Position Paper

Insurance Europe position on the EU taxonomy in view of trialogues

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Summary

In view of the ongoing discussions on the proposal in the trialogues, 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.

Key messages

Scope

- The insurance industry is fully supportive of the EC and Council of the EU focus on financial products marketed as environmentally sustainable. While including exceptions, the European Parliament proposal to extend the scope to other financial products is premature and brings about feasibility and proportionality issues.

Creation of an additional category of transition activities

- The EU taxonomy should be able to fully encourage the transitional process to sustainability and to capture a forward-looking element. Therefore, Insurance Europe welcomes the Council proposal to recognise enabling and transition activities as potentially contributing to sustainability. This approach will encourage all sectors to make their business models more sustainable and will not unnecessarily restrict the investment universe.

Related disclosures requirements

- The insurance industry notes that, given insurers' large and diversified investment portfolios, the taxonomy is too complex and that assessments by different investors may lead to inconsistent results. Therefore, the industry asks that a reliable assessment is directly made by the investee companies themselves instead.
- Individual companies should be required to provide ESG data in relation to their activities and for each funding instruments so that investors can comply with proposed disclosures. Mandatory reporting of standardised ESG information would enhance comparability across investments, fight greenwashing and decrease dependency on external data providers.
- Pending the availability of necessary data, investors should comply with proposed disclosures on a best effort basis to avoid unnecessary liability and compliance risks for investors.

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Verification mechanisms

- 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 future-proof and proportionate, introduced once a robust taxonomy is in place.

Platform on sustainable finance

- The establishment of a Platform on sustainable finance is supported as an essential channel to promptly inform the taxonomy and monitor related key developments. The industry is ready and willing to contribute to its work and to provide insight on the development and maintenance of the taxonomy.

Timeline

- Proposed timelines are challenging as they might lead to compliance challenges and liability risks for market players, as well as confusion for investors. A successful implementation should be based instead on a realistic timeline that avoids timetable misalignments between the adoption of the Regulation and that of related Delegated Acts specifying its requirements.
- For this reason, the European insurance industry urges policymakers to take any steps possible to achieve a more realistic implementation timeline and recommends that, as long as a timing problem remains, investors should be allowed to comply to sustainability-related requirements on a best effort basis for a transitional period. This will allow insurers to have sufficient time to implement the finalised requirements as well as to find solutions to deal with issues related to the availability and quality of sustainability data.

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Overview of EC proposal and Council/EP positions with comments

Article 1 – Subject matter and scope

The industry fully supports the EC and Council approach to focus on financial products marketed as environmentally sustainable.

The Parliament's proposal to extend the scope to other financial products is premature and brings about significant feasibility and proportionality issues. Eventually the extension of the scope suggested by the Parliament might end up becoming an informal requirement on providers of financial products to carry out taxonomy-based assessment for all financial products. The expansion of the scope will lead to extensive reporting costs. Data availability will remain an issue that will certainly lead to increase data providers services' costs for investors. There is also a risk that these additional reporting costs be passed on to clients.

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. 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 and that there is no incentive to green washing.

Maintaining the scope of the proposal focused on sustainable products:

- is in line with 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 Parliament's 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 Parliament 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 introduction of corporate bonds in the definition of financial products is inconsistent with the scope of Article 2(j) of the regulation on disclosures. The definition of financial products should remain aligned with that in the disclosures regulation and not expand the scope of the regulation without a proper investigation. Therefore, corporate bonds should not be included in the definition as proposed by the Parliament. The EC and Council definitions are more appropriate and will help guarantee consistency across legal requirements.

Article 3 – Criteria for environmentally sustainable economic activities

The insurance sector 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 the need for 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 investment (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 and are dynamic enough to adequately capture the transition of companies towards a more sustainable business model. In particular, the "not harm requirements" should not be too restrictive and unnecessarily restrict the investment universe. For this reason, the industry strongly welcomes the Council approach to consider enabling (as per Article 2) and transitional activities (as per Article 6) as potentially sustainable.
- 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. It needs to be recognised that data availability and reliability for large part of insurers' investments will remain an issue. Therefore, a reliable assessment should be made directly by the investee companies themselves. This will also avoid that assessments by different investors lead to inconsistent results, which a regulatory framework should not allow.

