Frankfurt am Main,
23 August 2018

European Commission's Sustainable Finance Initiative – Establishment of a framework to facilitate sustainable investment

Encouraging investments in sustainable products is a core element in the strive towards a more sustainable environment. BVI[1] therefore welcomes the European Commission's Action Plan and in particular the aim to build a classification for sustainability ("Taxonomy"). A common language and disclosure building on such common language have the potential to facilitate a shift towards a more sustainable environment. Only a comprehensive concept on sustainability will solve the problems we are facing. We urge the Commission to provide for a holistic approach which builds on transparency and unleashes sustainable investments.

Key messages

- **Purpose of Taxonomy should be clearly defined.** The Taxonomy should be the reference for standards and labels for sustainable products, green bonds and for reporting throughout the investment chain. In order to unleash sustainable investments, it should also serve as orientation for (i) selecting investments where material extra-financial considerations are taken into account and (ii) systematically taking environmental, social and governance ("ESG") risks into account as investor and investee. Only a Taxonomy that can be used for these purposes and will in particular be used for reporting, will allow integration of sustainability into mainstream and a proper shift to a more sustainable environment. It is hence important that the Taxonomy is built in a modular, dynamic, forward-looking way.

- **A holistic approach is decisive**. Only a holistic approach regarding sustainability and Sustainable Finance ("SF") will provide for the broader economic effect and avoid redirection of capital with unintended consequences:
  - SF needs to **cover all aspects of ESG considerations**. A focus on environmental – in particular climate – aspects as a first step should not be to the detriment of other aspects.
  - **All asset classes and strategies** need to be covered. While the economic activity is the right approach for financing dedicated green projects, it is not practical for general equity investments, fixed income investments, investments in real assets. Further, a focus solely on economic activities will provide a basis for impact and thematic investments only, thereby limiting the scope of SF to niche investments.
  - The Taxonomy needs to be **flexible and compatible with international standards**. Investments are made worldwide and information on investments follows different standards outside the EU. The Taxonomy therefore needs to be compatible with international standards.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

- SF can only be **part of a broader strategy on sustainability**; a consistent approach towards e.g. energy policy, climate protection, waste prevention and a healthy ecosystem is required.

- **Fragmentation of Regulation hinders innovation.** We believe that all disclosure requirements should be linked to the Taxonomy, once established, in order to achieve a consistent approach throughout the investment chain. Disclosure requirements prior to the establishment of the Taxonomy should not be too detailed in order to avoid further fragmentation. We object to duplications of disclosure requirements as it is currently proposed within both the Regulation regarding the Taxonomy and the Regulation on disclosure. Inconsistent regulation and duplicated disclosure will confuse investors.

- **Investment decision must remain with end investor.** Once established, the Taxonomy can be used to set the right incentives for investing. However, it is very important that the Taxonomy is not used to restrict the investment options beyond an investment due diligence including assessment of ESG risks. The investment decision must remain with the end investor for several reasons including for the avoidance of misallocations of investments. We welcome that neither green supporting nor brown penalising factors are part of the Commission's proposals. Both factors would interfere with general regulatory concepts, in particular systemic stability.

Purpose of Taxonomy

ESG factors play an increasingly important role in investment decisions. Besides sustainable products, a growing number of institutional investors and asset managers already use methods of selecting investments taking also material ESG considerations into account throughout all portfolios.[2] Reliable and comparable data on sustainable factors regarding equity, fixed income investments or real assets facilitate such integration of ESG considerations in the investment process. We hope that the Taxonomy will improve quality and comparability of such data. We therefore welcome the proposal for a Regulation on the establishment of a framework to facilitate sustainable investments ("Taxonomy Regulation").

