

11 March 2021

## ICMA Response to GFIT Taxonomy Consultation

The International Capital Market Association (ICMA) welcomes the opportunity to provide feedback on the GFIT Taxonomy Consultation Paper.

### About ICMA

ICMA is a not-for-profit membership association, with offices in Zurich, London, Paris and Hong Kong, that serves the needs of its wide range of member firms in global capital markets. It has around 600 members in more than 60 countries, including some 70 institutions in the Asia-Pacific Region. Among its members are private and public sector issuers, banks and securities houses, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others.

In Asia-Pacific, ICMA is regarded as a market-leading association in the cross-border debt capital markets and sustainable finance, a key partner to policymakers and banks, and an authority on understanding of international regulation and reform. ICMA works closely with its members and also central banks, regulators, trade bodies and government authorities to support robust development of capital markets in the region.

Through its work with the Green and Social Bond Principles, the principal globally recognised framework for issuance of sustainable bonds, and its key advisory role in other sustainable finance initiatives (including the ASEAN Green and Social Bond Standards, the EU Technical Expert Group and Platform on Sustainable Finance, and the Hong Kong Green Finance Association), ICMA is at the forefront of the financial industry's contribution to the development of sustainable finance and in the dialogue with the regulatory and policy community. ICMA has responded to [numerous sustainable finance public consultations](#) in the EU on topics including:

- Strategy: European Commission's Renewed Sustainable Finance Strategy;
- Taxonomy: the EU Taxonomy Regulation;
- Financial products: the EU Green Bond Standard, the EU Ecolabel for financial products;
- Disclosure regulations/guidelines: the Sustainable Finance Disclosure Regulation (SFDR), the Non-Financial Reporting Directive (NFRD), Guidelines on Disclosure Requirements applicable to Credit Ratings;
- Other: integration of sustainability risks and factors in MiFID II, UCITS Directive and AIFMD.

ICMA would welcome further enquiries or requests for information. Please contact Mushtaq Kapasi, Managing Director, Chief Representative, Asia Pacific at [Mushtaq.Kapasi@icmagroup.org](mailto:Mushtaq.Kapasi@icmagroup.org).

**Question 1 – The workstream seeks comments on the useful measures of success, and whether other measures may be considered in addition when evaluating the implementation of a taxonomy**

The measures of success listed by the GFIT are very comprehensive. We would suggest taking into account the following as a priority:

**(1) Purpose**

It is crucial to determine at the outset what a taxonomy is being designed to do. Is it primarily intended as a classification framework or will it also serve other purposes?

Looking at other jurisdictions such as the EU, taxonomies can serve a purpose, beyond simply classification, as product, disclosure, or risk assessment tools (or a combination of several or all of these). The consultation paper proposes a taxonomy for the purpose of identifying and classifying activities that can be considered green or transitioning toward green in order to compare and assess products and services. We have noted that while the paper doesn't seem to go any further, a separate handbook has already been published by the GFIT on "Implementing Environmental Risk Management" which also contains disclosures albeit with a focus on climate change based on TCFD recommendations.

For each of the above-mentioned purposes, therefore still, careful considerations and clear guidance for implementation will be needed when applying a taxonomy. In particular, applying a taxonomy for systemic risk management purposes—which will have direct and mandatory economic implications for the financial sector—could lead to unintended consequences and regulatory arbitrage. While we agree with the reasons for the taxonomy set out in the consultation, we believe that it is also advisable to take into account the intended practical uses of the taxonomy in market regulation and development.

**(2) Usability**

The consultation paper primarily refers to the taxonomy intended for use by financial institutions such as banks, for classification of their portfolios and loan books. For that purpose, and to ensure that the taxonomy is sufficiently understood by banks and their potential advisors, the taxonomy should be clear on both the embedded methodology as well as how to implement it.

In particular:

- The taxonomy should specify which parties are responsible for undertaking the classification of particular activities. Is the intention for corporates to self-declare and for banks to rely on that classification, or should banks make the judgement as part of their due diligence process? Who will be held liable for the classification results?
- The design and implementation of the taxonomy should be clear as to whether and how the classification is to be done at the business group level, legal entity or company level, project level, or by individual activities within any of these. From our experience, this would also be helpful if the taxonomy were to be extended to financial products or adopted for regulatory purposes. If the taxonomy were to be used for sustainable finance products such as green or other sustainable bonds, it would need to take into account that the green, social and sustainability bond market functions with a project-based approach, rather than the activity-based one proposed in the consultation.

