August 2018

EACB Answer to European Commission Consultation on the proposal for a "Regulation on the establishment of a framework to facilitate sustainable investment"

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 27 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, sustainability and proximity are the three key characteristics of the co-operative banks' business model. With 3.135 locally operating banks and 58.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 209 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 80.5 million members and 749.000 employees and have a total average market share of about 20%.

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GENERAL REMARKS

The European Association of Co-operative Banks (EACB) is following the European Commission's work on sustainable finance with sincere interest, as this is a very important work stream for the EACB members. This is due to the fact that co-operative banks, as local and regional banks, play a key role in sustainable finance. This is via sustainable investments or savings products, energy transition project financing, green financing to SMEs and energy efficiency financing of private and public buildings, to mention some. Some co-operative banks are leaders in green bonds. Co-operative banks also reinvest significant portions of available profits back into the community and are driver for territorial and social cohesion. Numerous national awards for institutions from the co-operative banking sector are the evidence of this specific approach based on proximity and sustainability.

This being the case, the EACB and its members would like to stress that they expressly support the political targets for creating sustainable and climate-friendly regulatory frameworks. These can be achieved via diverse measures to which public authorities, private households and companies should contribute. In this context it is of particular importance to create incentives in such a way that economic actors take the decisions that combine welfare growth and development, i.e. of 'sustainable growth'.

As a step in achieving these goals, the European Commission published on 8 March 2018 its Action Plan on 'Financing Sustainable Growth', which has been welcomed by the EACB. This Association considers sustainable growth a responsibility that goes beyond the role of individual companies, customers, or finance –whether we are talking about insurers, pension funds, asset managers or banks. Sustainable finance is undeniable a joined responsibility of all branches of the economy.

In May 2018, the Commission adopted a package of measures implementing several key actions announced in its action plan. One of these is the proposal for a "Regulation on the establishment of a framework to facilitate sustainable investment" on which we welcome the opportunity to comment in this paper. The EACB is also honoured of the opportunity of bringing its contribution to the crucial work of the new technical expert group on sustainable finance, in charge of taxonomy as one of its four mandates.

Thus, the EACB would like to highlight that it supports and welcomes the establishment of a common classification system for environmental sustainable activities. However it cautions that the present proposed regulation ('taxonomy') can have potentially far reaching consequences for financial institutions. Indeed the taxonomy shall be the basis for all future legislative measures, not only impacting asset managers, pension funds and insurers but also banks. The retail (network) banks views and the specific co-operative approach shall therefore be taken into account in developing the taxonomy. Therefore, the EACB asks that the taxonomy as well as reporting are simple and flexible, while the implementation is gradually tested and carefully assessed, for example using non-binding or soft tools. Finally we underline the importance of the principle of proportionality and of a thorough impact assessment (see par.8 Proportionality).

Please find below the EACB detailed remarks.

DETAILED REMARKS

1. **Include co-operatives approach /governance when defining sustainable finance**

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As a co-operative sector we see sustainable business as a long-term economic promotion of our customers by financing sustainable projects in the regions, including in rural areas. In co-operatives, members voluntarily join forces in order to support one another in the attainment of shared purposes. Based on their statutes, the co-operatives' pre-eminent aim is achieving economic advancement of their members. Co-operative banks success depends strongly on the economic, ecological and social wellbeing of their operating area. The daily financing of sustainable projects in European regions are a main feature of the co-operative banks business model. In line with their mission co-operative banks are committed and support the creation of a sustainable European economy.

In the introducing Explanatory Memorandum of this proposal (p.1), the Commission is referring to the United Nations (UN) 2030 Agenda for Sustainable Development in order to create a more sustainable economy. The EACB would like to underline that co-operatives can play a decisive role in the context of the UN 2030 Agenda, i.e. in creating durable and sustainable economic growth and achieving productive full employment (see UNDESA initiatives on the co-operative sector /Agenda 2030 or the ILO study "Co-operatives and the Sustainable Development Goals").