Approaches toward sustainable investments

Asset managers incorporate ESG factors into investment decisions with the aim to better manage ESG risks and to generate sustainable, long-term risk-adjusted returns.[3] Sustainable products seek to combine financial return with a moral or ethical return. Both of the aforementioned approaches are based on ESG data and one or more of the following or similar strategies:

- ESG integration: Integration of material ESG factors into fundamental analysis to enhance investment decision making
- Positive/best-in-class screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers
- Negative/exclusion screening: Negative screening or exclusion

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[2] See also the explanation on the difference between Responsible investment and Socially Responsible Investment, https://www.unpri.org/pri/what-is-responsible-investment
[3] See also PRI, "What is Responsible investment?", https://www.unpri.org/pri/what-is-responsible-investment.

- o Norms-based screening: Screening of investments against minimum standards of business practice based on international norms
- o Engagement: Encouraging positive change of a company's strategy contributes to its long-term value by using so-called Engagement as strategy[4]

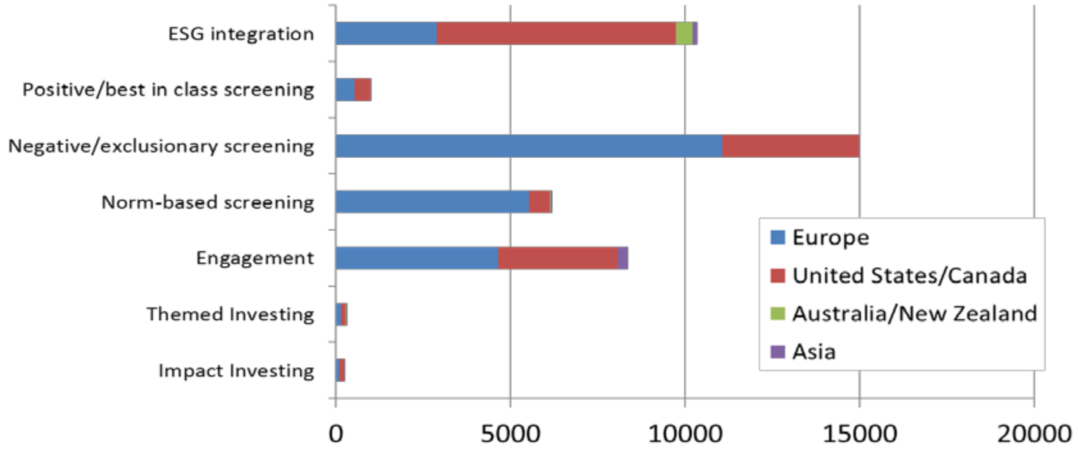
The following two approaches are in practice only relevant for sustainable products:

- o Themed investing: selection of assets that contribute to addressing one or more sustainability challenges such as climate change or water scarcity
- o Impact investing: investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return

While the potential usability of the Taxonomy cannot be predicted – given that delegated acts will define the details – below considerations outline the Taxonomy's potential for a comprehensive SF framework:

- **Sustainable products should be linked to the Taxonomy; it should also serve as orientation for integration of ESG factors.** Sustainable products should be linked to the Taxonomy by way of either labelling or reporting. This also includes a link for green bonds to the Taxonomy. However, sustainable funds as of today remain a niche.[5] This is in particular the case for impact or thematic funds.

Strategies by Region (in US $ billions)



Source: Global Sustainable Investment Alliance, Global Sustainable Investment Review 2016, p. 8, 27.

Even if the integration of sustainability into the advisory process may provide some market movement towards sustainable products, sustainable products have a very specific focus and are hence not very likely to become mainstream. Systematic integration of ESG considerations though has the potential to become mainstream[6], since it does not focus on specific moral or ethical returns but allows for aiming at an improved, stable, risk-adjustedperformance – something most

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[4] See e.g. EuroSIF SRI Study 2016, p. 22; http://www.eurosif.org/wp-content/uploads/2017/11/SRI-study-2016-LR-.pdf

[5] See for instance the Global Sustainable Investment Review 2016 of the Global Sustainable Investment Alliance, p. 8, download at http://www.gsi-alliance.org/members-resources/trends-report-2016/

[6] The German SIF "Forum Nachhaltige Geldanlagen" for the first time accumulated figures on systemic integration of ESG considerations. As of 31 December 2017, the total value of assets managed on that basis in Germany amounted to approximately 1.4 trillion Euros.

investors are looking for. The majority of sustainable investment strategies are based on the understanding that ESG criteria help to understand and Engagement helps to improve the viability of a company's strategy.