As we recommend that the taxonomy embeds trajectories or pathways to reaching the sustainability thresholds, thus functioning as a “dynamic” taxonomy to better incorporate transition, this will pose further implementation questions on how often the classification should be reviewed against thresholds that may be dynamic.

### **(3) Compatibility**

It is important that guidance and recommendations by existing initiatives and tools such as the TCFD, SBTi, and TPI are being referenced in the taxonomy as appropriate. Furthermore, we recommend that a taxonomy should be compatible with established market-based global frameworks such as the Green Bond Principles (GBP) and other taxonomies such as the EU Taxonomy or the CBI Taxonomy.

Finally, we would like to emphasize again that if a taxonomy at some stage will be adopted for regulatory purposes as we are seeing in the EU, it is important to think about its implementation and incorporation as a law, as well as the availability and provenance of the required data. As an example, if the taxonomy were to be turned into a regulation with mandatory disclosure obligations for both financial and non-financial corporates as well as financial market participants (FMPs) such as asset managers, it would be helpful if corporates were already required to (or otherwise prepared as much as possible to) report and/or disclose the data that FMPs would be asked to disclose.

### **Question 2 – The workstream seeks specific feedback on the extent to which disclosure requirements may present an ‘undue burden’ on corporates.**

Listed corporates are already accustomed to using globally recognised frameworks and disclosure practices to guide their reporting. A taxonomy initiative may lead to the risk of creating an undue burden, if:

- the taxonomy is overly complex with a multiplicity of objectives and requirements
- the taxonomy does not provide a clear or sufficiently developed methodology for its implementation
- there is no substantial ecosystem of advisors to support organisations with its implementations and related obligations
- the taxonomy is integrated into legislation too quickly and rigidly while not allowing for best practice to emerge. Potential legislative initiatives should prioritise the need for realistic timelines for implementation and flexible application at least at the initial stage
- there are direct conflicts with existing taxonomies (as borrowers will look to attract international capital from investors who may have developed internal policies and systems to follow a different taxonomy)

### **Question 3 – The workstream seeks feedback on potential risk considerations around the development of a taxonomy, including other risk considerations not mentioned in this section.**

One of the main challenges in creating a taxonomy is the selection of sectors to prioritise and the establishment of thresholds to determine what counts as green or in transition. Also, once the

taxonomy is established, it will be important to determine how often thresholds will have to be reconsidered based on, for example, developments in technology. This will also have an impact on any financial products or regulation linked to the taxonomy. As an example, if sustainable bonds were linked to a taxonomy, there would have to be allowance for appropriate taxonomy grandfathering reflecting the duration of the bonds.

The risk considerations listed by the GFIT are very comprehensive. Specifically, on the question of the taxonomy being too static, we would recommend that the taxonomy embeds trajectories or pathways to reaching the sustainability thresholds, thus becoming a “dynamic” taxonomy.

If a local taxonomy is to be developed, we believe that sectors which are clearly environmentally sustainable (green) and those that are clearly problematic like “hard-to-abate” and carbon-intensive sectors, should be identified as a priority. Sectors not covered by this approach could be seen as neutral or comparatively low impact.

The time required to develop the taxonomy will also determine its utility. Currently the EU taxonomy is the most comprehensive and we believe it is likely to become the most widely used taxonomy for, amongst other, market participants like international borrowers in the capital markets. Hence, a prolonged taxonomy development period will risk it becoming less relevant in a market that aligns itself to an existing taxonomy in the interim. At the same time, the taxonomy should be flexible enough to be able to integrate international developments and technological advancements yet to come.

#### **Question 4 – The workstream seeks specific feedback on the extent to which the introduction of a taxonomy would introduce additional cost and compliance burden to Financial Institutions.**

Given the various challenges around data provenance, availability, and consistency, a number of ICMA members have expressed concern about the potential additional costs for implementation and compliance, as well as liability issues. Before mandatory reporting or disclosure regulations are in place to require corporates to report/disclose the relevant data, FIs may have to rely on data purchased from several data providers or ESG rating agencies, which will result in higher costs and additional resources to consolidate data that follow different methodologies.

The DNSH principle, in particular, should be carefully calibrated because it may pose data, methodological and implementation challenges due to, among other, legal or liability issues.

We re-emphasise the point that while the introduction of a taxonomy in itself does not constitute a burden to financial institutions, an obligation for product alignment and/or disclosure would. Without any concrete legislative initiative to refer to, we would just like to point out in general that FIs will have to rely on data from their investee companies. In the context of having to assess whether no significant harm has been done to any environmental objectives, the right data might not be available or even if available it might not be clear how to evaluate “significant harm”. If left to the discretion of FIs this could also lead to liability issues, if any issues are missed or wrongly interpreted.

