ICMA
International Capital Market Association

European Action Plan on Sustainable Finance

by Nicholas Pfaff,

Background

The European Commission established the Technical Working Group on Sustainable Finance (TEG) in June 2018 following the publication in March 2018 of the *Action Plan on Sustainable Finance*. ICMA, with the support of the GBP SBP Executive Committee, was nominated on the TEG following a highly selective process. The TEG published on 18 June 2019 reports and guidelines relating to its four key deliverables on which ICMA has provided a summary review with comments. The TEG's mandate has been extended until the end of 2019 and continues its work especially with respect to the Taxonomy, the EU Climate Benchmarks and the EU Green Bond Standard.

This paper provides an update on these workstreams from ICMA's perspective. It also provides in Table 1 an update on the parallel EU legislative initiatives on sustainable finance that are under way, reflecting the Commission's legislative proposals of May 2018.

Taxonomy

The report on the *EU Taxonomy for Sustainable Activities* published in June 2019 sets out the basis for a future EU Taxonomy in legislation (See Table 1). The TEG held a subsequent call for feedback on this report from 3 July until 16 September 2019. ICMA with the GBP Executive Committee provided a response to the consultation.

As for background, the Taxonomy report provides for technical screening criteria for 67 activities that can make a substantial contribution to climate change mitigation across the sectors of agriculture, forestry, manufacturing, energy, transportation, water and waste, ICT and buildings. Almost all activities have also been assessed for identifying the risk of significant harm to other environmental objectives. The report also provides for a methodology, worked examples for evaluating a substantial contribution to climate change adaptation and gives investors further guidance and case studies to prepare for using the Taxonomy.

Our feedback through this consultation focused especially on usability issues raised by the Taxonomy for the green, social and sustainability bond market. We continue to emphasize that this market operates by identifying sustainable projects rather than activities, and that as a result green, social and sustainability projects need to be reframed within these proposed activity categories which is neither automatic nor necessarily straightforward (eg when projects pertain to multiple activities). The project approach also allows for a multi-dimensional approach to environmental benefits, including an analysis of the supply chain and the end use, and a greater "differentiability" of eligibility.

We also express concerns relating to the applicability of the proposed "Do No Significant Harm" (DNSH) criteria. Issuers of green bonds will indeed likely be concerned about the potential legal liability/litigation risks of attesting DNSH, especially outside the EU. The proposed DNSH requirements also involve quantitative thresholds based on EU legislation as proposed (Art. 14) and may therefore be challenging for issuers with activities and/or projects largely based outside of the EU.

The GBP SBP requires issuers to transparently communicate their process for project selection including "any other process applied to identify and manage potentially material environmental and social risks associated with the projects". This is more appropriate for issuers of green, social and sustainability bonds and is applicable regardless of the geography of the underlying investments/projects.

Looking to wider developments in sustainable finance, Enel, the Italian energy company, launched on 6 September 2019 a "General Purpose SDG linked Bond".

We suggest therefore in our feedback an alternative process-based approach for DNSH methodology. We recommend implementing DNSH criteria at the issuer level and not the project level, ie issuers must demonstrate that they have the right ESG policies in place to mitigate DNSH risks.

With the respect to the status of the Taxonomy legislative proposal, the Council's proposal on the mandate for negotiations with the European Parliament was approved In September 2019 by MS representatives. The Presidency compromise text (Addendum) has created some controversy by, for example, potentially allowing as "environmentally sustainable" nuclear energy. It also defers the entry into force of the Taxonomy for mitigation and adaptation activities to end-2022 from 2020.

EU Green Bond Standard

The report on the EU Green Bond Standard proposes that the Commission creates a voluntary, non-legislative EU Green Bond Standard. It requires: (i) alignment with EU Taxonomy; (ii) publication by the issuer of a Green Bond Framework confirming among others the voluntary alignment of green bonds issued with the EU GBS; (iii) mandatory reporting on use of proceeds (allocation report) and on environmental impact (impact report); and (iv) mandatory verification of the Green Bond Framework and of the allocation report by an external reviewer.

On this final point, the TEG recommends that external verifiers are formally accredited and supervised. The TEG argues that the most suitable European authority to design and operate such an accreditation regime for verifiers would be the European Securities and Markets Authority (ESMA). As this will take time, the TEG calls for the set-up of an interim registration process for external verifiers of green bonds, for a transition period of approximately three years, in close cooperation with the European Commission. ICMA is actively reviewing with other key market stakeholders how it can contribute to the establishment of such an interim registration process.

