Position Paper

Comments to EC TEG final report on the EU taxonomy

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Usability of the taxonomy

1. Do you expect to use the Taxonomy in your business activities in the short term (1-3 years) or long term (4 years or more)? If YES, please indicate when (short term or long term) and specify the activities for which you will use the Taxonomy. If NO, please explain why not?

Yes, to some extent.

The European insurance sector welcomes the improvements in the TEG's work, especially on enabling and transition activities. The sector supports common criteria for sustainable economic activity in future, but open questions remain about the practical application of the taxonomy to different asset classes and local contexts.

While the taxonomy may provide guidance to assess the degree of sustainability of certain investments, given insurers' large and diversified investment portfolios, it is still too complex to be used as a list of eligible investments. The disclosures in Art. 4 (2) of the proposed taxonomy regulation require financial actors to disclose the alignment of investments with the taxonomy at investment product level. However, the taxonomy is far too complex for them to do such an assessment on individual investee companies. As it stands, the assessment requires tailored IT solutions, a thorough knowledge and resource-intensive analysis of economic activities. Investors should consider the overall sustainability of their investments instead.

A reliable assessment should be made by the investee companies themselves. Assessments by different investors may lead to inconsistent results, which a regulatory framework should not allow. In terms of the proposed five-step check process, this means that the investor cannot do the identification and verification steps 1-3. Those three steps can only be performed by the investee company. The investor can only perform step 4 and 5 at portfolio/investment product level, provided data are available.

Finally, it needs to be recognised that data availability for the large part of insurers' investments will remain an issue. In fact, not all companies/issuers are covered by the taxonomy and/or will report according to it. When data is available, then it is often poorly standardised, unreliable and inconsistent between data providers. Moreover, data can be expensive, especially for small- and medium-sized insurers that are fully dependent on external data providers.

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2. Can the Taxonomy be made more useful for disclosures related to your specific financial product? This question covers only financial products where disclosure obligations are foreseen by the Taxonomy proposal.

Yes.

If YES, which specific financial product(s) did you have in mind? *- Portfolio management – yes/no?* *- UCITS funds – yes/no?* *- Alternative investment funds – yes/no?* *- Insurance-based Investment Products – yes/no?* *- Pension products and pension schemes – yes/no?*

Yes, for Insurance-based Investment Products

How could the Taxonomy be made more useful for Insurance-based Investment Products?

The TEG Taxonomy Technical Report and the Supplementary Report 2019 ("Using the taxonomy") describe how investors would apply the taxonomy to an equity portfolio, using the proposed "five-step check process" for the implementation. The fifth step commands the investor to disclose the alignment of investments with the taxonomy at the investment product level.

As noted in the response to question 1, it is key to recognise that it may not be possible for an insurer to apply the proposed methodology and disclose information about its whole portfolio as suggested. Therefore, the insurance sector invites the TEG to improve the usability/implementation of the taxonomy, in particular with respect to large portfolios and with respect to the availability of data.

An insurer's investment portfolio may consist of many assets for which data is no available. There may be a number of reasons why there is no available data. Some entities are less likely to report their activities in line with the taxonomy requirements, specifically:

- Sovereigns, municipalities, multinational development banks, or international organizations, eg the IMF
- Companies outside the EU
- Some companies in the EU, especially the small ones

Since insurers invest in many assets, not least government bonds, global equity and private equity, it may be useful for them to report not just the share of taxonomy-eligible investments, but also the share of the investment portfolio for which there is no data available for the taxonomy implementation.

Compliance issues which could result in liability risks for investors should also be addressed. In practice, this means that the disclosure by financial market participants must 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 these issues are evaluated and clarified, especially because of the potential liability risks related to the use of the taxonomy.

See also competition concerns in question 3.

insurance europe

*3. Can the Taxonomy be made **more useful** for your investment decisions in different asset classes?*

Yes.

If YES, which asset class(es) did you have in mind?
- Public equity – yes/no?
- Corporate bonds – yes/no?
- Green bonds – yes/no?
- Private equity – yes/no?
- Real estate – yes/no?
- Project finance – yes/no?
- Green loans – yes/no?
- Other assets – yes/no?

Yes, for public equity and for corporate bonds

How could the Taxonomy be made more useful for public equity?

Addressing the issues already highlighted by the TEG will make the taxonomy more useful. As acknowledged on page 97 of the TEG Technical Report, the taxonomy will bring about increased costs for investors (related to IT systems, required expertise etc) and challenges related to collecting the information necessary to use the taxonomy (eg reliable standardised data). Users of the taxonomy will also incur a burden associated with embedding the taxonomy check steps, including the proposed environmental due diligence processes, in the investment processes.

The issues with the sources of information for the classification of economic activities are highly relevant, in particular for listed companies. 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. A regulatory framework should not allow divergent interpretations and expose financial market actors to unnecessary liability risks. This means that the taxonomy should be applied on the basis of harmonised information to ensure that the sustainability assessments are coherent and comparable.

How could the Taxonomy be made more useful for corporate bonds?

As noted above, lacking reliable sources of information for the taxonomy screening process, disclosure by financial market participants should be done on a best effort basis to avoid unnecessary liability risks for investors. If the necessary information was made available directly by the company/issuer in which the insurer invests and the five-step check process was reduced to the last two steps, then using the taxonomy would be easier.

The insurance sector notes that these simplifications are key for bonds. European insurers currently hold about 60% of their portfolio in bonds (see EIOPA's 2017 investment mix by insurers in EEA). Government bonds represent about 50% of these bonds, which is why the sector invites the TEG to:

- Clearly consider how to increase the supply of government bonds eligible under the taxonomy, eg via Green Bond Standard, European labels.
- Encourage issuers of all bonds, including sovereigns, to report the information necessary for the implementation of the taxonomy. This is key especially in a context where ESG data providers tend to deliver bond data based on a public equity view.