Against this background, the EACB would therefore like to request a reference to the local sustainable development's role of co-operative banks in Article 11(1) of the proposal (objective 6- substantial contribution to protection of healthy ecosystems) where inter alia the role of sustainable land and forest management and agricultural practices for creating a sustainable, biodiverse ecosystem are mentioned.

2. **Subject matter, scope and definitions: comments and questions**

- Types of taxonomies

Currently two types of green finance taxonomies are known:

a) *Principle-based and open taxonomies*: these taxonomies list a number of asset classes and industrial activities that are eligible to be financed as Green Projects. Examples are the Green Bond Principles and the Green Loan Principles (and very recently also Circle Economy Principles). These taxonomies function by providing guidance on what investments could be deemed to be green finance, while being open to these investments and their impacts being particularly further defined in the form of 'guidance'. Guidance is a set of examples how environmental benefits could be specifically measured or estimated. The Guidance can be derived from market standards or based on best practices. These taxonomies function because they bring together examples, common understandings and specialised standards that allow debt issuers to be transparent about their investments, leaving it to the debt issuer to be accountable for how he wishes to argue that his investments are green. These taxonomies explicitly recognise that other assets or industry classes can be deemed green, based on transparent and proper arguments, so the taxonomies are not conceptually closed.

b) *Norm-based and closed taxonomies*: these taxonomies exclusively list assets and activities that are deemed green, based on fully specified science-based norms. Any asset or industry activity class not listed in such a taxonomy is not eligible to be deemed a Green Project. An example is the taxonomy of the Climate Bond Initiative. While providing rigor and clarity, these closed taxonomies are only used and usable for a relatively small segment of green assets and activities, and therefore they are not accessible to the majority (approx. 85%) of potential Green Projects.

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Another widely used classification system already existing in Europe and that could be enhanced with green related criteria is NACE. NACE is used to designate the various statistical classifications of economic activities making them comparable at European and, in general, at worldwide level. The latest update was achieved in 2006 and needs to be refreshed: for instance, there are no specific classifications for Renewable Energy. The updating of NACE would in addition, ease the production of reporting on a comparable basis for any market participant.

With this in mind, the EACB considers that the main taxonomies that the EC develops should conceptually be sufficiently 'open'. On top of that more targeted taxonomies can be developed for certain specific activities and these can be more normative and closed in scope. However, the downside of that approach is a less wide applicability. It should be clear which of the two sorts of taxonomies we are talking about, in order to create certainty in the market about ' what is considered green and what not'.

➢ <u>The scope of application of a taxonomy of 'economic activities'</u>:

Concerning Art. 1, the proposed regulation sets the subject matter and scope, indicating in the perimeter of application: financial products, corporate bonds and environmental sustainable investments. Since, the EC Action Plan defines the regulation on taxonomy as the basis of any future measures, it could be inferred from this that the scope will cover in practice not only green/sustainable investing but also for example green/sustainable lending . The same is valid for the technical screening criteria. Once determined, they will be used both by investors and other institutions including lenders. Even if this was not the case right from the beginning, investors and regulators, rating agencies, clients etc. may question lenders on the use of the taxonomy. In our view, if the EU sets a new standard, provided it is workable, than this taxonomy could be broadly used and referenced to. Therefore the EACB requests that the banking sector's views are taken into account for the development of such a taxonomy for all economic activities.

For example, common efforts are ongoing (both via market led initiatives or at international level within the ISO- International Organisation for Standardisation) to define green loans as *any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and or exisiting eligible Green Projects.* Moreover as retail banks, we would like to highlight the importance of the definition of green/sustainable savings beside green loans. We request that the criteria for sustainable savings are taken on board in the taxonomy. In order to do this in the most effective way, a stock taking exercise can be done about nationally applied criteria in EU.

