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Kamppi Elina

Finance Finland's views on how to make the EU taxonomy for sustainable investments to work in market practices

Finance Finland (FFI) welcomes the EU's sustainable finance agenda and is engaged in efforts to make it work in the financial markets. The idea of directing more investments to sustainable economic activities has gained a wide support among the Finnish market participants. We think it is key to facilitate these kinds of investments to reach a higher volume, to enable various companies to benefit from the opportunities of sustainable finance, and to build the agenda incentives-based and dynamic for future developments.

The biggest challenge is to make the system credible and science-based, while avoiding excess complexity

Financial market participants have the willingness to direct money to sustainable economic activities. Yet it needs to be recognized that the skills of financial professionals haven't been acquired from natural sciences. Therefore, the taxonomy needs to be simple enough so that people who are supposed to use it in their investment decision making can understand it. If we create a taxonomy so complicated that its usage requires highly specialized personnel, smaller companies' chances to make use of it disappears, and it doesn't serve transparency or credibility of the financial market. The principle of proportionality is vital to make sustainable finance work in practice.

We see the proposed taxonomy (the six general environmental objectives as well as the Technical Expert Group's first draft) providing a useful starting point. However, the provision of data and the verification and assessment processes seem to require significant additional resources and competences. There is a risk of differing methods to do this, which causes potential data quality questions. Making use of existing standards and frameworks, e.g. appropriate ISO standards, is important to ensure uniform application across markets and types of financial institutions.

Sustainable investments are much needed outside as well as inside the EU. We don't see the need to limit the taxonomy's applicability to only the EU region. On the other hand, reporting obligations' elaborateness will determine how widely the taxonomy can be used, because data availability and creditworthiness differs between regions and sectors. The more detailed we want reporting to be, the more it limits potential investments, especially outside the EU.

Finally, we hope that the taxonomy is prescribed so that also SMEs have the possibility to provide the required data and input to be eligible as sustainable investee companies.

Taxonomy regulation should not overlap and diverge from what is already regulated in the disclosures proposal, nor from the general principles on which the sustainable finance action plan is based on

Some of the European Parliament amendment proposals would significantly change the underlying principles that have been behind the EU's sustainable finance action plan's legislative proposals. For example, the package has been prepared from investment activities' point of view, and we do not think it wise to add lending activities in the scope without proper impact assessment and dedicated consideration to their nature. Lending and investment activities differ, and the same requirements cannot be simply added from one to the other.

☛ Credit institutions should not be obliged to disclose their corporate lending that funds environmentally sustainable activities at this stage. A good taxonomy will facilitate future disclosure, but this requires co-operation between all market participants, and the legislative proposals have been prepared for investment activities only as the first step.

Another underlying principle has been to *incentivize* sustainable investments. By creating a harmonized way to understand what is sustainable, is an objective we support, but naming economic activities with *a significant negative environmental impact* does not follow this principle.

☛ The taxonomy should focus on the positive and not the negative environmental impact. Focusing on the negative impact could lead to an abrupt and disorderly transition and create dangerous instability to the market due to speculation already before its final form is decided. We advocate for a gradual approach, to achieve a solid and generally accepted framework on sustainable activities first.

The legislative proposals published by the European Commission in May 2018 separated the sustainable finance actions into two distinct proposals for regulation; disclosures and the framework (taxonomy) parts. Because the disclosure requirements have their own regulation being prepared, to not create conflicting and confusing regulatory environment, the taxonomy regulation should not impose overlapping disclosure rules for financial companies. Especially since disclosures on sustainability are likely to develop over time, it is problematic if rules on it are spread across different regulations and directives.

☛ The taxonomy regulation should be about defining sustainable economic activities and leave reporting and disclosure requirements to be described in other legislative texts, which have been prepared specifically to that purpose. There are several financial services regulations already governing companies' reporting, in addition to the already mentioned sustainability disclosures proposal, e.g. the non-financial reporting directive and sector-specific regulations. Adding provisions on disclosure to the taxonomy regulation only confuses companies' understanding of what is required from them.

Proposals for improvement

Here are some practical suggestions that we think would help make the taxonomy workable:

1. Create a list of which national/EU regulations and market certifications already cover the criteria of sustainable economic activities as well as the “do no significant harm” -principle. This avoids unnecessary double analysis from companies, if they can rely on existing laws where they are sufficiently aligned with the taxonomy's objectives.

2. General company reporting practices need to be renewed to ensure sufficient data provision for financial companies. The review of NFRD guidelines is a good start, but not adequate for the requirements of the taxonomy. Data collection and transfer need to be designed so that it can be automated, there's no other way to reach the desired volume.

3. Make use of external certification bodies being able to conduct assessments in a uniform, standardized manner. This allows for a more efficient process than all financial market participants conducting individual assessments. In addition, financial market participants might differ in their assessment methodology etc., potentially causing clients to “shop” for the most lenient financial institution to label the operation as “green”.

4. Enable companies to label themselves as “green” (i.e. their equity), and especially for companies/conglomerates having multiple economic activities, clarify what share of their economic activities should be “green” for the company/group as a whole to be classified as “green”. If only individual economic activities apply, the ability to label companies/equities as “green” becomes rarer as most investments are in fact general corporate purpose funding. Threshold to be eligible as “green” company should be set at an ambitious, but reasonable level. This would better encourage shifting business activities in a sustainable direction. The threshold should be subject to regular reviews and raised as companies mature.

5. The effect to existing green bond programs that do not qualify is unclear. Addressing this is crucial. Especially, as real estate is the biggest green bond sector in the Nordics. In its present form, the taxonomy would not label most existing Nordic real estate bonds as “green”. Please see also CICERO’s comments on the taxonomy’s potential impact to the green bond market.

6. Regional flexibility might be needed in certain areas, but we caution against giving too much leeway to this in the regulation’s level 1 text. It should be left to the Technical Expert Group, and its successor Sustainability Platform, to decide where the criteria need to be adapted to local conditions. If the decision is open for policy-makers’ choice, it risks making the taxonomy a tool for national interests rather than a science-based criterion.

7. It is important to align the taxonomy with existing market practices and initiatives. We point out that one of the ongoing green finance projects is to create a “green mortgage”, a project led by the European Mortgage Federation (EMF). Currently, banks are already piloting this product. The eligibility threshold for a mortgage to be considered “green” in the EMF’s model wouldn’t align with the TEG’s taxonomy proposal. The EMF’s green mortgage product demands 30% energy efficiency improvement of the building, while the TEG’s taxonomy proposal requires an energy efficiency improvement of at least 50%. In the Nordics, where energy efficiency is generally at a high level, finding eligible projects in real estate sector might prove to be near impossible with the TEG’s 50% threshold.

The above proposals are meant to transmit the Finnish market participants’ views for a workable, market-based practices to integrate and mainstream sustainability into financial services reality. We hope that they inform both policy makers ahead of the ECON vote as well as the TEG’s members in their work to create a holistic EU sustainable finance agenda.

For more information, FFI’s adviser Elina Kamppi is at your disposal:
elina.kamppi@financefinland.fi, +358 20 793 4228