SwissFinanceCouncil
Fostering International Dialogue

2 June 2021

European Commission consultation on the draft EU Taxonomy Article 8 Delegated Act

The Swiss Finance Council (SFC) welcomes the opportunity to provide feedback on the draft EU Taxonomy Article 8 Delegated Act (DA) and commends the European Commission's active commitment to make the European Union climate-neutral by 2050. The SFC engages in dialogue around policy developments in finance at a European and international level. It represents the interests of its Members, Credit Suisse and UBS, who are internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge. We firmly support and advocate for a strong and ambitious response to climate change as demonstrated by our members' commitment to transparency through TCFD aligned disclosures and working with peers to embed sustainability into their business strategy and practice through the Principles for Responsible Banking and Principles for Responsible Investment. SFC Members have committed to align operational and attributable emissions from their portfolios with pathways to net-zero by 2050[1]. More broadly, SFC members are also committed to directing financial flows and supporting clients to invest according to their preferences in a way that also helps achieve the Sustainable Development Goals.

We acknowledge the efforts made by the European Commission to make the EU a global leader in setting regulatory standards conducive to accelerating sustainable finance. The SFC is supportive of the Commission's initiative to develop an EU Taxonomy and considers it a key instrument in setting out a definition of sustainable economic activities. In this respect, we particularly welcome the Commission willingness – as outlined in its April 21st Communication on "*Directing finance towards the European Green Deal*" – to explore ways to operationalise the EU Taxonomy globally in an appropriate and proportionate way and to conduct further work on the usability and international operability of the EU Taxonomy. This work is indeed crucial as, while the success in the EU of the Commission's Action Plan on Sustainable Finance hinges upon an effective implementation of the EU Taxonomy, the EU´s global ambition relies on a good reception of the Taxonomy by foreign jurisdictions and businesses.

However, we are concerned that, in the context of operationalisation, the volume of data being required along with the level of granularity defined in this DA might reduce the willingness of key foreign jurisdictions to use or consider the EU Taxonomy, in particular where more streamlined and market-driven approaches are currently being considered. The proliferation of incompatible sustainable finance frameworks brings the risk of increasing global regulatory fragmentation, which we consider a key obstacle for the efficient roll out of sustainable finance instruments and for the fight against climate change more broadly. While recognising the Commission´s choice on its approach and policy instruments, we are convinced that a more proportionate approach to reporting requirements would help limit unintended extra-territorial impacts and help ensure continued cross border investment and capital flows.

In this regard, the SFC would like to express its full support for the response provided to this consultation by the Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA) and to highlight the SFC's key concerns identified in relation to the European Commission's proposed Delegated Act under Article 8 of the Taxonomy Regulation.

[1] https://unfccc.int/news/new-financial-alliance-for-net-zero-emissions-launches

Ensuring appropriate sequencing of disclosure obligations of financial institutions and real economy

We welcome the Commission's decision to provide for a phased implementation approach in this DA, with more limited requirements for the first reporting cycle. However, this approach does not solve the outstanding challenge that financial institutions face in collecting EU Taxonomy data from their non-financial counterparts which are not subject to non-financial disclosure obligations themselves (i.e. not subject to the EU Non-Financial Reporting Directive – NFRD). The phased-in period, as proposed by the Commission, applies also to non-financial companies which are supposed to report complete KPIs only in 2023. We would like to stress that the availability of EU Taxonomy information from the real economy is crucial for financial institutions to calculate their own KPIs. The currently expected data gaps will provide potential investors with disclosures of low reliability or with substantial legal disclaimers, hence with no real added value and comparability across financial market participants – a situation clearly at odds with the objectives of enhanced investor protection and information and that may instil distrust in the sustainable finance market which is at a crucial stage of development. Therefore, we urge the Commission to implement a sensible sequence of disclosure requirements, whereby non-financial undertakings are required to disclose the complete KPIs one year earlier than financial institutions. We refer to the AFME/ISDA position for further details.

Ensuring KPIs consistency and comparability

We are concerned about the draft DA's approach to include exposures to market actors that are not covered by NFRD (future Corporate Sustainability Reporting Directive – CSRD), in particular SMEs and non-EU companies, in the denominator but not in the numerator of the KPIs for financial institutions. According to the draft DA the numerator would contain the proportion of Taxonomy aligned exposures and the denominator would include the amount of total assets, only excluding exposures to central banks and central governments (Total GAR = Total taxonomy aligned exposures / (Total assets – Exposures to central banks and governments)).

As noted by the EBA in its advice to the Commission, KPIs should be defined consistently. This means that if certain activities are excluded from the numerator, they should be excluded also from the denominator. The EBA rightly explained that including certain exposures in the denominator but not in the numerator would mean, de facto, that they are also included in the numerator but with a 0% weight, that is, assuming that no part of the activity is associated with activities that qualify as environmentally sustainable, which is inaccurate, as in reality there is no methodology or public information that allows their sustainability to be assessed[2].

Moreover, this approach will lead to a lack of comparability between different institutions' KPIs, jeopardising the Commission's objective of the Sustainable Finance Action Plan to enhance the reliability, comparability and usability of sustainability information. Since each financial institution has a different degree of exposures to companies not covered by the NFRD (future CSRD), all KPIs from different financial institutions will be incomparable. This distortion will be particularly evident for financial institutions headquartered outside the EU due to the natural home bias that that exists in their lending books, which means that non-EU financial institutions will very likely have a much smaller potential universe of exposures that could qualify as Taxonomy-aligned for the numerator, thus providing a skewed picture of their sustainability performance to EU investors.