Concerning the definition of "corporate" bonds currently in the scope (Art. 1, 2 a), we highlight that this seems to exclude bank issued bonds, especially assets backed or mortgage backed. Therefore the EACB requests that bank bonds are explicilty included in the scope. Indeed for some market participants "Corporate" includes banks: it should be specified.

It has to be underlined that taxonomy creates a label for sustainable financial products, but it should not be made compulsory for all financial products at a later stage, i.e. banks should not be obliged to check the sustainability of all financial products and the underlying business ventures – such as the financing of investment projects of SME clients.

Finally an element of unclear definitions emerges in Art 1(2) (b) whereby the scope of the regulation is extended to investments having "similar characteristics" as environmentally sustainable investments, thus possibly leading to uncertainty and additional burdens for the issuers of "conventional" investments.

Next to the afore mentioned comments on type and scope of the taxonomy the EACB has the following comments on the application: several EACB Members indicated that some areas of uncertainty emerge in Article 2. Does Art 2 (1) (a) for example consider that Co2 stocking, sustainable agriculture are environmentally sustainable? Can the opinion differ from Member State to Member State? These uncertainties may lead to practical problems in the course of implementing the taxonomy in the company processes and strategies.

Another element to consider is in Art.2 (1) (b) that refers to financial market participants, without yet defining them. For the definition, the article refers to another proposed Regulation (i.e. regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341). The same applies to the definition of financial products also referring to same proposed Regulation. In our view it is necessary that definitions are clearly defined in the proposed regulation on taxonomy itself.

Art.2 (1) (i) talks about the definition of healthy ecosystem as an ecosystem that is in "good" physical, chemical and biological conditions. Where possible references to standardized values should be made.

With a reference to the information provision obligations, a certain degree of information obligation seems to be assumed. How and what, by whom and to what extent, and if and to what extent it may be trusted by other parties has yet to be completed. By contrast, these are essential elements for market participants.

To conclude this section of EACB comments:

The Commission aims to formulate criteria on the basis of which 'the ecological sustainability of an economic activity' can be determined. The framework is set down in this proposal; the further elaboration will take place later. As a result, the relevant criteria will also apply later; see article 18. For market participants it is therefore now unclear what the exact criteria are going to be. Acting on those criteria (such as, for example, the offering of a fund) would only be possible after the definitive technical standards have been established. The question is whether the 'training time' will allow the players to slowly work on the criteria and get used to their implementation or that the uncertainty will lead to rigidity. Although those are difficult considerations, not easily answered, the EACB underlines that the Commission should allow time to adapt processes. An appropriate period for implementation will be necessary, much longer than the 6 months that have been indicated in the draft regulation.

3. Use of the criteria for environmentally sustainable economic activities (Article 4)

a. <u>Liability and responsibility to evaluate the degree of sustainability</u>

As far as we currently understand the logic of the Commission´s proposal, corporates issuing 'sustainable' securities (bonds or equities) should publish the degree of sustainability on their homepage and fund-managers or investment managers shall be obliged to incorporate, evaluate and disclose on their own products/activities. The EACB suggests that primary the corporates/issuers themselves shall increase and disclose the degree of sustainability – because

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only they have the most accurate knowledge of their company and data to present results. This can be complemented with more general sector research by investment managers.

In particular, Article 4 (2) of the proposed regulation on "taxonomy" currently says:
"Financial market participants offering financial products as environmentally sustainable investments, or as investments having similar characteristics, shall disclose information on how and to what extent the criteria for environmentally sustainable economic activities set out in Article 3 are used to determine the environmental sustainability of the investment."

We *suggest* inserting a new paragraph 2a in Article 4 as follows:
"The financial market participants offering financial products as environmentally sustainable, or as investments having similar characteristics, should disclose the methodology used and the source of information. (In case of the source being the company,) they shall not be considered responsible for the incorrect assessment of the environmental sustainability of an investment as the information and details provided by a company cannot be checked and verified."