The Taxonomy has the potential to facilitate SF if it can be used as an orientation point for integration of ESG considerations beyond sustainable products. For this, it is very important that the Taxonomy covers all assets, and any link to it in terms of organisational requirements for asset managers or for disclosure needs to take into account the different approaches and strategies (see also below in detail on the holistic approach). If the Taxonomy can be built that way, it will allow for a dynamic shift towards a more sustainable environment.

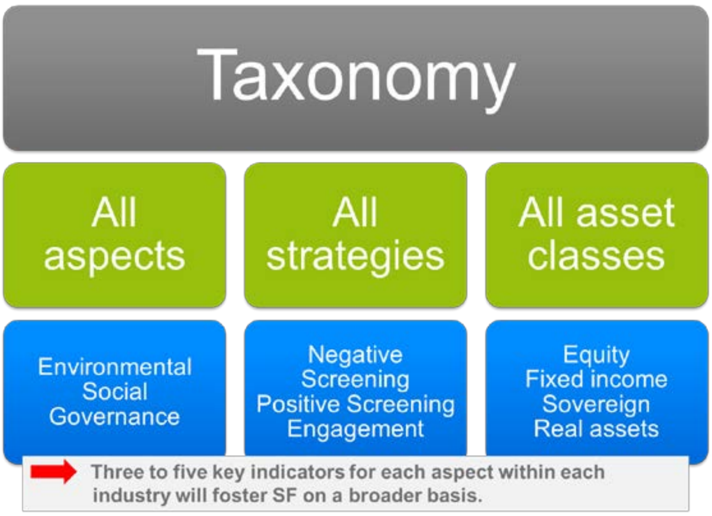
Consequently, we urge the legislators to clarify that the Taxonomy will serve as a basis for standards and labels for investment products including green bonds in order to provide a better understanding of sustainability for both institutional and retail investors. Furthermore, it should be built in a way that it could be used as orientation for systematically integrating ESG considerations and for taking ESG risks into account.

- **The Taxonomy should provide a basis for ESG reporting.** The comprehensive Taxonomy for sustainable assets will not only facilitate comparability of data for asset managers but also serve as a basis for ESG reporting throughout the investment chain, i.e. for investee companies, asset managers and (institutional) end investors. It is very important that all parts of the investment chain are covered. Otherwise intermediaries like asset managers or institutional investors might not have access to the relevant data on reporting. Moreover, standardised, reliable and credible information is a pre-condition for SF and is decisive for a proper assessment of long-term risks or long-term factors. The less information on ESG aspects is available, the more difficult it is to take these aspects into account. Generally, the data available has improved significantly over the last few years. This is in particular the case for data relevant for the impact on climate change. However, comparability of the data available could further be improved. Besides, forward looking data and indicators are crucial for ESG considerations and presently only available to a limited extent. In addition, the connectivity between financial and non-financial information could be improved. The Taxonomy should facilitate this.

- **The Taxonomy should be used neither to penalise nor to ban certain investments.** We appreciate that there is currently no discussion about penalising or banning certain investments. Such excessive approach could interfere with market stability and would limit the possibility to act according to specific investors' situations. Any bans or penalisations may have a significant impact on the financial market as a whole and should be considered very carefully and only based on a thorough analysis of sufficient research and data. This is also true with respect to any measures concerning potentially stranded assets. Systematic misallocation can only be avoided in case the decision remains with the asset manager or the end investor. Financial stability should remain a high priority of financial regulation. Furthermore, investors have their convictions and beliefs which the regulator should not predefine only based on its own beliefs. Depending on the specific circumstances the investor and/or the asset manager is in the best situation to make the adequate investment decision also with respect to ESG considerations. In addition, mandatory requirements will shift the question of ESG integration from a developing approach to a mere question of compliance which would likely have an effect of retrogression.

