Statement

Establishing a Framework to Facilitate Sustainable Investment

Federation of German Industries

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General comments

The Federation of German Industries, the BDI[1], shares the opinion that there is a funding gap in sustainable investment. As outlined in the *Action Plan for Financing Sustainable Growth*, the capital markets can be stimulated to contribute to better reaching the EU's climate and energy targets. For the BDI, it is nonetheless important that development banks and the private banking sector also retain the leeway they have in corporate financing and that their leeway regarding venture capital is not restricted further through banking regulations.

According to the European Investment Bank, there is an investment gap of 270 billion euros each year in mobility, energy and resource management required to reach the EU's climate and energy targets. The financial sector can play a key role in fostering investment in sustainable growth and in the creation of jobs and prosperity.

Sustainability and all three pillars of sustainability – the environmental, the economic and the social – are rapidly becoming integral components of the financial markets. Demand for sustainable investment products is rising constantly. The rating agency Standard & Poor's anticipates green investment to grow by more than 30 percent this year alone. This would bring the global market for green investment up to 200 billion US dollars, the lion's share (around 60 billion dollars) coming from Europe. Sustainability principles have long become established in the financial sector, and the rising demand for green investment products will see the volume of these investments increase further. The BDI is therefore working to ensure that this growing market is not hampered by unnecessary regulations. Criteria should be market-driven and take account of the heterogeneous investor structure and strategy.

The Sustainable Finance project has the potential to become a big success for the real economy and must not be regarded solely from a financial perspective. The project's objective is to increase investment in transport, energy and resource management, etc., and not to create new classifications in the sale of investment products. The divergent preferences of investors and other stakeholders in relation to sustainability must also be taken into account. In a first step, the European Commission should thus restrict its efforts to providing a guideline of which criteria can be used to evaluate a sustainable financial product.

[1] The Federation of German Industries (BDI) is the umbrella organisation of German industry and industry-related services. It represents 36 member associations and more than 100,000 large, medium and small enterprises with over eight million employees.

Specific comments

The core of the package of 24 May 2018 on Sustainable Finance is the classification, or taxonomy, of environmentally sustainable economic activities. The objective of this classification is to set uniform standards throughout the single market in order to foster cross-border investment. Numerous member states have already established classifications for capital investment so a harmonisation has the potential to create synergies.

The BDI supports the Commission's approach of commencing the initiative with establishing a taxonomy so as to define a common language for sustainable investment. In order to avoid putting European companies at a disadvantage in global competition, implementation must not be solely on a European level. Existing standards should, in particular, be taken into account. Tried and tested systems should under no circumstances be pushed back. Market-driven standards and classifications have proven to be very successful in the past. The share of green financing according to the Principles for Responsible Investment (PRI) by German development bank KfW, for example, was 43 percent in 2017, up from 31 percent in 2010. The KfW has also issued green bonds worth 13.5 billion euros to date. There are also other established classifications on the market. Investors have confidence in the instruments that have developed on the markets and these have proved to be effective in combating greenwashing.

Economic activities that are classified as sustainable according to the established market-driven classifications should, in all cases, be accorded the same status in an EU taxonomy. In addition to the voluntary, market-driven information on sustainability factors, companies already disclose a wide range of mandatory information in the scope of their financial and non-financial reporting. Information on sustainability is therefore already available to a sufficient degree, particularly from the larger companies operating on the capital market. The new taxonomy should therefore on no account lead to any additional reporting duties or disproportionate cost increases for the real economy.

Further measures of the Action Plan on Sustainable Finance can then be taken once the taxonomy has been established. Before a common language has been agreed upon, however, further steps would be premature. The legislative proposals on prospectuses for green bonds, features of benchmarks, and investor duties should only be addressed subsequently in order to guarantee clarity and legal certainty. These measures will only succeed if the classification established is workable and industry-oriented. The BDI, its member associations and business representatives must be involved in establishing this classification.

Taxonomy of sustainable economic activities

The European Commission has proposed six environmental objectives overall. An environmentally sustainable economic activity needs to substantively contribute to one of these objectives and not significantly harm any of the other five objectives.

