Together we can do more

The implementation of the EU Taxonomy

Recommendations

Brussels, 14 December 2020

The members of the European association of Long-term Investors (ELTI) and the Network of European Financial Institutions for Small and Medium Sized Enterprises (NEFI) are fully committed to the ongoing process of turning the EU into a sustainable, carbon-neutral economy. They act in close cooperation with States and local authorities as well as private financial actors, joining forces for the sake of a greener economy.

NPBIs welcome the creation of the Taxonomy and deem it as a useful and powerful tool to foster the European green transition. The EU Taxonomy will have several implications for NPBIs. Among them, some NPBIs:

- will be required to disclose the alignment of their financial products with the EU Taxonomy,
- will be subject to the reporting requirements of the NFRD based on the Taxonomy,
- might consider using the upcoming EU Green Bond Standard,
- could be asked to apply the Taxonomy in the context of the implementation of EU financial instruments such as InvestEU.

Given the fact that there are still many uncertainties regarding the practical implementation of the Taxonomy[1], ELTI and NEFI members call the European Commission and the European supervisory authorities for a comprehensive consultation process with relevant stakeholders including NPBIs. They would like to point out seven recommendations with regard to its operationalisation, in particular the need for:

1. Adapting the EU taxonomy to smaller entities to overcome its implementation challenges.
2. Ensuring coherence and consistency between the EU Taxonomy and EU Financial Instruments requirements, notably InvestEU.
3. Taking into account the differences between financing methods (debt or equity)
4. Incentives and capacity building to ensure the effective application of the EU Taxonomy.
5. Preserving the benefits of long-term funding for the transition.
6. Ensuring a gradual implementation of the Taxonomy.
7. Avoiding discrepancies about accountability for certification of data.

[1] Such as KPIs definitions, reporting models, “do not significant harm” requirements and minimum safeguards.

1. ELTI and NEFI members see the need to adapt the EU taxonomy to smaller entities to overcome its implementation challenges

The Taxonomy, in its current form based on extensive quantitative and qualitative technical criteria, will pose significant challenges to smaller entities (start-ups, SMEs, local authorities) willing to demonstrate the sustainability of their small projects given their modest size and the need to ensure them a quick and easy access to finance. At the project promoter level, the cost of applying the Taxonomy will be disproportionate and dissuasive. At the financial institution/financial market participant level, the access to information will be severely limited.

Thus, and given this methodological complexity, there is a risk to exclude *de facto* projects carried out by smaller entities from the scope of sustainable finance. It is crucial to ensure a proportionate application of the Taxonomy for smaller projects in case they volunteer to apply the taxonomy or in case they are legally asked to do so. Such a proportionate approach will be appropriate both at the level of the final recipient and at the level of the financial actor. The following thresholds could be considered:

- Operations (e.g. amount of the banking pool/fundraising) <€10M: giving the possibility to apply on a voluntary basis simplified and proportionated requirements against the background of the Taxonomy (for instance by envisaging to limit the application of the Taxonomy to the demonstration of the substantial contribution).
- 10€M ≥ operations: full application of the Taxonomy.

2. ELTI and NEFI members see the need for ensuring coherence and consistency between the EU taxonomy and EU Financial instruments requirements, notably InvestEU

The fact that the Taxonomy is already used as a “reference mile” whereas many technical issues are still to be defined hampers the development of viable products under the umbrella of InvestEU. There is high uncertainty around sustainability proofing and climate tracking considering the partially undefined requirements of the Taxonomy. From our point of view, sustainability should be incorporated as an eligibility criterion of a programme/instrument when relevant. Otherwise the Taxonomy might backfire on the goal of fostering sustainability and contributing to the continent’s transformation. In addition, any double-reporting under the Taxonomy, and under InvestEU, would be burdensome, provide no added value and should therefore be avoided.

Once launched, products should remain eligible under InvestEU, irrespective of updates to either InvestEU or Taxonomy-related requirements. Changes with retroactive effect should be avoided as it would induce higher uncertainty around the financing of green projects and in light of high costs involved in the setting up of necessary processes. The threat of reviews might already represent a disincentive to IPs and intermediaries alike.

