AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

AmCham EU's position on the European Commission's Sustainable Finance package

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2017, directly supports more than 4.7 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

American Chamber of Commerce to the European Union
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Executive summary

The American Chamber of Commerce to the European Union (AmCham EU) supports the Commission's initiative to better leverage private capital to meet EU climate and sustainability goals. This paper outlines key priorities for each proposal in the Commission's latest package, each of which will need to remain suitably flexible, clear and objective to achieve their objective of leveraging the potential of private capital.

Introduction

AmCham EU represents over 150 companies of American parentage – from a wide range of sectors – committed to and invested in Europe. We have followed the European Union's (EU's) Sustainable Finance initiative closely since late 2016, including the Commission's March 2018 Action Plan, and believe that industry has a significant role to play alongside policymakers. A number of our member companies were also participants of the High Level Expert Group on Sustainable Finance and the ongoing Technical Expert Group on Sustainable Finance.

AmCham EU believes that there is potential in harnessing capital flows for sustainable investment. The goal of our Sustainable Finance Task Force is to combine the expertise and experience of business from across our membership with the technical insight of the transatlantic financial services sector. This cross-sectoral group intends to act as a trusted and valuable partner for policymakers throughout the implementation of initiatives laid out in the Commission's Action Plan.

The AmCham Sustainable Finance Task Force uniquely includes:

- Banks and insurance companies;
- Investment firms;
- Benchmark providers;
- Financial data providers;
- Energy companies;
- Automotive manufacturers and suppliers; and
- Consultancies and law firms.

Key principles

Given the importance of its objectives, the sustainable finance project is likely to be a key focus of policymakers for the rest of the current Commission and its successor. We believe there are three guiding principles which will be crucial for ensuring lasting success as policymakers implement the Commission's Action Plan:

1. Regulatory certainty and economic stability

It is essential that the EU ensure a coherent, holistic and long-term framework to promote sustainable growth, including clear and objective definitions of 'sustainable', without which investors would lack regulatory certainty. In the interest of financial and economic stability, complex default or market risk must be taken into account as a pre-requisite for sound action.

2. Evidence-based policy

Businesses are uniquely placed to provide expertise on the real-world challenges associated with climate change and on the impact of transition-orientated policy initiatives. Policymakers should ensure that evidence drives decision making and that all stakeholders are able to provide meaningful and substantive input throughout the legislative process.

3. International openness

EU leadership is critical to building international momentum on sustainable finance. However, the ambitious energy transition targeted in the Paris Agreement will require the mobilisation of global financial markets. In line with the principles of the CMU, we recommend that EU initiatives take an open, flexible, and outward-looking approach to ensure equal and non-discriminatory access for third-country financial institutions, businesses and investors – all of whom can, and do, make a critical contribution to the European economy. We encourage the Commission to promote discussions in international fora. International standardisation will both prevent fragmented jurisdictional approaches and promote harmonisation.

Policy-specific recommendations

Framework for sustainable investments

The Commission's proposal to develop a taxonomy to serve as the basis to define sustainable economic activity is ambitious. We agree it is essential to provide clear definitions for which activities and sectors are considered 'sustainable' or 'green', as a basis for the clarity and comparability needed for other inter-linked initiatives in this area. **However, the taxonomy should not take a 'one size fits all' approach**. All investors and companies have different risk and carbon appetites and the taxonomy should serve as a guide for these choices.

The taxonomy should ensure that any such definition is derived from **objective and technology-neutral criteria**, and takes into account the **different shades of green** which an economic activity might take. It should enable all economic activities to be classified, while remaining **flexible enough to adapt** to new activities and technologies, assessment standards and investor preferences. A one-size-fits-all, or narrowly defined definition, risks locking investors into a path that cannot adapt to changing real-world demands for developments, technological innovation, and scientific progress. A restrictive approach to the taxonomy may impede heterogeneous approaches to investing sustainably. The taxonomy should take account of relative carbon reductions to incentivise efforts to make existing assets more sustainable where possible and thereby ensure a smooth transition for all sectors.

It is essential that the taxonomy is conceived in such a way that it does **not disrupt the classification of investments according to other, previously existing green taxonomies** globally. Examples of such taxonomies that relate to sustainability include the Principles for Responsible Investment (PRI) Reporting Framework and the European Investment Bank's (EIB's) work on eligible sectors and eligibility criteria for climate action. Outstanding investments which are considered 'sustainable' **currently should not become 'unsustainable' overnight** merely because they do not fit the definition provided by the new EU taxonomy.