Article 3a (EP) – Criteria for economic activities with a significant negative environmental impact

The insurance industry 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**, ie that companies which are crucial to support the transition to a greener economy are 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, ie 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).

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.

Article 4 – Use of the criteria for environmentally sustainable economic activities

The requirement 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 reflect this by changing the wording from "*marketed as environmentally sustainable*" to "*marketed as environmentally sustainable* ***according to the EU taxonomy***".

Such an approach will allow insurers 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.

Regarding Article 4(2), the insurance sector welcomes increased transparency provided proposed requirements are efficient and proportionate to the already available information and customers' needs. Regardless of the choice of the legal instrument to develop the content and presentation of the taxonomy-related disclosures, the proposed disclosures should be aligned with those in the Disclosures regulation. This will avoid duplication of information and unnecessary overlaps. For this reason, the references to complementarity with respect to the Disclosures regulation in Article 4 (2c) of the Council and Parliament positions are welcome. Concrete consideration of the peculiarities of various types of financial products are also highly beneficial. Regarding small and non-complex undertakings, they could benefit for a longer transitional regime to develop reporting processes.

Equally important, **level 1 legislation needs to clarify what information financial market participants will be required to disclose and how this should be quantified.** It is not entirely clear what information financial market participants will be required to disclose, especially with respect to the share of the investment funding environmentally sustainable economic activities (Article 4(2)(a) of the Parliament's proposal and **Article 4(3)**(b) of the Council proposal). Market participants' sustainability assessment and disclosures are dependent on relevant information reported by investee companies in accordance with the EU taxonomy. Therefore, lack of clarity on the required disclosures paired with insufficient companies' data, will result in different evaluations of companies' sustainability by market participants. In practice, disclosure by financial market participants should be done on a best effort basis, considering public information disclosed by investee companies, until issues related to data availability are addressed.

Finally, 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 entities, 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. The reporting on the share of investments funding environmentally sustainable economic activities as a percentage of all investments selected for the financial product should also include at least sovereign bonds considered as "Green Bonds" as per the EU Green Bond Standard. In this respect it is important that the issuance of sovereign green bonds of EU Member States and other green bonds aligned with the EU green bond standard, and therefore the EU taxonomy, is encouraged.

Article 4a (EP) – Market monitoring

While the insurance sector considers market monitoring by national competent authorities to be legitimate, it is key that the provision of information to the relevant ESA (indicated in Article 4, point 2a) is efficient. The insurance sector believes that certain restrictions, eg the prohibition of financial products, could have a disproportionate effect on the markets and that the proposal of the Council is more appropriate given current issues on the implementation of the requirements (see comment to Article 15b as per Council proposal).

Article 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.

The insurance sector considers 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. When 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.

The insurance sector is in favour of the proposal of the Council to have one-year period between the adoption of delegated/implementing acts and their entry into application. This will allow investors to develop their reporting processes efficiently. A unique adoption date is key in order to be able to assess the "do not significant harm" principle.

Article 12 – Significant harm to environmental objectives

The insurance industry considers that there is a need to further clarify this article. In particular, the meaning of "significant harm" is not clear. The industry supports the Parliament's position which tends to ensure that life cycle considerations are taken into account when assessing the environmental impacts of a given economic activity. However, it considers that the definition of sustainability should be expanded. As it stands, the proposal is narrow and does not allow taking into account value chain aspects. This might lead to unwanted trade-offs if no support is given to companies that are crucial for sustainability targets, such as decarbonization. To this end, the introduction of transition and enabling economic activities in the scope, as per the Council proposal, is welcome as it allows to fully capture the transitional process to a low-emission economy.