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

The precise details of the six objectives are to be adopted subsequently in the framework of delegated regulations. This would lower the opportunities to participate in the legislative process and incorporate industrial expertise. The BDI therefore urges the details of the objectives to be clarified in the regulation itself. Prior sustainability investments and achievements of companies should also be taken into account. Transferring these highly political decisions from Level I to the more technically structured Level II legislation at all is incomprehensible. Politically sensitive issues, such as the evaluation of energy sources that have both different carbon emissions and other environmental risks, cannot be clarified on a technical level. While the European Commission plans to define the screening criteria in delegated regulations, the BDI urges that these are defined in the present legislative proposal. Delegated regulations should only be used for eventual adaptations of the technical screening criteria following evaluation. We therefore call for a corresponding amendment to Article 16 and the corresponding second clauses of Articles 4 to 11 of the six environmental objectives. On no account should there be an explicit list excluding specific types of economic activity from the list of environmentally sustainable investments. All companies whose environmental performance is significantly better than the global industry average should be classified as sustainable. A purely binary classification into sustainable versus non-sustainable would not correspond to the real picture. This is too simplified in view of the complexity of the value chains of European industry.

Nor should the scope of application be extended over and above economic activities. In particular, the proposed criteria are not suitable for classifying entire companies or industries as sustainable. Furthermore, sustainability encompasses many other criteria besides (e.g. social aspects and aspects of good corporate governance). These factors are not considered in the approach currently under discussion and could lead to investor preferences not being catered for. In this context we view the proposal to measure the degree of environmental sustainability using quantitative factors with criticism. Weighting financial indicators, such as share of sales from sustainable activities, will indirectly serve to classify entire companies as sustainable or not even though this does not serve the desired purpose as explained above. In addition, this approach to determine the degree of sustainability is excessively based on the past and only takes past investment decisions into account. Qualitative and future-focused factors should also be included, such as development or innovation potential.

Recital 23 of the regulation rightly states that reducing the negative impact of economic activities on the environmental objectives can make a significant contribution towards reaching environmental targets. The proposed regulation refers, among other things, to the industry average. We recommend giving more weight to this key recital and including it in Article 5(7). This article should also be clarified by defining the industry average as the global industry average. In many sectors, European industry is leading the way globally in environmental sustainability; even economic activities that inherently have a negative impact on the environment are at least optimised to such an extent that the negative impact has been minimised. These kind of economic activities, that are better than the global industry average, must also be classified as environmentally sustainable. We therefore propose the following supplement to Article 5:

> *“For the purposes of this Regulation, the following shall be environmental objectives:*
>
> Clause 7
> *“Better environmental performance than the global industry average.”*

Industrial value chains

The taxonomy does not take sufficient account of industrial value chains: Article 14(1)(f) only specifies that the technical screening criteria shall take account of the production, use and end-of-life of the provided products and services of an economic activity. But this falls far short of a rigorous evaluation of industrial value chains. Individual economic activities that do not themselves meet the specified sustainability criteria may nonetheless be inputs required for economic activity that is classified as sustainable.

For example, the production of basic materials such as metals and chemicals are often very energy and carbon intensive. However, these materials are irreplaceable components of environmentally sustainable activities such as the production of renewable energy or low-emission mobility. It is simply not possible to build electric vehicles without the energy-intensive and emission-relevant production of lightweight materials, electric engines and energy storage systems made from commodities and raw materials. An evaluation of the beneficial environmental impact of a product therefore also needs to include an evaluation of the commodities and materials needed to produce the product. The present proposal does not yet provide a workable approach for including these complex value chains.

We therefore recommend amending Article 14(1)(f) as follows:

> 1.
> *"The technical screening criteria adopted in accordance with Articles 6(2), 7(2), 8(2), 9(2), 10(2) and 11(2) shall:*
>
> (f)
> *take into account the entire value chain of the economic activity by considering all phases of the value chain and the production of the required commodities and raw materials and intermediates in the overall evaluation of the production of particularly environmentally sound products."*

This aspect is only one example to show that an unambiguous and precise classification of individual economic activities is not possible. We would therefore recommend that no obligations are imposed on the basis of such a classification. The European real economy must, under no circumstances, be restricted in international competition.

Technical expert group

In June 2018 the European Commission appointed a technical expert group to guide and assist the establishment of a framework to facilitate sustainable investment. Most of the 35 members of this group are financial industry representatives. Only the minority of experts have any relevant industrial expertise. Experts from industry are, however, essential for evaluating the sustainability of complex industrial value chains.

The proposal will only accomplish its objective of increasing investment in sustainable projects if the companies in question actively participate in structuring the legal framework. With its focus on the financial industry, the current composition of the expert group suggests that the objective of the initiative is rather to generate for sale new investment products classified as environmentally sustainable.