On a product level, conducting “do no significant harm” due diligence for corporate bonds could be unduly burdensome especially for large companies given the breadth of their activities and their

geographical footprint. For example, if applied to green bonds which are funding or refinancing specific projects or assets, it will be even more difficult to assess certain indicators.

Finally, while large listed corporates are already used to using globally-recognised frameworks and disclosure practices to guide their reporting, for FIs lending to SMEs it will be even more difficult to obtain the necessary data to assess and compare activities, let alone evaluate a “do no significant harm” principle.

**Question 5 – The workstream seeks feedback on this proposed approach. If you disagree, please comment on alternative options, including:**

- 1) alternate approaches to the development of a Singapore taxonomy,**
- 2) an option where Singapore does not develop a taxonomy and makes no further contribution,**
- or,**
- 3) an option whereby Singapore does not develop a taxonomy but instead provides transparency and guidance around existing taxonomies to the market.**

ICMA’s view is that Option 3 would be most preferable.

An alternative under option 3 would be for Singapore to publish targeted local implementation guidance relating to recognized international taxonomies such as the EU Taxonomy (with related future guidance from the International Platform on Sustainable Finance) and the Climate Bonds Initiative’s taxonomy. Potential additional guidance could be provided in areas which are either not covered by other taxonomies or which are priorities from a Singaporean perspective, and which require more granular detail.

In all these instances, we recommend focusing on technical criteria. If other considerations such as social safeguards and/or DNSH are adopted, we recommend that they be carefully calibrated to avoid implementation challenges.

**Question 6 – The workstream seeks feedback on ways in which a taxonomy can recognize and support transition efforts by, and specify pathways for, companies currently in activities that may currently be causing significant harm to be able to move to less harmful activities, and from less harmful to ultimately sustainable levels of environmental performance.**

There are at least four key ways by which a taxonomy can recognize and support transition efforts. These are:

- (i) to embed in the taxonomy realistic future trajectories and pathways for companies to reach the identified sustainable technical thresholds;
- (ii) to relatedly encourage the use of taxonomy thresholds and metrics for forward looking targeting by companies;
- (iii) to confirm the acceptability of taxonomy grandfathering for sustainable financial products;
- (iv) to recognize the use of complementary approaches and metrics outside the taxonomy that provide guidance for science-based transition trajectories and pathways aligned with the goals of the Paris Agreement, such as those proposed by the SBTi, the

Transition Pathway Initiative, ICMA's Climate Transition Finance Handbook and the Climate Bonds Initiative.

**Question 7 – The workstream seeks and welcomes feedback on the inclusion of transition fuels such as natural gas in the proposed taxonomy. In particular, the workstream seeks views on whether:**

- a) There are certain types of activities involving transition fuels and chemicals which should be included in the taxonomy- eg. natural gas, lower emissions shipping, aviation fuel which are blended with fossil fuels, less emissions intensive petrochemicals, and under what circumstances,**
- b) Natural gas could be included as a transition fuel, on an abated basis, and only where it plays a role in materially lowering the carbon emissions of a company (e.g. as it moves away from coal / oil and towards abated natural gas),**
- c) Such inclusion would necessarily need to be accompanied by clear alignment with, and trajectory towards, science-based low-carbon scenarios at a national or international level, alongside investment-specific emissions targets that are necessarily disclosed, *and / or***
- d) Abated natural gas could be included as a transition fuel, including where a company is *an existing natural gas operator and has no existing coal / oil exposure* (ie natural gas investment is not part of a transition towards a lower carbon footprint)**

The workstream welcomes any other views / suggestions on this issue, including:

- e) Thoughts around the level of abatement or intensity thresholds for natural gas that may be required, *and***
- f) The degree to which Nationally Determined Contributions (NDCs) should be included in assessments of transition, or whether alternate transition goals (eg other international transition / climate guidance) would be preferable**

ICMA does not provide guidance on the transition eligibility of specific sectors or technologies. ICMA's Climate Transition Finance Handbook is however clear on the requirements for transition strategies to be aligned with the goals of the Paris Agreement and to be guided by the objective of limiting global temperature increases ideally to 1.5°C and, at the very least, to well below 2°C.