[2] https://www.eba.europa.eu/sites/default/documents/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20Advice/2021/CfA%20on%20KPIs%20and%20methodology%20for%20disclosures%20under%20Article%208%20of%20the%20Taxonomy%20Regulation/963616/Report%20-%20Advice%20to%20COM_Disclosure%20Article%208%20Taxonomy.pdf

Finally, if the KPI information is presented this way, it will be misleading and EU financial institutions may be encouraged to improve their KPIs by purely reducing the denominator, moving their financing away from activities linked to companies not subject to the NFRD (future CSRD).

For these reasons, **we strongly believe that matching the scope of the numerator and denominator is essential to guarantee the consistency and usability of the EU Taxonomy framework. We recommend including in both numerator and denominator only exposures to activities from which data can be reliably sourced, meaning only exposures to companies subject to the NFRD (future CSRD) obligations.**

Limiting unintended extra-territorial impacts of the EU Taxonomy

We have concerns regarding the impact that the EU Taxonomy Article 8 reporting requirements may have on both financial sector and real economy companies in jurisdictions outside the EU, where the EU Taxonomy definitions are not legislated. We have identified a twofold extra-territorial impact of the EU Taxonomy Regulation.

Firstly, there will be a direct impact as, in the proposed revision of the NFRD, the future scope of the CSRD will be extended to non-EU companies with subsidiaries in the EU or securities listed on EU regulated markets[3]. Some financial institutions headquartered outside the EU would fall in scope of the future CSRD at the group level and would thus be subject to the disclosure obligations under the EU Taxonomy Regulation Article 8 for their entire portfolio.

Secondly, the draft DA requires financial institutions to take into account their exposures to all types of underlying companies, including SMEs and non-EU companies, not subject to the NFRD (future CSRD), in the calculation of their KPIs. To provide these companies with sufficient time to decide whether to report voluntarily according to the EU Taxonomy Regulation, the draft DA provides for a transitional period of three years, during which financial institutions will include exposures to companies not subject to the NFRD only in the denominator (see above our recommendations on KPIs consistency). After the three-year transitional period and subject to a review and impact assessment, the Commission might decide to include exposures to SMEs and non-EU companies (not subject to the future CSRD) in the calculation of the numerator.

Third-country large financial institutions subject to the EU Taxonomy obligations will face significant challenges in collecting EU Taxonomy data from their clients/investees as a large part of non-EU companies will not have legal obligations to generate and disclose EU Taxonomy-relevant information. Non-EU companies outside of the scope of the NFRD (future CSRD) are unlikely to report on a voluntary basis according to the EU Taxonomy Regulation due to the operational and implementation burden, even if they recognise the benefits of a common classification of sustainable activities. The same applies to small financial institutions located outside the EU and falling outside of the NFRD (future CSRD) scope.

For these reasons, we reiterate our recommendation to include in both numerator and denominator only exposures to activities from which data can be sourced reliably, meaning only exposures to companies subject to the NFRD (future CSRD) obligations. This will not only ensure consistency and comparability of the KPIs as explained above, but would also limit unintended extra-territorial impacts of the EU Taxonomy Regulation.

---

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189

If the Commission is still inclined to expand the scope of the numerator beyond that of the NFRD (CSRD), we urge the Commission to consider the jurisdiction of the exposures, including only SMEs based in the EU to limit the extra-territorial impact of the EU Taxonomy Regulation. The Commission could consider including non-EU companies only in the jurisdictions where an equivalent system to the EU Taxonomy is put in place. As explained earlier, also in this case it is of paramount importance to match the scope of the numerator and denominator of the KPIs.

Lastly, we would like to point out that Annex V of the DA, dedicated to credit institutions, refers exclusively to the accounting terminology of the International Financial Reporting Standards (IFRS), which could be problematic for non-EU financial institutions preparing financial statements according to the Generally Accepted Accounting Principles of the United States (US GAAP). In 2008, the European Commission formally confirmed that US GAAP are considered equivalent to IFRS as adopted by the EU (EU IFRS)[4]. The Commission took this decision following a consultation with the Committee of European Securities Regulators (CESR), which found US GAAP to be equivalent to the EU IFRS[5]. We would appreciate if the Commission could clarify that non-EU companies will be able to use US GAAP's classifications as it would be disproportionate to require non-EU companies to prepare financial statements under EU IFRS for the purpose of this DA.

To conclude, the SFC is willing to contribute to the debate in a constructive manner and glad to respond to any question the Commission might have on this position. The SFC would also appreciate the possibility to further discuss the aforementioned issues in a meeting with the Commission.

The Swiss Finance Council was established in 2013 to engage in dialogue around policy developments in finance at a European and international level. It represents the interests of internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge through a permanent representative office in Brussels. The current members of the Swiss Finance Council are Credit Suisse and UBS. The Swiss Finance Council supports an integrated Single Market that can contribute to the creation of a strong, open and globally competitive European financial sector, and it advocates for an EU that remains attractive to foreign investors and service providers.

4 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32008R1289
5 https://www.esma.europa.eu/press-news/consultations/cesrs-advice-equivalence-chinese-japanese-and-us-gaaps