Holistic approach for Sustainability and the Taxonomy

The Taxonomy requires a holistic approach in order to avoid misallocations and facilitate a transition to a more sustainable environment. Only a comprehensive concept of sustainability will strengthen environment (e.g. energy policy, climate protection, waste prevention and a healthy ecosystem) and foster development (e.g. poverty reduction, adherence to ILO standards, human rights).[7] This requires taking into account (i) the interaction between all elements of sustainability (environmental, social, governance) as well as within these elements (e.g. for environmental: climate, waste prevention, ecosystem, etc.) and (ii) the different types of activities, sectors, asset classes etc. as well as strategies which can act in favour of the objective. Furthermore, SF is only one element which can contribute to a more sustainable environment. Clearly, it can only be one of several political measures.



- **The Taxonomy needs to cover all aspects of sustainability.** We understand that the project of building the Taxonomy is already very ambitious and that any broadening of the scope would provide an additional challenge. However, all elements of sustainability (environmental, social,

[7] See also "World Commission on Environment and Development: Our Common Future", http://www.un-documents.net/our-common-future.pdf.

governance) interact and are relevant for ESG considerations today. SF therefore needs to cover them all. This is generally acknowledged as the right approach towards sustainability – see for instance the Principles on Responsible Investments, the World Commission on Environment and Development or UN Global Compact.

In this regard, we appreciate the "do no harm" principle in the Taxonomy-Regulation. However, we believe that it does not take into account the interrelation between social and environmental aspects as well as aspects of governance sufficiently. While for governance issues we do not see a specific need for a Taxonomy since there are already universally accepted principles, this is not the case for social aspects. For governance aspects it would be sufficient to recognise them as part of a sustainable approach throughout the legislative package. But social aspects should be part of the Taxonomy. The reference to ILO only covers the aspect of human resources in the social element and disregards other aspects which are of social relevance such as product safety or social opportunities.

> *Illustrative example: Lack in drug or chemical products safety can socially harm consumers and have a material impact on the company. For instance, Bayer's affiliate known as Monsanto sold weed killers which allegedly cause cancer. A class action suit may expose Bayer to billions in legal liabilities.*

Furthermore, we are concerned though that climate change as first priority could be to the detriment of other goals. Environmental goals in themselves can be contradicting, i.e. specific technologies can be in line with one goal but be detrimental to others.

> *Illustrative example: Activities relating to nuclear energy – which have low impact on carbon emissions – may be considered as sustainable although they produce nuclear waste.*

Consequently, it needs to be clear how in such situations the activity should be qualified, taking into account all effects that will be triggered by the qualification.

- **The Taxonomy needs to cover all asset classes, industries and strategies.** The Taxonomy should not only provide the means to determine whether an economic activity is sustainable. The focus on activities seems to be the right approach for specific green projects (e.g. green bonds), where it is easier to identify whether such specific project is a sustainable activity or not. It would, however, hinder a broad facilitation of SF. With a focus on economic activity and absent a translation to the investment level, the Taxonomy would only be relevant for a small niche, e.g. funds that are only investing in the underlying green activities (green bonds, green infrastructure) or pure-play green companies. We believe that the legislator should rather use the potential of the Taxonomy to facilitate implementation of SF into mainstream. Only this will achieve the required shift to a more sustainable environment. In detail:

    o **Focus on economic activity deviates from market approach.** Today, ESG research is focused on industry sector and corporate entity levels. In addition, asset managers need information relevant for the respective asset class. A granular Taxonomy focusing on economic activity would have to be translated into investments in equity, fixed income including sovereign as well as alternatives like real estate. So far, we do not see a coherent approach of such translation. Such translation will likely be very complex and time consuming and might not work throughout all asset classes.

Illustrative example: If an asset manager invests in a company which – inter alia – produces recyclable footwear, this activity could be considered as sustainable. The proposal does not account for how a fund could identify to what extent the equity investment in such company could then be considered as sustainable. This limits the approach to green projects and purely green companies.