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, eg 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. The notion of mitigation and management plan, introduced as "DNSH" criteria in the TEG report, should be mentioned at level 1 legislation.

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 requirements to adhere to responsible business conduct codes and international standards should respect feasibility and proportionality principles. Care should be taken to ensure that references to specific guidelines, which may later be updated, 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 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 use. This means that it will need to accommodate a wide range of companies, investment instruments and various investment strategies.

Therefore, the insurance sector supports a simple taxonomy that does not unnecessarily restrict the investment universe, while providing the right incentives to promote the sustainability transition. To this end, the industry welcomes the Council proposal to consider enabling and transition activities as potentially sustainable, especially for the development of the requirements for screening criteria as proposed in Article 14 ("*possible enabling nature of activities referred to in point (a) of Article 3 and activities which support the transition to a carbon neutral economy in accordance with Article 6(1a)*").

In general, 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 also 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 insurance sector representatives 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 Council and Parliament to enhance transparency of the platform work and to achieve an efficient functioning of the taxonomy are welcome. In addition, as the insurance industry supports a holistic approach to sustainability comprehensive of all ESG factors, it welcomes the EC and Parliament proposals on the development of a social taxonomy in the future.

Article 15a (Council) – Competent authorities

The industry also notes that taxonomy-related disclosures should be aligned to the disclosures under the Disclosure regulation so that duplication of information is avoided. Therefore, for consistency, the control mechanisms should be aligned.

Please see, comments under Article 4a on market monitoring and under Article 15b on measures and penalties.

Article 15b (Council) – Measures and penalties

Regarding potential **verification mechanisms**, Insurance Europe believes that compliance mechanisms 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 future-proof and proportionate, preferably introduced once a robust taxonomy is in place and taking into account existing issues related to the sustainability assessment.

Specifically, current 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 sustainability assessments are coherent and comparable. Therefore, 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 terms of timeframe, the industry considers that, even if the application of this article is subject to the completion of the related DAs, the industry should have sufficient time for implementation and compliance. Therefore, the industry recommends that the application of the potential verification mechanisms and penalties is postpone to when all Level 2 measures are finalised and published in the OJEU.

Finally, given current issues with the implementation timeline (see comments to Article 18) and with data availability and quality (see comments to Article 3), the industry recommends that the sustainability assessment and related disclosure by financial market participants is done on a best effort basis at least for a transitional period. This will avoid that investors are liable for compliance with the disclosed information while the taxonomy is still under development.

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 Article 17(1)(c) of the Council and EP proposals.

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. Therefore, 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 Disclosure 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;"*

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 this objective alone. 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. This considered, the insurance sector is in favour of the Council proposal

on the treatment of equity securities and other securities to encourage issuers and other legal entities to apply the EU taxonomy on a voluntary basis. The insurance sector welcomes the Parliament 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.

Regarding potential **verification mechanisms**, please see comments under Article 15b.

Article 18 – Entry into force and application

Proposed timelines by Parliament and Council are challenging as they might lead to compliance challenges and liability risks for market players, as well as confusion for investors. A successful implementation should be based instead on a feasible and realistic timeline that avoids timetable misalignments between the adoption of the Regulation and that of related Delegated Acts specifying its requirements.

On one hand, the EC and Parliament timelines are challenging because the Regulation and the Delegated Acts on the screening criteria will apply at the same time, meaning that insurers would not have any implementation time to comply with the proposed requirements. On the other hand, the Council timeline leaves a one-year period between the adoption of the Delegated Acts and their application, which is strongly supported. However, the Council proposal also sets the application of the Regulation well in advance of the finalisation of the Level 2 measures.

For this reason, the European insurance industry urges policymakers to take any steps possible to achieve a more realistic implementation timeline and recommends that, as long as a timing problem remains, investors should be allowed to comply to sustainability-related requirements on a best effort basis for a transitional period. This will allow insurers to have sufficient time to implement the finalised requirements as well as to find solutions to deal with issues related to the availability and quality of sustainability data.