Comments on the EU sustainability taxonomy

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In view of the ongoing discussions on the proposal and in light of the European Parliament’s position agreed in March 2019, the comments below provide Insurance Europe’s views on key aspects of the taxonomy proposal. Insurance Europe’s comments on the EC proposal as adopted in May 2018 can be found here.

Summary
With more than €10tn of assets under management, the insurance industry is the largest institutional investor in Europe. As a result of their business model, insurers invest their assets with a long-term perspective. Several considerations affect insurers’ investment decisions and sustainability is already a key factor for insurers. This includes sustainable investment strategies, but also sustainable approaches based on stewardship and engagement to contributing to sustainability. The increasing number of insurance companies voluntarily committing to sustainability objectives confirms that a transition towards sustainability is already taking place.

Insurance Europe welcomed the recommendations of the EC High-Level Expert Group report and the subsequent Action Plan on Financing Sustainable Growth. The insurance industry supports the EU efforts to make the European economy greener and more resilient in line with the CMU project goals. Since sustainability has different meanings to investors across markets, Insurance Europe believes that reaching a shared understanding of sustainability must be the key priority of the EC. In this context, the EC proposal on the framework (ie taxonomy) is therefore a very positive step.
General comments

Scope (Art 1 & 4)
- Financial market participants: the insurance industry is fully supportive of the EC focus on financial products marketed as environmentally sustainable. While including exceptions, the EP proposal to extend the scope to other financial products is premature and brings about feasibility and proportionality issues.
- Related disclosures requirements: the EP proposal to extend the sustainability disclosures to all financial products is extremely burdensome and is not balanced by sufficient benefits for customers. Increased transparency is welcome, but it is necessary to ensure that respective requirements are proportionate and efficient.
- Social dimension: in principle, the insurance sector supports a holistic approach to sustainability, inclusive of all ESG factors. For this reason, the insurance industry recognises the importance of working on the development of a social taxonomy in the future, as indicated in the review clause in Article 17. Due to the degree of complexity involved, the development of a classification of social economic activities would still require intensive work and coordination with several stakeholders. This considered, the industry believes it is key that the development of a social taxonomy is further discussed with respective stakeholders and that the environmental framework is developed first, without delay, to facilitate compliance with the climate targets agreed at the Paris Climate Summit in 2015. Governance aspects should be a prerequisite to sustainable investments and are expected to be implicitly integrated in the framework, in line with the definition of sustainable investment provided in Article 2 of the disclosures regulation.

Definitions (Art 2)
- The definition of financial products should be aligned with that in the disclosures regulation. Therefore, corporate bonds should not be included in the definition as proposed by the EP.

Brown taxonomy (Art 3a)
- The insurance sector finds the proposals for a brown taxonomy concerning. A gradual transition is needed to ensure that the taxonomy will not unnecessarily restrict the investment universe. Therefore, the EC proposed positive approach towards the transition is preferred to encourage all sectors to participate to the sustainability transition. It is also key that the introduction of a brown taxonomy first considers the implementation of the framework and its potential consequences on financial markets.

Minimum safeguards (Art 13)
- The minimum safeguards are welcome as a means to ensure social resilience in the transition towards a more sustainable economy and integrate crucial social considerations in the framework. This considered, they should respect feasibility and proportionality aspects.

Technical screening criteria (Art 14)
- The technical screening criteria should clearly evaluate market impacts, with specific attention to liquidity, stranded assets and financial green bubbles.

Platform on sustainable finance (Art 15)
- The establishment of a Platform on sustainable finance is supported as an essential channel to promptly inform the taxonomy and monitor related key developments. It also represents a forum for insurers to provide insight on the development and maintenance of the taxonomy.

Requirements for technical screening criteria and verification mechanisms (Art 14 & 17)
- Insurance Europe believes that a proper compliance mechanism should avoid costly verification requirements that might ultimately affect investors’ preferences for sustainable investments. Such compliance requirements should be flexible and proportionate.
- The issues with the sources of information used for the classification of economic activities, in particular for listed companies, should also be taken into account and the development of a social taxonomy is further discussed with respective stakeholders. The taxonomy should be based on harmonised information to ensure
that the sustainability assessments are coherent and comparable. Therefore, the information on the classification of the economic activities should be made available directly by the company/issuer in which the financial market participant invests, possibly in a standardised manner. At the same time, it is key to acknowledge the current issues, including cost, time and processes required for market participants to comply with the taxonomy. For example, data may not always be available, especially for non-EU companies or SMEs. In practice, this means that the sustainability assessment and related disclosure by financial market participants must therefore be done on a best effort basis.

