovation.

This is especially important for residential buildings, where it will be difficult to incentivize mortgage customers to renovate their house or apartment without being able to classify their entire mortgage as "green".

However, with the proposed taxonomy criteria for renovation of existing building, the financing of renovation of residential buildings would be serious hampered. This is because the incentive for the customers would be very limited when only the renovation cost can be considered taxonomy-eligible.

Having said this we support eligibility of loans financing building renovation: (i) the entirety of loans for renovation can be categorised as eligible 'transition activities' or "green activities" when at least 50% of the loan relates to energy efficiency measures or when the end result is a good energy label and (ii) when expenditures cannot be distinguished by type, 50% of the total renovation expenditures may be counted as the proxy representing energy efficiency measures. . Furthermore, where costs cannot be practically separated in loans for acquisition and renovation, acquisition costs should be considered integral with eligible renovation costs. Finally, when determination of whether the loan relates to energy efficiency is not feasible, which is often the case for mortgages to retail customers, eligibility should be based on a minimum 30 % decrease in primary energy demand certified by an EPC pre- and post-renovation.

Climate adaptation activities- DNSH criteria with regard to climate mitigation

We welcome the development of more specific criteria with regard to climate adaptation activities, which give more guidance to identify relevant activities.

That being said, we have strong reservations with regard the emission threshold **newly** introduced to identify the DNSH on climate mitigation for electricity generations activities (it did not appear in the TEG report). This threshold is set at 270 g CO2e/kWh, which means that over this threshold power generation installation will be considered as significantly harming climate change mitigation. In this respect, we are wondering how this threshold may interact/preempt any debate on potential brown taxonomy.

This level of the maximum GHG emission threshold for the production of electricity from gas combustion translate into a de facto inclusion of natural gas into harming activities, **as 350g-400g CO2/kWh** is in practice the lowest thresholds that can be reached today without carbon capture and without injecting biogas or green hydrogen into the source gas.

Yet, as recognised by IEA's scenarios (IEA Report of July 2019 https://webstore.iea.org/the-role-of-gas-in-todays-energy-transitions), the gas has to play a role in the until 2030.
This is particularly important in emerging countries, where rapid economic development goes hand in hand with high energy needs, to replace heavily polluting means of energy production with natural gas. This need might also exist in some Eastern European countries.

The need to better calibrate taxonomy according to this necessity appears to be paramount here to guarantee an energy transition that is as socially inclusive as possible.

Hence, instead of the current DNSH threshold the following solutions could be suggested:

- Provides that the exact threshold should give rise to a deeper analyse on its potential impact;
- Review of the threshold considering the most efficient power plants, including through the inclusion of some complementary conditions: (i) decrease of threshold after a certain period, (ii) the particular use of the infrastructure[1] (to compensate for the unstable nature of renewable energies or to cope with a one-off increase in demand) or (ii) **the need to be able to justify the absence of an economically reasonable alternative in the region concerned.**

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[1] The condition could relate to the number of annual hours of infrastructure use or a maximum annual level of GHG emissions.