- **Focus on economic activity facilitates crowding of investments.** Asset managers invest their clients' assets in their best interests in particular with the aim to generate returns with a certain level of risk tolerance adequate for the investor. Taking ESG criteria into account can affect the level of risk involved in both ways: Some risks pertain to sustainability, like the risk of assets suffering from devaluation due to discontinuation of the use of fossil fuel (stranded assets). Others are linked with sustainable investments.

  Illustrative example: Investments in wind and solar energy power plants would possibly be considered sustainable. Operators receive remuneration for feeding in energy. The valuation of the investment is also based on this remuneration. In case of an overproduction of energy, the operators might not receive the remuneration which will have an impact on the investors' return.

  Setting incentives to redirect assets into sustainable activities also bears the risk that certain assets become overvalued. Sustainability considerations therefore need to remain linked to the economic value of an activity or investment. For instance, projects which are in a development stage or projects which are simply too small may not be economically viable investments. Nevertheless, if the investment is considered sustainable, this might lead to a crowding, which in turn could lead to overheated markets. In addition, pricing of investments does not yet sufficiently reflect the environmental changes which we could face in the next decades. Also for this reason, it is important that the regulation allows for enough flexibility for the asset manager to assess and decide on the over- or undervalue of an investment. The investment decision therefore has to remain with the asset manager in order to avoid misallocations of investments.

- **The Taxonomy should not discriminate against specific sectors and therefore recognise sector-neutral strategies.** The Taxonomy should not prefer specific strategies for sustainable investments or focus on investments that are fully sustainable. Asset managers today apply different strategies in order to take sustainability considerations into account (see above the textbox p. 3). A focus on economic activities does not recognise sufficiently forward-looking approaches that allow for product innovation and for inducements to a more sustainable behaviour throughout all sectors.

  For instance, encouraging positive change of a company's strategy contributes to its long-term value by using so-called Engagement as strategy.[8] For asset managers managing passive funds – besides tracking sustainable indices – Engagement is the only sustainable strategy they can pursue.

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8 See e.g. EuroSIF SRI Study 2016, p. 22; http://www.eurosif.org/wp-content/uploads/2017/11/SRI-study-2016-LR-.pdf

Illustrative example: An investment in an oil company should be recognised as SF if the asset manager strives for the development of alternative fuels by that company and has the means to encourage the company accordingly.

In addition, ESG integration and positive screening allows asset managers to also select investments on the basis of companies performing better than others within their industry sector in terms of sustainability. They are industry neutral and therefore allow investing in all sectors and improving sustainability within any sector. Such strategies allow for the real economy generally to shift towards are more sustainable environment. Therefore, it is important that the Taxonomy does not prefer specific types of sustainable strategies or specific industries in order to avoid disruptions for the real economy for instance by favouring divestments in a specific sector.

Illustrative example: If no positive screening strategy could be used, a low carbon portfolio will likely comprise fewer investments in the transport and more in the services sector.

- **The Taxonomy should cover all asset classes.** A focus on the economic activity will likely not cover all asset classes. However, asset managers invest in a broad range of assets and liabilities which include equity, bonds (including sovereigns) other fixed income, real estate, infrastructure, private equity as well as loan investments. We believe that the Taxonomy should cover all these types of investments in order to mobilise capital for SF on a broader basis.

Illustrative example: If an asset manager invests in real estate, it is unclear to what extent such investment could be considered as sustainable. For instance, it could be considered as sustainable if its carbon emission is below the standard, but how are other relevant factors such as power consumption or generation of waste taken into account?

Therefore, the Taxonomy should also include a more high level approach which could be used for RI. In the first step it could identify three to five key indicators for the specific ESG elements which are relevant for this specific aspect in a given industry. It could be built on standards which are already developed and should be compatible with international standards.[9]

Illustrative examples: While in commercial banking key indicators should comprise systematic Risk Management, management of the legal and regulatory environment, integration of ESG risks and opportunities in lending / financing, as well as customer satisfaction, a pharmaceutical company should better be evaluated regarding product quality and safety performance, responsible marketing, access to medicines and affordability as well as its research & development performance – especially regarding safety of clinical trials as the material key issues in these industries.