Pending full development and operationalisation of the framework, issuers and market participants should not be liable for compliance with the disclosed information. It is key that policymakers evaluate and clarify these issues.
**Article 1 - Scope**

The industry fully supports the EC approach to focus on financial products marketed as **environmentally sustainable**. The EP proposal to extend the scope to other financial products is premature and brings about significant feasibility and proportionality issues. The consequence of such an extension would be that providers of financial products would have to carry out a taxonomy-based assessment for all financial products. This goes far beyond the aim of the taxonomy, ie to make financial products marketed as sustainable comparable and to prevent greenwashing. This requirement could also lead to negative consequences in terms of diversification and freedom of investment established in the Solvency II Directive. In extreme cases, financial market stability could also be impaired. Substantial changes to the scope of the regulation need to be properly investigated with an impact assessment to ensure that the resulting administrative burden for financial players is counterbalanced by substantial benefits for customers.

Maintaining the scope of the proposal focused on sustainable products:

- addresses the original objective of the EC proposal – "to address the divergence of existing national taxonomies and market-based initiatives at national level, in order to tackle the risk of "green washing", make it easier for economic operators to raise funds for environmentally sustainable activities across borders, and to try to establish a level playing field for all market participants" (EC proposal, page 5) – in a proportionate way.
- supports a **gradual transition** to sustainability as it will encourage companies to launch new environmentally sustainable activities/projects. This will allow for the broad acceptance and gradual take-up of the taxonomy.
- does not contradict the application of the taxonomy to other financial instruments on a voluntary basis, as highlighted in the EP report.
- allows market players to efficiently deal with the practical challenges of the sustainability classification, eg need for reliable and comparable data, additional expertise and resources, increased costs, tailored automated IT systems, etc.
- takes into account proportionality with respect to differences in the size and resources of insurers.
- mitigates potential issues related to market stability, which is key for long-term investors.

The introduction of exceptions by the EP is welcome but it represents a partial acknowledgment of the issues related to the application of the taxonomy. In particular, the requirement for insurers to provide information to national competent authorities at the level of all financial products (“explanations, supported by reasonable proof to the satisfaction of the relevant competent authorities, …”) is excessively burdensome. Such requirement should be instead efficient and proportional to customers’ needs.

**Article 2 – Definitions**

The EP introduction of corporate bonds in the definition of financial products is concerning and represents a substantial expansion of the scope which has not been investigated. In addition, the proposed introduction of corporate bonds in the definition of financial products is not correct as corporate bonds are not defined in Article 2j of the regulation on disclosures.

The definition of financial products should remain aligned with that in the disclosures regulation. Therefore, corporate bonds should not be included in the definition as proposed by the EP. This definition is more appropriate and will help guarantee consistency across legal requirements.

**Article 3 - Criteria for environmentally sustainable economic activities**

The insurance sector generally welcomes these criteria and highlights the need to keep them simple. This will encourage the operationalisation and the use of the taxonomy in financial markets and will limit investors’ reliance on external expertise.
Given the approach followed so far at technical level, it is questionable whether the taxonomy, as currently discussed, will be fit for purpose for the investment in entire companies (see position on the usability of the taxonomy here). In this respect, the insurance industry stresses that it is key that the classification criteria:

- capture a wide range of economic activities contributing to the sustainability transition. In particular, the “not harm requirements” should not be too restrictive and unnecessarily restrict the investment universe.
- are not too static and adequately capture the transition of companies towards a more sustainable business model.
- are workable from an investors’ perspective, especially considering the large number of economic activities to be analysed. It should be clearly specified what information should be used for the sustainability classification and who should provide it.