**Question 8 – The workstream seeks specific feedback on four environmental objectives identified, namely:**

- a) Climate change mitigation**
- b) Climate change adaptation**
- c) Protect biodiversity**
- d) Promote resource resilience**

We believe that while these objectives are consistent with other frameworks such as the EU taxonomy and the Green Bond Principles (GBP), "pollution prevention and control" should also be added as a self-standing objective. Moreover, although the above objective "promote resource resilience" seems to include water pollution control measures, an explicit objective for "pollution prevention and control" should also include air pollution.

**Question 9 – The workstream seeks specific feedback on the negative requirements identified, ie that an activity must not:**

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- a) Impose negative impact on communities' social and economic well-being in the long-term
- b) Impose negative impact on communities' social and economic well-being, unless the trade-offs can be justified in the long run
- c) Breach local laws and regulations

If a Singapore Taxonomy were to be developed, we would recommend adopting the process-based approach of the Green Bond Principles (Pillar 2: Process for Project Evaluation and Selection) in relation to negative impact considerations. This requires that issuers communicate to their investors *“the related eligibility criteria, including, if applicable, exclusion criteria or any other process applied to identify and manage potentially material environmental and social risks associated with the projects”*. There can also be a general disclosure on how the taxonomy user's financial product is positioned against its own sustainability objectives, strategy, policy and/or processes.

**Question 10 – The workstream seeks feedback on the process for identifying sectors, as well as the sectors identified.**

We understand that the NACE classification used in the EU Taxonomy might not be appropriate for a potential Singapore Taxonomy. However, the use of ISIC for sector selection could pose problems as well. Both NACE and ISIC codes, if used in the taxonomy to classify economic activities, are not obviously reconcilable with other classification systems widely used by financial market participants to analyse their data, such as the GICS (Global Industrial Classification System). GICS is certainly the most widely known sector classification used globally and would in our view be the most advantageous system to choose when looking at potential use of the taxonomy.

We note, however, that the response above does not represent the unanimous view of ICMA stakeholders, and that European-headquartered FIs in general are more familiar with NACE.

**Question 11 – The workstream seeks feedback on this proposed approach.**

If a local taxonomy were to be developed in Singapore, we would support the adoption of a phased approach, which will allow market participants to adapt, and best practices to emerge. Focusing on activities and related thresholds is a good start but the taxonomy should also allow for a project-based approach such as allowed by the CBI Taxonomy for example.

We recommend that the DNSH concept, if introduced, should be carefully calibrated to avoid practical usability issues which could arise either from the required complexity or by the lack of available data.

**Question 12 – The workstream seeks feedback on the use of a traffic-light system, including suggestions for expansion and granularity in any subsequent taxonomy.**

We understand the rationale for a “traffic light system” approach which is indeed used to some extent in existing taxonomies, most notably the CBI one. However, in practical terms, we believe this would be difficult to implement comprehensively in a reasonable timeframe because it could lead to lengthy and complex debates around the classification of each sector.

ICMA members have expressed concern that there is a risk for the “red” category to become the default for any activities not yet identified as green or in transition, with potential unintended consequences if that category was to be used for reporting/ disclosure requirements or expected to be disclosed by market participants.

An alternative approach would be to identify clearly environmentally sustainable (green) sectors as well as activities and high priority areas in “hard to abate” or carbon intensive sectors for which recommendations for transition can be given. Sectors not covered by this approach could be seen as neutral or comparatively low impact and should not be automatically regarded as “red”.

Furthermore, we would recommend that to the extent possible, any such “traffic light” system should not have punitive implications for FIs that have companies, and activities classified as “red” or “yellow” in their portfolios. Rather this system should be designed and used to encourage, guide and incentivize the companies to transition towards the goals of the Paris Agreement.

### **Question 13 – The workstream seeks feedback on this proposed approach.**

Overall, we support the approach of using globally accepted metrics referencing and adopting the previous work from the EU Technical Expert Group (TEG), the current work from the EU Platform on Sustainable Finance and the EU Taxonomy Regulation, while potentially adjusting when appropriate the thresholds according to local requirements. Work done by the International Platform on Sustainable Finance (IPSF), which Singapore joined in 2020, could also be helpful in that regard. Local adaptation may be especially relevant for “transitional activities”.

The GBP’s Climate Transition Finance Handbook refers to “science-based trajectories” necessary to align with the goals of the Paris Agreement while acknowledging sectors and geographies can be at different starting points and therefore follow different pathways.

Finally, we would like to reiterate that DNSH is a concept which should be carefully calibrated because it may pose methodological and implementation challenges due to data unavailability or liability concerns.