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[9] For instance SASB provides provisional standards for SEC filings which include five to fifteen material ESG key factors for around 80 industries, see https://www.sasb.org/approach/disclosure-topics/. The GRESB has developed standards for investments in real assets.

- **The Taxonomy needs to remain flexible and compatible.** The Taxonomy should help capital markets to more generally understand and take into account long-term ESG considerations. It is hence important that it remains flexible in order to be compatible with international standards, individual investors' needs and in order to avoid a tick-the-box compliance approach. In this regard, a screening approach also allows taking into account changes over time. This seems to be harder if the focus is on the economic activity which will be considered either as green or not.

  Furthermore, building the Taxonomy, the European Union will potentially set standards for the rest of the world. However, it is important to bear in mind that investments are made worldwide. While European companies might report based on the Taxonomy, companies outside the European Union will most likely not. In this respect, asset managers would face additional challenges for investments outside Europe and the qualification of activities as sustainable. The Taxonomy therefore needs to be compatible with international standards.

- **Broader Strategy on Sustainability.** While there is a general focus on SF, the financial industry alone will not be able to achieve the desired change.[10] Governments as well as public entities generally have to play an important part. First of all, they should serve as role models regarding their own investments. Public funds should also be required to take ESG criteria into account for their investments. Secondly, it is of utmost importance to bring the broader European strategy on Sustainability forward and improve politics regarding energy, climate protection, waste prevention and a healthy ecosystem. Measures have to be implemented consequently in order to achieve the desired outcome.

  Illustrative example: The EU Emissions Trading System (EU ETS) aims at limiting or reducing greenhouse gas emissions in a cost-effective way. However, prices for carbon emission allowances are only rising slowly, thereby so far limiting the effect of the system. A reduction of the cap (total amount of greenhouse gases that can be emitted) as has been passed by the EU member states in February 2018 will improve the situation but only starting 2021.

  Furthermore, there is an interaction between politics. Only a holistic approach will be able to avoid unintended effects of regulatory interventions.

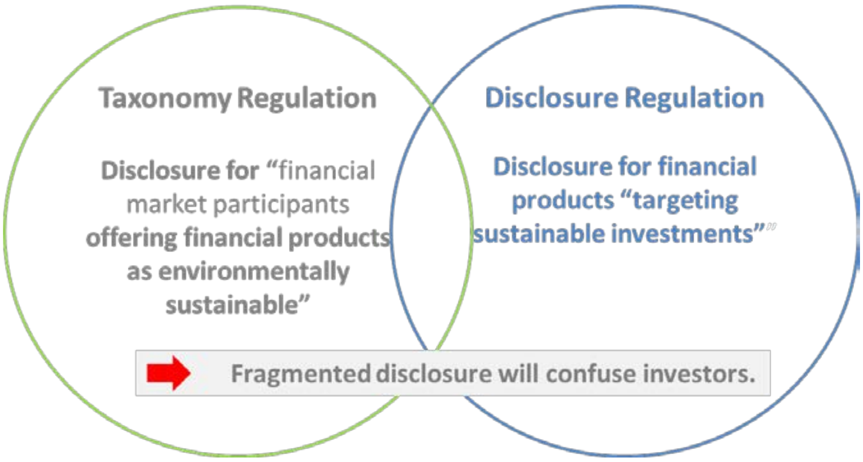
  Illustrative example: In Germany, capital is made available to expand renewable energies. However, grid connections are not sufficiently developed in order to allow proper use of all renewable energies. Expansions inter alia face public protests against power lines near residential areas. As a consequence, renewable energy systems are not necessarily built where they are needed or where the grid connection expansion could be minimised. This leads to higher costs of renewable energy for consumers.

Fragmentation of Regulation hinders innovation.