Benchmarks

The TEG report on *EU Climate Benchmarks and Benchmarks' ESG Disclosures*, published in June 2019, recommends a list of minimum standards for the methodologies for the EU Climate Transition Benchmark (EU CTB) and an EU Paris-Aligned Benchmark (EU PAB). The report's recommendations aim to address perceived risks of greenwashing, and include disclosure requirements to improve transparency and comparability of information across benchmarks, not only regarding climate-related information but also on a variety of ESG indicators.

In parallel with the release of the climate benchmarks report a six weeks call for feedback was launched. With the benefit of the feedback received, the TEG is expected to publish the final version of the report early in Q4 2019.

Contact: Nicholas Pfaff
nicholas.pfaff@icmagroup.org

Update on EU legislative and regulatory Initiatives on Sustainable Finance

Initiative	Current Status	Comments
Taxonomy Regulation	The progress report on political discussions under the Romanian Presidency was published on 24 June 2019. On 25 September 2019, MS Representatives approved the Council's on the mandate for negotiations with EP.	Changes proposed by EP as its first position in March 2019: (i) lifecycle and value chain assessments to be taken into account for the technical criteria as well as the "no significant harm"; (ii) disclosure of the relevant information allowing firms offering financial products to establish whether the pre projects they offer qualify as environmentally sustainable investment pursuant to the criteria under the Taxonomy Regulation. In June 2019, the Council discussions during the Romanian Presidency resulted in a compromise text aimed at (i) better involvement of MSs in the Platform on Sustainable Finance going forward; (ii) extension of the Taxonomy's scope to cover transition activities; and, (iii) clarification of the interaction between the Taxonomy Regulation and the Regulation on sustainability related disclosures (below). In September 2019, the Council's proposal on the mandate for negotiations with EP was approved by MS representatives. The Presidency compromise text (Addendum) potentially allows nuclear energy to be classified as "environmentally sustainable" and also defers the entry into force of the Taxonomy for mitigation and adaptation activities to end-2022 from 2020.
Amendments to Benchmark Reg. (2016/2341)	First reading by the European Parliament completed on 26 March 2019, expected to be approved by the Council without amendments as per the political agreement of 25 February 2019.	Benchmark categories/terminology in the European Commission's proposal were revised to: (i)EU Climate Transition Benchmark, which aim to lower the carbon footprint of a standard investment portfolio and which is targeting companies that follow a measurable, science-based "decarbonisation trajectory" by end-2022; (ii)EU Paris-aligned benchmarks, having more ambitious goals to select components that contribute to attaining the 2°C reduction set out in the Paris climate agreement.
Regulation on sustainability-related disclosures in financial services sector	The European Parliament's position after first reading (adopted on 18 April 2019) to be approved by the Council without amendments.	Applicable to (among others); investment firms and credit institutions providing portfolio management, AIFM, UCITS management companies. The European Parliament adding definitions for "sustainability risks" (defined with reference to the materiality of the negative impact on the investment) and "sustainability factors" (defined with reference to environmental, social and employee matters, human rights, anti-corruption and bribery matters). The European Parliament also extended the scope of applicable transparency requirements in order to cover (among others): (i) potential adverse impacts of investments decisions on sustainability factors (Art.3 gamma); (ii) interaction between remuneration policies and the integration of sustainability risks; and (iii) the promotion of environmental or social characteristics in pre-contractual disclosures (Art 4a).
Various Delegated Acts and Amendments to respective ESMA guidelines	European Commission's request on 24 July 2018 for technical advice from ESMA and EOIPA. Following the regulators' input, the European Commission will take these delegated acts further.	Public Consultations took place for amendments to various delegated under MiFID II, UCITS/AIFMD, Solvency II and Insurance Distribution Dir and on amendments to ESMA guidelines on product suitability and press releases as part of CRA disclosures. EIOPA and ESMA published their final reports in response to the technical advice on sustainability of the European Commission on 30 Apri. ESMA's technical advice on sustainability considerations in the credit rating market and its final guidelines on disclosure requirements applicable to credit ratings were published on 18 July.