**Article 3a - Criteria for activities with a negative environmental impact**

The insurance sector believes that a binary classification of investments should be avoided. A positive approach is preferred to encourage all sectors to participate to the sustainability transition and avoid unwanted trade-offs, i.e., that companies which are crucial to support the transition to a greener economy are not left out. The taxonomy should be able to fully capture and encourage the transitional process to sustainability and encourage long-term sustainable investments. Unlike a penalising approach, this will provide incentives for all sectors to adapt their business models towards a sustainable low-emission economy.

It is key that, when assessing the possibility to introduce a brown taxonomy, the EC:

- evaluates realistically the potential consequences of the brown taxonomy on the stability and liquidity of the financial markets, i.e., risks of stranded assets, green bubbles and other distortions.
- considers first the evaluation of the implementation of the current framework, as planned in the review clause (Article 17).

In addition, the inclusion of a brown taxonomy in the Taxonomy Regulation is neither reasonable nor appropriate for the following reasons:

- the classification of brown activities risks being at odds with the technology-neutral approach of the taxonomy. A technology-neutral approach is suitable for covering all sectors of the economy and especially for creating an incentive for “brown” industries to move to more sustainable business models and even issue sustainable corporate bonds. In fact, a number of Green Bonds issuances have been used to lower greenhouse gas (GHG) emissions from coal-fired power plants. For example, investments in coal-fired power plants that reduce GHG emissions compared to similar economic activities are desirable to support the transition. Such activities should not be excluded or indirectly prohibited under a brown taxonomy, at least for a transitional period. In this sense, the creation of a “brown” taxonomy risks harming the transition of the economy rather than promoting it, at the European but above all at the international level.
- The identification of economic activities that significantly violate environmental objectives does not satisfy the principle of proportionality. On the contrary, the original EC approach complies with this principle as “the proposed measures create incentives for investing in green activities without penalising other investments” (EC proposal, page 4).

**Article 4 - Use of the sustainability criteria for economic activities**

The requirement on Member States in Article 4 (1) is too restrictive as it does not recognize that there may be financial products that pursue other environmental objectives than those defined in article 5. In fact, the definition of “sustainable investments” enshrined in the disclosures regulation is broader and the disclosure obligation applies to a wider array of sustainable financial products and investment strategies, which are not subject to the taxonomy regulation. For consistency, Article 4(1) should account for this issue by changing the wording from “marketed as environmentally sustainable” to “marketed as environmentally sustainable according to the EU taxonomy”.

Increased transparency is welcome, but the requirements should be proportionate and efficient. This considered, the insurance industry supports the EC proposal aimed at environmentally sustainable financial products.
A taxonomy focused on sustainable financial products will allow to:
- promptly and effectively deal with existing issues related to the sustainability classification, eg issues with respect to the availability and comparability of data can currently lead to contradictory sustainability results for a given company, and in turn to inconsistent disclosures.
- gradually address and mitigate potential reputational and competitive consequences arising from investment differences across market players and jurisdictions. This would need to be aligned with a realistic transition period for existing financial products marketed as environmentally sustainable.

Finally, disclosures should be proportional to the already available information and customers’ needs. Duplication of information and unnecessary overlaps with other related regulations should be avoided. Point 2c of the EP position is therefore welcome. Simplified provisions for small and non-complex undertakings as proposed by the EP in point 2d are also welcome.

**It needs to be clarified what information financial market participants will be required to disclose according to Article 4(3) and how this should be quantified.** It is not entirely clear what information financial market participant will be required to disclose according to Article 4(3), especially with respect to the share of the investment funding environmentally sustainable economic activities (point (b)). It is crucial that level 1 legislation specifies what is meant with these requirements.

In addition, the insurance sector stresses that market participants’ sustainability assessments and disclosures will be dependent on companies reporting relevant information in compliance with the EU taxonomy. It will not be possible for financial market participants to make the assessment by themselves. Data may not always be available, especially for non-EU companies or SMEs. Moreover, external assessments based on insufficient data will almost inevitably result in differing evaluations of companies’ sustainability, contradicting one of the main objectives of the taxonomy, namely to enhance transparency in the market. In practice, disclosure by financial market participants must therefore be allowed to be done on a best effort basis. Also, it needs to be recognized that a large share of an insurer’s holdings is in government bonds and bonds issued by local governments, supranational and similar, and that such assets probably will not qualify as environmentally sustainable according to the taxonomy. The introduction of the taxonomy should not put insurers with large and diversified investments in a competitive disadvantage to other financial market participants.