The Taxonomy Regulation should not provide for disclosure requirements as currently foreseen in Art. 4 (2). Rather, it should focus on the establishment of the Taxonomy and leave any related disclosure requirements to the respective relevant legislation, e.g. the fund regulation or the CSR.

[10] See for instance the comprehensive report of the German Industry Association BDI, Klimapfade für Deutschland 2050

Currently the proposal provides for a fragmentation since both the Taxonomy Regulation as well as the proposed Regulation on disclosures relating to sustainable investments and risks ("Disclosure Regulation") feature disclosure requirements for sustainable products. Specifically, the Taxonomy Regulation refers to "financial market participants offering financial products as environmentally sustainable" whereas the Disclosure Regulation stipulates a comprehensive approach with respect to financial products "targeting sustainable investments."



In addition, both sets of rules provide for empowerments for different Delegated Acts. Beside the fact that the wording of the Disclosure Regulation should be improved (see our position paper on the Disclosure Regulation), the Taxonomy Regulation should not provide for an additional and different set of disclosure rules. This could in the end mean that market participants will be required to disclose specific detailed information for some products (those marketed as sustainable), other information for products "targeting sustainable investments" or in some cases even comply with both disclosure requirements if a product fulfils the criteria in both cases.

In addition, due to the time frame of the legislative process and the number of players involved, there is a risk that the proposals become even more inconsistent with existing and proposed regulation over time. Such fragmentation and confusion will likely not contribute to a concise disclosure for investors. The legislative package should therefore provide for a consistent approach in this respect and Art. 4 (2) to (4) of the Taxonomy Regulation should be deleted.

Process of establishing Taxonomy

We support the idea for the common language as a basis for reporting and disclosure requirements and as orientation for RI. Furthermore, we appreciate the idea of establishing the platform on SF with experts of the financial industry involved which shall advise the Commission on screening criteria. In this respect, we urge the Commission to ensure that such group is balanced and that a sufficient diversity of market participants who have to work with the Taxonomy in practice is involved. The diversity should not only take into account different business models, jurisdictions, industry perspectives (e.g. asset managers, insurance companies, banks) but also the different aspects of assets.

Technical Comments

The following comments suggest specific changes to the Taxonomy Regulation.

Article	Comment
Art. 1 (1)	The focus on the economic activity is too narrow. Asset managers today use ESG research that is focused on industry sectors and corporate entity level and not on specific economic activities. Either the Taxonomy will be translated for the purpose of these investments or the Taxonomy will only facilitate investments in a green niche. We therefore suggest that the Taxonomy also provides a classification not only on an economic activity level but also on a sector level. The wording should be amended accordingly.
Art. 1 (2)	The Taxonomy Regulation should not stipulate the purpose of the Taxonomy but only the process and terms of the Taxonomy. Rather other regulation, e.g. the Disclosure Regulation or any Green Bond standard should be linked to the Taxonomy Regulation. We therefore propose to separate these two aspects strictly by deleting this paragraph. A general description could be included that the Taxonomy's purpose is in particular its use for sustainable products (including green bonds) and reporting.
Art. 2 (1) (b) and (c)	These definitions should be deleted since they are only referred to in the disclosure requirement in Art. 4 (2) to (4) which also should be deleted.
Chapter II	The Taxonomy Regulation should also provide for a Chapter on social and development aspects and should recognise Governance aspects as relevant for SF.
Art. 4 (2) to (4)	The Taxonomy Regulation should not mix the establishment of a framework with its use. The use should be stipulated in other frameworks in order to avoid fragmentation of the regulation to the detriment of the investor and market participants. Art. 4 (2) to (4) should therefore be deleted.
Art. 13	The minimum safeguards should be replaced by criteria for social and development activities and investments.
Art. 14	Art. 14 should introduce a new paragraph. This should be the basis for building the more high-level Taxonomy on the Level of the investment (e.g. the company, the sovereign bond or the real estate). Such Taxonomy should identify the key indicators for each aspect of sustainability relevant for this industry.