3. The application of the EU taxonomy should take into account the differences between financing methods (debt or equity)

The Taxonomy requirements should be considered differently based on the financing method used (loan or guarantee portfolio, equity investments, etc.), as the relationship with a company changes accordingly. Whereas the implementation of the Taxonomy is already demanding and challenging for funds, it will be more burdensome for lending financial institutions. Lending activities imply many counterparts as the number of companies in the portfolio is significantly higher. Loans must be granted quickly, limiting the time available to obtain extensive non-financial information from the company.

In addition, in the context of guarantee mechanisms for loans, the process of distribution and collection of information is becoming more complex, with two levels of intervention (guarantee body without direct contact with the company and financial intermediary benefiting from the guarantee). In this case, duplication of reporting should be avoided as much as possible to not hamper the participation of financial intermediaries to national and European guarantee schemes.

As a final general point, it is worth emphasizing that there is a sharp need to clarify how to apply the taxonomy to general-purpose financing, (i.e. loans and investments) that are not strictly related to a specific project or activity but devoted to support the 'business-as-usual' of enterprises.

4. ELTI and NEFI members deem necessary to provide incentives and capacity building to ensure the effective application of the EU Taxonomy

Financial actors, whose debt and small equity tickets operations do not suit the current form of the Taxonomy, are currently in a state of uncertainty as regards the reporting scope and methodologies related to the EU Taxonomy. Yet, the impact of the Taxonomy is likely to be major as they will have to carry out significant financial, technical and human efforts to comply (by updating IT systems and increasing staff support and training in particular). It is not a given that they will be able to develop and internalize a "Taxonomy" competence within their front-office team, possibly having to recur to external experts and consultants to evaluate debt and investment operation files. These efforts are mainly due to the complexity and the many requirements of the Taxonomy, for both undertakings and financial actors.

Moreover, there is a risk that the induced costs are then passed on to the final beneficiary and prove proportionately higher for small project promoters as well as start-ups and SMEs compared to their revenue. Such risk applies in the framework of the reporting created by the Taxonomy Regulation as well as in the requirements introduced by the Disclosure Regulation. In any case, application of the "Do No Significant Harm" (DNSH)-principle will prove very difficult for all actors, on a methodological level (access to data, need for an objective reference) and at the level of the economic activity (the criteria when taken separately can be fulfilled but when cumulated make it particularly burdensome).

Against this background, the EU should favour technical assistance initiatives for all actors impacted by the EU Taxonomy "Advisory-vouchers" which could usefully be implemented to co-finance advisory services for companies, especially the smallest ones, and assess the degree of compliance of their activities with the Taxonomy. In addition, incentives could foster the broader use of the taxonomy.

5. **ELTI and NEFI members emphasize the importance of preserving the benefits of long-term funding for the transition**

As the Taxonomy criteria will legitimately evolve, attention should be paid not to lead to self-inflicted stranded assets. Long-term financing tools (loans and bonds) are especially adapted to the most impactful sustainable projects but for which the profitability horizon cannot be met short-term. In this regard we advocate for a grandfathering clause for long-term loans: a green loan should remain green until its maturity.

As regards to bonds, and more specifically the upcoming EU Green Bond Standard (EU GBS), this could be reflected via the concept of "Vintage green bonds" which refer to different generations of EU GBS compliant green bonds according to the period of time they have been issued within. Such a scheme would allow to maintain the right level of protection and information of investors and avoid the emergence of market risks for issuers.

6. **ELTI and NEFI members see the need for ensuring a gradual implementation of the Taxonomy**

The Taxonomy is expected to be applied as of 01/01/2022 for activities of 2021. However, reporting rules for financial undertakings are not known yet and will be specified in the course of 2021. Therefore, financial undertakings will not be able to report on their 2021 activities based on fixed and uniform rules nor disclose the alignment of their products with the Taxonomy due to a lack of data issued by companies. Furthermore, the ongoing revision of the NFRD (Directive 2014/95/EU) might lead to changes in relation to the reporting characteristics (scope and presentation of reported information). Consequently, a gradual implementation of the Taxonomy would bring about a considerable increase in market successful implementation and acceptance and thus reorient private funds more quickly into sustainable economic activities.

7. **ELTI and NEFI members call for avoiding discrepancies about accountability for certification of data**

The Taxonomy regulation empowers the national competent authorities to monitor alignment disclosure by financial market participants (article 21). However, no provision is sought for the certification of data reported as per article 8. This makes financial market participants accountable for the use of data to which they have no formal recourse in case of abuse. We therefore advocate for a limitation of financial market participants accountability in this regard.

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