Rationale: this suggestion can be justified by the fact that financial participants must rely on the published capital market information, otherwise the regime would not be administrable. Financial market participants can only be responsible for the correct process and not for the outcome of the process, because there is no own knowledge / perception of the relevant circumstances.

b. Assessing "Activities"

It is obvious that the process to determine the sustainability of an activity performed by a company is very extensive. A UCITS portfolio may consist of hundreds financial instruments, which leads to multiple "activities". It would be an unreasonable burden to determine the degree of environmentally sustainability by assessing all activities of the respective companies as indicated in Article 4 (3) of the "taxonomy proposal" ("*to identify … the share of the investment funding environmentally sustainable economic activities as a percentage of all economic activities"*). Therefore, Article 4 (3) lit b should be deleted.

4. Environmental objectives

➢ Open questions

The EACB members generally support the 6 environmental objectives laid down in Art 5.There are however some open questions: i) why objective 3 (sustainable use and protection of water and marine resources) is in the scope, while sustainable use of (other) natural resources and land-based resources including soil are out of scope? ii) why are agriculture and health excluded from the environmental objectives?

➢ Co-operative banks standpoint
An important aspect in the problems associated with climate change is the migration of the population from rural areas to urban spaces. In recent years, it has surpassed a historical record: more than 50% of the population in the world lives in urban spaces. This phenomenon has very severe implications for climate change, affecting the loss of diversity, deforestation, the abandonment of crops and the loss of soil. Plant material and soil are the two great reservoirs

or carbon sinks. The loss of plant material and the loss of soil, as a consequence of the change in social behavior, is releasing large volumes of carbon into the atmosphere. The agricultural sector is essential to preserve these reservoirs, and credit co-operatives are essential to continue maintaining local agro-food production systems, and, above all, to promote territorial cohesion. Within the framework of the new taxonomy, this is not present either tacitly or expressly.

The protection of the rural environment and the cohesion of the territory are fundamental to avoid these problems. The co-operative banks and the credit co-operatives play an important role to at the same time preserve the traditional agriculture as well as to help foster the sustainability of agriculture. The local productive systems are very important to address climate change from the local, and co-operative banks and credit co-operatives are organizations closely linked to the territory, and perform a role as provider of finance, of knowledge and of social territorial cohesion, transforming the environment for the benefit of the climate.

For this reason the *EACB requests recognition of these activties in Art 11 of the present regulation* (see also p.1 above "Include co-operative approach and governance in defining sustainable finance").

5. Commission's power to adopt delegated acts

➢ Technical screening standards: not so technical, high policy implication

In a number of provisions of the proposal, it is stipulated that the uniform criteria for determining environmentally sustainable economic activities will be developed and operationalised through subsequent delegated acts by the Commission that will particularly define the technical screening criteria. The EACB cautions that given the highly political consequences of defining environmentally sustainable investments, the technical measures, screening criteria and formulation of delegated act shall be accompanied by a transparent process with appropriate involvement and support of experts and stakeholders, while not losing sight of potential far-reaching impact, well beyond "technical standards".

➢ Differences in entry to force dates and grandfathering

The application of the different environmental objectives at three different dates seems not to be useful nor practical. Indeed the implementation of the new classification systems will require substantial adaptation of internal processes and IT systems that risks becoming extremely complex and unclear. The EACB recommends a convergence of date in the application of all environmental objectives to simplify and clarify as much as possible the framework.

Moreover the EACB requests grandfathering for contracts made before the entry into force date of the new taxonomy.

6. Implementation timeframe

The EACB Members share the concerns of the Regulatory Scrutiny Board regarding the immediate use of the taxonomy and the risks associated with making such use mandatory for financial market participants before the taxonomy has reached sufficient stability and maturity. The proposal of the European Commission that the operational part of this regulation (articles 3 to

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12) will enter into application six months after the entry into force seems too short for us. We favour a period of at least 12 months before entering into application.