Concerns & recommendations

We are concerned that the Commission's taxonomy proposal takes an approach which may fall short of providing the clarity, flexibility, objectivity and predictability necessary to provide investors and companies with a workable framework for making investment decisions.

Firstly, though we understand some technical questions may need to be moved into **secondary legislation**, we believe the extent to which the taxonomy will be left to the Commission's expert groups **may go too far**. Such a move will mean that both the co-legislators and affected stakeholders from across the economy will only gain a full picture of the taxonomy at a much later date. Crucially, this will also **preclude a comprehensive impact assessment** and stakeholder input which we believe is essential for a proposal of this significance – particularly in light of the Commission's Better Regulation agenda. It is **essential that the taxonomy is developed prior to any important review** of existing financial regulations

The proposal also raises confusion and uncertainty in the following areas:

- Some parts of the proposal (e.g., Recital 18) imply that the taxonomy should be considered an exhaustive list. This appears to **exclude the possibility that investors go above and beyond** the taxonomy, should they choose to do so, or depart from it when it is in line with their investment strategy.

- The **binary nature** of the proposed taxonomy may **limit the flows of investment** into sustainable activities which have a significant carbon reduction benefit, but which, for example, may cause some unavoidable environmental or biodiversity disruption. The concept of 'significant harm' needs to be revisited and clarified.

- It is **unclear how the six environmental priorities will be taken into account** holistically when assessing an asset's 'sustainability'. Many of the concepts that buttress the priorities are core to EU environmental policy, but have been designed either to disclose what is 'environmentally leading' within the same product category (e.g., Eco-design & Ecolabel), or to assess the weight of and compensate for environmental externalities such as pollution and unsustainable water use. **Applying these concepts** to financial assets across industrial sectors and without thinking of specific business models **may lead to confusion**. Industry needs to be better represented in the process of creating the taxonomy.

- We are particularly concerned about the additionality of these criteria. On a product basis and within an industry, environmental impact can be assessed for what is identified as 'best in class' at a certain point in time. Among industries with widely different manufacturing processes and energy consumption, profiles assessing impact on land use or air pollution may not be an objective differentiator. **Clarity is needed on how these objectives could be prioritized, not only added together**.

- The taxonomy should be complemented by tax incentives and co-funding mechanisms. Its application should be informed by and aligned with other major European policy priorities, including reindustrialisation, employment and energy security.

Low-carbon and positive carbon benchmarks

Capital markets have a key role to play in the transition towards a greener economy. When it comes to reorienting capital flows financial benchmarks can be used as tools by investors in their investment decisions. However, introducing an overly restrictive legislative framework could limit, rather than enhance, the adoption of low carbon indices, which **could be detrimental to this policy objective**. Indices are chosen by investors to suit their particular investment profile. The specific index an investor chooses to use as a benchmark can be an accumulation of many different screening factors including sectoral, risk, resource, carbon and social criteria. Investors must be allowed to **choose the index that works best for their objectives**.

It is important to ensure that low carbon and positive carbon benchmarks deliver what they advertise in order to ensure investor protection. However, it should be recognised that the existing EU benchmark framework already requires and regulates transparency through prescribed benchmark statements and methodology documents, as well as the oversight of all benchmarks used in the EU.

In addition, suggesting that all benchmarks must transition to become positive carbon benchmarks would cause massive disruption to financial markets and the economy. The **number of companies that can be considered 'positive carbon'** (e.g., within the Commission's explanation, that they save more carbon than they produce), is **very small** and is highly concentrated in the renewable energy sector. As such, 'positive carbon' benchmarks are not a substitute for market benchmarks. 'Positive carbon' and 'low carbon' benchmarks are valid investment choices for an investor to make, but should not be the only choice available. For example, a pension fund wishing to lower its carbon footprint will also be required to protect the pension policy holders from the high risks associated with a 'pure play' green investment. This pension fund may opt to use an index which lowers its carbon footprint while maintaining exposure to industries that are not the 'lowest carbon' footprint available to balance these mutually necessary objectives.

It should also be recognised that there is no single way to calculate low carbon or positive carbon indices. In order to 'reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth' as called for in Recital 4 of the proposal, it is critical to **ensure investors can choose the benchmark that best suits**

their risk and carbon appetite. Providing for investor choice, ensuring index providers can innovate, and safeguarding competition requires the ability to have a number of methodological approaches creating an index for any sector or purpose. The index that works for a 'pure play' climate impact fund may not necessarily work for a pension fund with a remit to lower its carbon footprint while remaining within certain risk parameters. Both choices are valid but will result in very different benchmark methodologies. Hardwiring a single, static methodology delegated to the Commission into legislation could in fact prevent the uptake of low carbon alternatives to mainstream benchmarks by preventing the ability of investors to choose the appropriate methodology for them.