We therefore urge the Commission to appoint more industry representatives to the group in order to increase its experience and expertise in sustainable business. The real economy should also be closely involved in drawing up the taxonomy. Industry, in all its breadth and depth, will make its expertise and experience available and take an active part in this process.

Platform on sustainable finance

The legislative proposal sets out the establishment of a platform on sustainable finance. The role of the members will be to advise the Commission on the technical screening criteria, and the possible need to update those criteria. In view of the objective of the legislative proposal, this platform will need to have a focus on representatives from the real economy who will, ultimately, be making the targeted environmentally sustainable investment. We recommend explicitly anchoring the role of members from the real economy and their expertise. Article 15(1) should therefore be amended as follows:

> 1.
> *"The Commission shall establish a Platform on sustainable finance composed of:*
>
> (d)
> *Representatives of the real economy with expertise in environmentally sustainable economic activity. This group shall represent a wide range of industries and account for at least one quarter of the Platform's members."*

Capital requirements

The introduction of a green supporting factor, in effect lowering the capital requirements on banks for environmentally sustainable investments, has been suggested repeatedly in the course of the debate on sustainable finance and in the Action Plan of 8 March 2018. We explicitly reject this proposal in this form. Capital requirements serve to strengthen financial stability and are based on the risks of an investment. Classifying an investment as environmentally sustainable gives no indication as to the risks of a project. Lowering capital requirements for environmentally sustainable investments without precisely analysing the associated risks is dangerous from a financial stability perspective and not appropriate. A move to lower capital requirements would only be possible a few years after the taxonomy has come into effect and following a comprehensive evaluation of the risk profiles of environmentally sustainable economic activities, should these prove to have a lower risk of default.

We are also categorically opposed to increasing capital requirements for economic activities that are classified as not being environmentally sustainable. While disadvantaging other types of investment, this approach would not even foster green investment. It would also impact on other policy areas that the European Union has identified as priority areas and would conflict with the objectives of these policy areas. Furthermore, European companies would be put at a clear disadvantage in global competition.

Sustainability for SMEs

Small and medium-sized enterprises (SME) and midcaps up to 3,000 employees are the foundation of European industry. SMEs and midcaps rightly have less stringent reporting duties than large companies. Consequently there is less public and prudential information available to evaluate the environmental sustainability of the economic activities of these companies. The present legislative proposal must ensure that this will not put smaller companies at a disadvantage. The regulation must not impose a direct or indirect obligation for additional reporting. Furthermore, the lower data availability must not become a barrier for the economic activities of SMEs and midcaps to be classified as environmentally sustainable.

We therefore urge that the screening criteria take account of the lower data availability of SMEs and midcaps. A paragraph should be added to Article 14 to this effect:

> Article 14
> 5.
> “*Small and medium-sized enterprises (SMEs) and midcaps up to 3,000 employees have lower reporting duties than large companies and there is less information available on the economic activities of this group. A lack of data for one or more screening criteria in this group should therefore be evaluated as positive in each case. The Commission shall ensure that the size of a company does not put it at a disadvantage.”*

Closing remarks

Investment in sustainable technologies are a key factor for reaching European and global climate and environmental targets. The BDI is expressly in favour of fostering sustainable investment. The financial market, alongside many other policy areas, can make a contribution to reaching these targets. For this to happen, the Sustainable Finance project must take a holistic approach. **Industrial value chains** should therefore be given explicit consideration in the sustainability criteria. To achieve this, representatives of the **real economy** need to be appointed to the **technical expert group**. A holistic approach also means measuring the **environmental objectives against global benchmarks**, particularly in view of the fact that European standards are already high in comparison. Furthermore, **the objectives of the project should not conflict with those of other policy areas** and the stability of the financial markets must not be endangered by amending capital requirements. Special regulations need to apply to **SMEs and midcaps** to avoid putting smaller companies at a disadvantage.

About the BDI

The Federation of German Industries (BDI) communicates German industries' interests to the political authorities concerned. She offers strong support for companies in global competition. The BDI has access to a wide-spread network both within Germany and Europe, to all the important markets and to international organizations. The BDI accompanies the capturing of international markets politically. Also, she offers information and politico-economic guidance on all issues relevant to industries. The BDI is the leading organization of German industries and related service providers. She represents 36 inter-trade organizations and more than 100.000 companies with their approximately 8 million employees. Membership is optional. 15 federal representations are advocating industries' interests on a regional level.

Imprint

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