**Article 4a - Market monitoring**
The insurance sector believes that market monitoring and reporting to national competent authorities is legitimate. However, it is key that the provision of information to the relevant ESA (indicated in Article 2a) is efficient. The insurance sector believes that certain restrictions, eg the prohibition of financial products, could have a disproportionate detrimental effect on the markets.

**Articles 5-11 — Environmental objectives**
The insurance industry welcomes the proposals to introduce environmental objectives, as defined in Article 5, as well as the definition of how economic activities contribute to them as detailed in Article 6-11. The objectives should be kept general under this legislative act and be specified further at technical level in order to ensure that the framework:
- is built on robust and comparable indicators accessible to all concerned users
- remains up-to-date and is based on the latest scientific evidence and technological developments

Insurance sector believes that it is essential to have a taxonomy based on harmonised information. This is key to help investors measure sustainability risks and impacts. In addition, it will ensure consistency and comparability between products and market participants. These considerations should take into account the cost, time, and adjustments required for market participants to prepare the relevant indicators and reporting.
Focusing on the development of harmonised indicators, it is also necessary to ensure the usability of the taxonomy and its consistency with the ongoing proposals for an EU Ecolabel for financial products.

**Article 12 — Significant harm to environmental objectives**

In general, the insurance industry believes that this article should be clarified and attempt to explain what exactly is meant by “significant harm”. Focusing on the article, the sector supports the EP clarification to ensure that life cycle and value chain considerations are taken into account when assessing the environmental impacts of a given economic activity. The insurance industry is concerned that the proposal follows a narrow definition of sustainability, not sufficiently incorporating value chain aspects. This might lead to unwanted trade-offs if companies that are crucial for sustainability targets like decarbonization are not supported.

The following example can illustrate this aspect:

- Company “A” produces an energy-efficient generator that can be used in a number of sectors and that qualifies as “green”.
- Company “B” produces an adhesive which contains environmentally toxic materials, but which is necessary for next generation solar photovoltaics.

At the time of the investment, e.g. in a corporate bond, company “A” would be preferred to company “B”, despite the latter producing a crucial supply-chain product for decarbonization. This shows why a more comprehensive analysis on ESG aspects of investable and insurable assets is necessary.

**Article 13 — Minimum safeguards**

The minimum safeguards are generally welcome. They will ensure social resilience in the transition towards a more sustainable economy and integrate crucial social considerations in the framework. This considered, the adherence to responsible business conduct codes and international standards should respect feasibility and proportionality. Care should be taken to ensure that references to specific guidelines within the legislation do not bring about legal uncertainty. Therefore, the sector welcomes an impact assessment to evaluate the inclusion and the application of the proposed safeguards. Such assessment should consider the practical application of the safeguards, within the taxonomy framework.

**Article 14 — Requirements for technical screening criteria**

The insurance sector welcomes the development of specific technical screening criteria for each environmental objective. Looking at the requirements defined in Article 14, Insurance Europe supports technical criteria that:

- incorporate all relevant economic activities that are in and can contribute to the transition
- incorporate a long-term perspective in the sustainability evaluation
- are based on conclusive scientific evidence and harmonised indicators measuring environmental impact

The insurance sector believes that the **market impact of the technical screening criteria** should be explicitly considered, with specific focus on risks related to liquidity, stranded assets and financial green bubbles. Given their long-term business model, insurers can only change their portfolio gradually, respecting asset-liability-management requirements over a certain time horizon.

**Article 15 — Platform on Sustainable Finance**

Insurance Europe particularly welcomes the establishment of a Platform on sustainable finance as an essential channel to promptly inform the taxonomy and monitor related key developments. The insurance sector strongly supports the inclusion of representatives from the insurance sector in this EC expert group. The possibility for insurers to provide input on the sustainability taxonomy would allow for the development of a more robust taxonomy, endorsed by the financial market. Proposals by the EP to enhance transparency of the platform work and to achieve an efficient functioning of the taxonomy are also welcome.
With respect to accounting and integrated reporting, proposals to amend Directive 2013/34 are considered premature. A potential review of Accounting Directive 2013/34 should be aligned with existing requirements from Directive 2014/95/EU on disclosure of Non-Financial Information (NFI). The EC Fitness Check on the EU framework for public reporting notes that existing requirements in Directive 2014/95 already include non-financial disclosures. Given that the recent extended transparency requirements in the non-financial information directive were implemented only one year ago, a period of stability to evaluate the impact and effectiveness of the directive should be observed before proposing new changes.