The complexity of EU banking regulation creates burdens for smaller, less complex banks. Therefore, we need more proportionality in the application of the framework as sustainability needs to involve all banks and cannot rely on a few larger financial institutions. We should bear in mind that the main addressee for sustainability is the real economy. Therefore, it would be counterproductive if small banks would not be able to cope with it.

Additionally and with this in mind, the EACB Members suggest to explore the *possibility of using non-binding tools that can be tested and easily revised* without the complexity of the legislative process - in particular when it comes to the technical screening standard. This may leave room for feedbacks and short term improvements, ensuring greater flexibility. Using a non-binding instrument does not mean no legal impact.

Traditionally, co-operative banks together with their member and clients are fully committed to the transition towards a sustainable and circular economy and the reduction of greenhouse gas emissions. At the same time, the transition is extremely complex and highly interconnected with many other issues in our society. Whether an economic activity really contributes to an environmental objective, needs further thinking on metrics and methodologies. Also for this reason, *it will need time and flexibility before a sufficiently stable and mature taxonomy can be reached.*

7. Platform Sustainable Finance

Art. 15 establishes the new Platform on Sustainable Finance. While recognising the need of a permanent expert body and while supporting the mandate and mission of the Platform, the EACB would like to flag the potential political implications beyond the technical role. In fact the platform will be in charge of advising, analysing the impact and update the technical screening standards (among other tasks). The balanced composition, in terms of public authorities, financial sector, retail banks and other stakeholders is extremely important. Against this background the compositon of this important body should follow the principle of rotation.For the same reason it is suggested adding rules regarding the organisation and the governance of the platform as it may become a new standard setter. Without a revision and clarification of competencies among existing authorities to streamline the process, this risks adding an extra layer of complexity.

In conclusion, *we suggest* that Article 15(3) is amended as follows:

“The Platform on Sustainable Finance *should follow the principle of rotation* and shall be chaired by the Commission.”

8. Proportionality

Given that the proposed Regulation will have an extensive impact on various banking functions, it is important to ensure that the legislative framework is manageable and can attain its objectives while embarking all relevant stakeholders.

Whilst welcoming the fact that the Commission, Council and Parliament in recent years have developed more awareness of the need for proportionality in developing thier regulatory initiatives

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(in particular ongoing CRR/CRD review), the EACB would like to make a call not to lose sight of the unintended consequences that a too far-reaching regulatory framework and supervisory (reporting) around sustainability may have.

The EACB is committed to the sustainable finance initiative and is very conscious that this will bring along a number of changes including production of an extensive set of comprehensive information and meet documentation requirements involving IT and organizational changes and challenges. EACB Members would like to warn that this may add to already heavy requirement and major organizational and administrative efforts that in particular smaller co-operative banks face in implementing complex pieces of legislation such as MiFID2.

For this reason, in order to allow proper functioning of the market and the local economies the principle of proportionality should be observed and allow some degree of flexibility, while avoiding unnecessary bureaucratic burden for those smaller entities.

CONCLUSIONS

In conclusion, co-operative banks support the political targets to significantly reduce the risks and consequences of climate change, as well as to improve social cohesion.

Co-operative banks, with their broad networks and geographical reach can play a key role in the development of a more inclusive and sustainable finance, taking into account both environmental and social aspects.

Additionally, co-operative banking groups/networks are active players in the field of sustainable finance both as underwriters and as originators/issuers of sustainable loans/ savings and bonds. For this reason, we highlight in our comments the retail banks aspects, considering that the Commission's and international initiatives are often too focused on the capital and asset management side. We believe that a greater emphasis should be put on local and regionally oriented banks such as co-operative banks.

Our comments aim at creating a workable and flexible taxonomy with sound adaptation and testing phase that takes into account the need of proportionality (reporting requirements, heavy organizational and administrative effort especially for smaller banks) and impact assessment. The EACB also takes the occasion to suggest some changes and to highlight some points that may need further clarification.

We hope that our comments will be taken into account and we remain available to answer any further questions.

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