

INVESTMENT ASSOCIATION FEEDBACK TO EUROPEAN COMMISSION TECHNICAL EXPERT GROUP (TEG) SURVEY ON USABILITY OF TAXONOMY

February 2019

QUESTIONS

1. Do you believe the taxonomy will provide a clear indication of what economic activities should be considered environmentally sustainable?

Please refer to:

[Example sheet: Energy production \(geothermal\)](#)

[Full list of 1st round climate mitigation activities, screening criteria and questions](#)

- **Yes**
- No
- Don't know / no opinion / not relevant

Please explain your answer to question 1:

2000 character(s) maximum

Yes. However, it is imperative that the Commission also clarify that this is what the Taxonomy is in fact intended to provide, and that it is not intended to reflect the full range of sustainable investment approaches on offer to investors today.

More specifically, we would welcome clarification that this is what is meant by the title of the original Taxonomy Proposal published in May 2018. The Proposal claimed to establish a "framework to facilitate sustainable investment", when in fact, a more accurate title would be "framework to facilitate the identification of environmentally sustainable economic activities" – as these are not the same thing. We recognise the Commission's longer term intention to extend to social and governance indicators, but nonetheless would welcome clarification on the Taxonomy's current scope. This would help to assuage any misconceptions that the



Taxonomy is intended to encompass the full range of sustainable investment approaches that are available to investors right now, many of which focus on sustainable investment processes, rather than specific economic activities that are intended to contribute to environmental goals.

With the European Commission Sustainable Finance Package being a significant and wide-ranging regulatory initiative, its component parts must work harmoniously with each other to deliver on the Commission's ambitious aims.

Therefore, where any other part of the Package refers to the Taxonomy, it must do appropriately and in such a way that does not conflate the Taxonomy's role in identifying environmentally sustainable economic activities with any other aspect of the wider sustainable investment landscape, including the identification of financially material ESG risks and opportunities.

On this point, we would draw particular attention to the references to Taxonomy that appear in the Disclosure Proposal of 24 May 2018 and the ESMA Consultation Papers relating to MiFID and to UCITS and AIFMD of 19 December 2018.

2. Do you expect any practical challenges within your organisation to classify an economic activity according to the taxonomy?

- **Yes**
- No
- Don't know / no opinion / not relevant

Please explain your answer to question 2:

2000 character(s) maximum

As asset managers, we anticipate significant practical challenges classifying an economic activity according to the Taxonomy, seeing as existing corporate disclosure practices will not typically provide information on their economic activities in such a way that would enable investors to comply with the Taxonomy.

In order to categorise an investment according to its economic activities, asset managers would need sufficient, robust and consistent information from companies regarding these activities. There is currently significant variation in how companies would report on the sustainability of their activities. Many will report material ESG risks and opportunities in their annual reports, and will often produce supplementary sustainability reports. However, these approaches would not provide sufficient consistency, nor would they necessarily target specific activities, to meet the expectations of the taxonomy implementation.

Company disclosure would require significant reform to meet the requirements of the Taxonomy and, at a minimum, this will take time.



We would also have concerns about redirecting companies' resources to the new Taxonomy disclosure requirements and away from improving existing disclosure practicing relating to material ESG risks and opportunities, especially as the latter would include developing a more meaningful application of the recommendations of the Taskforce for Climate-related Financial Disclosure – which is of course another priority of the Sustainable Finance Package.

Finally, we have specific concerns around the disproportionate impact that resources needed to adapt to the Taxonomy disclosure requirements could have on smaller companies who may already be struggling with existing disclosure requirements.

3. For financial market participants: will the proposed structure and format of the Taxonomy enable you to comply with potential future disclosure obligations?

- Yes
- No
- **Don't know / no opinion / not relevant**

What changes would you propose?

2000 character(s) maximum

The Taxonomy would help enable financial market participants to comply with the specific disclosure requirements under Article 4 of the Taxonomy Proposal itself.