Making the taxonomy more useful for all bonds is key for insurers, as there is a growing concern that taxonomy disclosures might introduce competitive distortions at product offering level. This might deter insurers, particularly smaller or less-resourced ones, from competing in the market for sustainable products. Specifically, insurers offering life products with a guarantee are at a competitive disadvantage compared with other financial market participants offering fund-like products. For guarantee products, the prudent person principle (Art. 132 of the Solvency II Directive) indirectly requires the insurer to invest in a broad mix of products (eg corporate bonds, covered bonds, government bonds, etc) for which the degrees of environmental sustainability will need to be determined. However, achieving a high sustainability degree for this complex mix of products would be more challenging. Therefore, green insurance products linked to a guarantee will not be able to successfully compete on environmental grounds against other portfolio products that can easily achieve full environmental sustainability.

4. Is it sufficiently clear when the entire activities of a company or other entity should be considered as Taxonomy eligible (revenues or turnover) and when only expenditures by companies or other entities should be considered Taxonomy eligible?

No.

If NO, it is not sufficiently clear, please specify how this could be made clearer.

It is clear when the entire activities of a company or other entity should be considered as taxonomy eligible (revenues or turnover) and when only expenditures by companies or other entities should be considered taxonomy eligible. However, the insurance sector invites the TEG to clarify how these two measures should be weighed together, possibly with supporting cases/examples.

For example:

- Using the example on page 10 in the Supplementary Report 2019 ("Using the taxonomy"), let us assume that a bond issued by a fourth company — company D — was bought and added to the portfolio. If this company reports a 10 percent expenditure as taxonomy-eligible, how should the investor calculate the eligibility of the investment fund?
- Assuming a company has 40 percent taxonomy-eligible turnover and 10 percent taxonomy-eligible expenditures, then how should an investor treat the company for the sustainability assessment? Should bonds and equity be treated differently — equity 40% compliant and bonds 10% compliant — even though they have been issued by the same company?

Equally important for the overall clarity of the framework, the TEG should address potential inconsistencies between the proposed regulation and its proposed implementation. In particular, the TEG Technical Report (page 62) states that the obligation for investors is limited to reporting how their green products relate to the taxonomy, and it adds on page 8 of the Supplementary Report that investors would be free to explain alternative methodologies in their disclosures. The TEG approach appears reasonable, especially for the initial stages of implementation, but it appears not to be consistent with the objectives of the proposed regulation. Therefore, this should be clarified.

5. What practical tools or measures could be developed to facilitate the implementation of the taxonomy by financial actors?

Please specify what these tools would be used for and provide sufficient explanation on how they can help to implement the taxonomy:

Data availability and reliability are one of the biggest barriers to make the taxonomy work in practice. Investors need data about company or issuer performance based on the taxonomy activity criteria. Specifically, they need data on the proportion of the company revenue or turnover that stems from Taxonomy-eligible activities and/or the proportion of the company expenditure allocated to taxonomy-eligible activities.

It is key that data is easily accessible and affordable. While it is reasonable to expect data markets to gradually develop to provide this information, the TEG might be underestimating the issues related to data availability and quality. While the sector agrees with the TEG that companies and data providers have incentives to report in line with the taxonomy and adapt their questionnaires/systems accordingly, the incentives, the speed and extent to which this will happen are uncertain (see response to question 2).

The insurance sector notes that the theoretical framework approach needs to be implementable in practice. This is why the sector encourages the TEG to develop an extensive and comprehensive test for the taxonomy. Using real company data would provide a valuable example to guide investors and show how to use the taxonomy in practice.

Specifically, the TEG could consider a given equity or bond index, screen the index companies with the taxonomy criteria, aggregate the resulting information to show the investment alignment with the taxonomy and report the results as required in the disclosures. This also would help:

- Find solutions to the issues of accessibility and reliability of information.
- Clarify how to comply with disclosures proposed in Art. 4 (2) and (3) of the regulation.
- Highlight at what level investors are expected to assess the investment sustainability.
- Guide investors in the application of the proposed taxonomy screening criteria.

6. What practical tools or measures could be developed to help non-financial companies assess what share of their economic activities is taxonomy-eligible?

As it stands, the taxonomy framework requires investors to assess whether the activities carried out by investee companies comply with the screening criteria for economic activities. Therefore, investors are under the obligation to explain their strategy for ensuring the environmental sustainability of their investments.

While investors are expected to have a due diligence process in place on sustainability-related investment information, they cannot be expected to assess their investments at the level of economic activities. The necessary information and its reliability are fully dependent on the company performing the economic activity in the first place. For example, investors cannot have access to data on emissions levels for a given production process, unless the company itself or a third-party provider makes it available. Non-financial companies are not always likely to report their activities according to the taxonomy (eg sovereigns, foreign companies, SMEs, etc). Should a third-party data provider be used, related costs would be passed on to the customers, making sustainable products less attractive.

As noted above, even if the necessary information was available, the investment portfolios still might consist of many assets, which makes the screening for the investors problematic. If investors are subject to unnecessary liability risks for investing sustainably, then the risk is that green products will be put at a disadvantage in comparison with other products.

With respect to the implementation of the taxonomy, the insurance sector is concerned about the TEG statement on page 97 of the Technical Report; ie that the Taxonomy will be used as a basis for the revision of prudential requirements. While the sector believes that the EU taxonomy might help investors to assess their asset allocations against climate change objectives, it reiterates that the EU taxonomy is not designed as a prudential tool to identify assets that have a higher/lower exposure to sustainability risks or to assess the sustainability risks of investments. In certain cases, the so called "green" assets may also be exposed to physical risks to a great extent.