**Article 17 — Review clause**

The insurance sector welcomes the review clause as a good means to ensure the development of a solid taxonomy.

With respect to the development of a taxonomy with social and governance objectives, in principle, the insurance sector supports a holistic approach to sustainability, which includes all ESG factors. Investments related to the "S" and "G" factors are already of significant importance to insurers in a number of EU countries. For this reason, the insurance industry recognises the importance of working on the development of a social taxonomy in the future, as indicated in the review clause in Article 17(c).

However, due to the degree of complexity involved, the development of a classification of social economic activities would still require intensive work and coordination with several stakeholders. This considered, the industry believes it is key that the environmental framework is developed first without delay to facilitate compliance with the climate targets agreed at the Paris Climate Summit in 2015 and the development of a social taxonomy is further discussed with respective stakeholders. Governance aspects should be a prerequisite to sustainable investments and are expected to be implicitly integrated in the framework, in line with the definition of sustainable investment provided in Article 2 of the disclosures regulation.

Following this reasoning, the industry suggests a change in wording for Article 17(c):

"By 31 December 2021 the Commission shall publish a report....to evaluate:

(c) the appropriateness of extending the scope of this regulation to cover other sustainability objectives, in particular with respect to social and governance objectives;”

Regarding potential verification mechanisms, Insurance Europe believes that a proper compliance mechanism should avoid costly verification requirements that might negatively impact financial investment returns and ultimately affect investors’ preferences for sustainable investments. Such compliance requirements should be flexible and proportionate, preferably introduced once a robust taxonomy is in place and taking into account existing issues related to the sustainability assessment.

Specifically, the issues with the sources of information used for the classification of economic activities, in particular for listed companies, should also be taken into account. The taxonomy should be based on harmonised information to ensure that the sustainability assessments are coherent and comparable. Therefore, the information on the classification of the economic activities should be made available directly by the company/issuer in which the financial market participant invests, possibly in a standardised manner. At the same time, it is key to acknowledge the current issues, including cost, time and processes required for market participants to comply with the taxonomy. For example, data may not always be available, especially for non-EU companies or SMEs.

In practice, this means that the sustainability assessment and related disclosure by financial market participants must therefore be done on a best effort basis. Pending full development and operationalisation of the framework, issuers and market participants should not be liable for compliance with the disclosed information. It is key that policymakers evaluate and clarify these issues, not only because of the verification costs but also because of the potential liability risks involved with the use of the taxonomy.

Regarding the role of the taxonomy in channelling private investments into sustainable activities, it is key to note that the taxonomy provides necessary support but is not a sufficient instrument to achieve alone this
objective. In fact, the taxonomy role should be to develop a common understanding of sustainability and to allow screening and eventually scoring of the various companies and related investments. The taxonomy will provide clarity for investors but will not be able to change the type of projects and assets of the real economy. Further policy actions are needed to address the limited supply of suitable sustainable investments to support a transition to a sustainable economy.

The insurance sector welcomes the EP position in paragraph 1a regarding the review of the scope of the regulation. This partially acknowledges the issues related to the application of the taxonomy as highlighted for articles 1 and 4, both in terms of the feasibility and administrative burden.

Other comments and considerations

The European insurance industry welcomes a sustainability assessment capturing various degrees of sustainability of an investment. The taxonomy regulation should:

- establish a shared understanding of sustainability to enable market actors to analyse and measure the sustainability impact of economic activities.
- be a screening device and eventually a scoring tool enabling investors to compare various investment options.

For the framework to be a usable and mainstream investment tool, it should remain sufficiently flexible and simple to be used. This means that it will need to accommodate a wide range of companies, investment instruments and various investment strategies.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 200bn in the economy.