However, the Taxonomy will not enable financial market participants to comply with disclosure obligations concerning how they take into account financially material ESG risks and opportunities. This means there are other significant disclosure requirements, for example the revised Shareholder Rights Directive, for which the Taxonomy will provide no assistance.

It is important that the intended use of the Taxonomy is acknowledged by all stakeholders across the wide-ranging remit of the European Commission's Sustainable Finance Package and that no other stakeholders look to the Taxonomy to enable the other disclosure requirements that financial market participants are required to comply with.

4. Is the proposed taxonomy approach sufficiently clear and usable for investment purposes?

- Yes
- **No**
- Don't know / no opinion / not relevant

What Changes would you propose?



Article 4 of the Taxonomy says that investors shall identify the “share” of an investment that is “funding environmentally sustainable economic activities”. Referring to the share of a company that is funding an economic activity does not reflect how companies fund their economic activities in practice. This might be applicable in the context of project finance or green bonds, where funding can be directly linked to a particular economic activity. However, when investing in equities or corporate bonds, exposure is to the full company, not to a specific segment of the underlying activities of that company.

We understand that the Technical Expert Group may in fact be referring to the proportion of a company’s *revenue* that can be attributed to an economic activity. We would therefore ask for clarification on this. If this is the case, we agree that revenue could provide a static picture of a company’s activities. This has some merit in demonstrating the particular activities that a company has carried out at a particular point in time.

However, the choice of revenue over, say, R&D spend or Capex will have significant consequences. In contrast to this static and backward-looking picture that revenue provides, information on a company’s R&D spend or Capex would provide a forward-looking assessment of the kinds of activities which a company is seeking to grow. This would help demonstrate whether a company is transitioning to greener activities.

Revenue as an indicator of sustainability would not help encourage the allocation of capital to those companies that have in place strategies to transition to greener activities over the next 5 years on a potentially far larger scale than their smaller “first mover” counterparts. These substantial movements of capital from large cap companies will play the greatest role in helping the Commission achieve its goal of channelling 270 billion Euros into green activities by 2030.

5. Would the use of the taxonomy require any additional resources (for example in human resources or information technology)?

- **Yes**
- No
- Don’t know / no opinion / not relevant

Above all, use of the Taxonomy will require significant changes to the kind of information investors receive from corporates.

As we outline above, we have concerns for corporates diverting resources from the improvement of existing disclosure practices to the new requirements under the Taxonomy, when existing requirements are already challenging – particular for smaller corporates.

6. Please provide any additional comments on the design and/or usability of the taxonomy, including proposals for improvement:



2000 character(s) maximum

We are supportive of the Commission's aim to allocate capital to environmentally sustainable activities, not least because companies that transition to a greener economy are more likely to provide opportunities for good long term returns than their less forward-looking counterparts.

However, we seek further clarification on how certain aspects of the Taxonomy Proposal are being interpreted and the possible unintended consequences of these interpretations.

The Taxonomy is one piece of the sustainability puzzle. Its merit will be in the agreed identification of activities that are environmentally sustainable. For this reason, we would also caution against an overly burdensome scope and application of the "do no significant harm" principle, to allow the necessary flexibility for companies to be able to allocate capital to green economic activities.

The Taxonomy should not be seen as a tool to help financial market participants assess the sustainability of a company as a long term investment prospect nor should it be seen as the cornerstone of the "sustainable finance" package as a whole.

Finally, whilst standardisation brings clarity and consistency, we do have concerns around the possible unintended consequences of adopting one single framework, which cannot possibly encompass all facets of sustainability in one go and, therefore, will not reflect the parts of the UN Sustainable Development agenda that pertain to social issues until a later phase.

We understand the global imperative to fight climate change but would welcome further consideration and analysis of what the possible unintended consequences may be on areas which are not covered by the Taxonomy in the short-to-medium term.