As recognised by the Commission in its explanatory memorandum for the proposal, it is **not appropriate to link the separately proposed EU taxonomy to the Benchmark Regulation.**[1] We welcome the Commission's statement that it 'will not require administrators of low-carbon and positive carbon impact benchmarks to use the EU taxonomy when designing parameters of the methodology for selecting underlying assets'.[2] We would welcome greater clarity on whether the proposal would relate to all low-carbon benchmarks or whether a separate category of low-carbon benchmark is being created, along the lines of European long-term investment funds (ELTIFS). We are also concerned about the level of detail that might be required to be disclosed as part of the methodology discourse, particularly when it entails making data public that originates from third party providers that administrators do not have permission to disclose.

Concerns & recommendations

- The Commission proposal risks introducing an overly restrictive legislative framework that could limit rather than enhance the adoption of low carbon indices and the investment in financial products leveraging such indices by investors. Therefore, a **prescriptive and inflexible methodology for low carbon and positive carbon indices as proposed by the Commission should be avoided**.

- It is not appropriate to prescribe benchmark methodologies in legislation. Benchmark providers can only offer low carbon indices that meet investor needs if they can innovate and make use of technological advances in data and carbon calculation.

- In addition, the Parliament Rapporteur's draft report is fundamentally flawed in its approach by suggesting that all benchmarks must be positive carbon benchmarks. There is no single way to calculate low carbon or positive carbon indices, therefore the proposal's **Annex should be amended to reflect the flexibility needed to innovate to meet both the goals of the proposal and investors' diverse objectives and risk appetites.**

- The Parliament Rapporteur's draft report also introduces the concept of price regulation for indices. As this does not relate to the sustainable finance agenda, AmCham EU considers this concept's inclusion inappropriate. Benchmark providers compete vigorously with each other in order to provide indices that investors wish to use. The choice to use, or not use, a benchmark is that of the investor. EU Competition laws are strong and well-suited to address any market questions.

Disclosures relating to sustainable investments and sustainability risks

To successfully reorient capital flows towards sustainable investments, AmCham EU welcomes the move to require institutional investors and asset managers to consider the Environmental, Social and Governance (ESG) preferences of their clients. We also agree that clients should receive clear and transparent information regarding the nature of the investment advice they are offered, when relevant to their investment decisions. Overall, we **support the objectives to improve the flow of ESG information** so that clients can make better informed decisions and understand the sustainable investment options available.

[1] Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds

[2] Proposal for a Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks, pp.10-12

However, as the Commission acknowledges in its proposals 'the magnitude of the reoriented capital flows will depend on the actual interest for sustainable products.' Clearly, disclosure in and of itself will not lead to a reorientation of investment into sustainable products.

It is essential that investors engage proactively with clients to understand their non-financial as well as their financial interests. However, it should be recognised that **the investor is the ultimate decision-maker**. Relevant ESG factors vary depending on the clients, and the investment being considered ultimately is for the investor to decide which ESG risks and opportunities, if any, they wish to take into account.

Concerns & recommendations

- Increasingly, investors are focused on the environmental and social impacts of their investments, but it is important that any initiatives do not conflict with asset managers' existing duty to consider their investors' long-term financial interests. Therefore, **legislative provisions which put pressure on or incentivise the investment adviser to sell 'green' assets in order to enhance variable remuneration are not appropriate and should not be pursued.** Equally, while we agree with the importance of robust ESG due diligence, the creation of a mandatory, pre-defined and fully harmonised due diligence procedure may not be practical for different types of investment strategies.

- Any definition of sustainability risks should focus on those that are relevant or material to an investment approach. Expanding the definition to include any risks that could have a potential environmental impact would be very difficult to capture.

- Without a consistent set of standards or objectives for disclosure practices in regard to ESG factors by corporations and others issuers of securities, it is difficult for asset managers to apply and simultaneously demonstrate a consistent methodology for integrating sustainability across their investments. Standards should be flexible enough to account for different sectors and to avoid a 'one-size-fits-all' approach. Effective ESG integration requires effective disclosures by companies.

- Inconsistency in the approach to disclosure practices provides significant room for interpretation, especially when ESG is just one of many factors being considered. Therefore, **an established and robust set of consistent standards or objectives for corporate disclosure may go a long way in encouraging incorporation of sustainability factors in investment decision making.** The Technical Expert Group should remain open and transparent with industry with regards to its ongoing work on these issues.

Conclusion

AmCham EU shares the Commission's view that it will be **critical to leverage the private sector**, and in particular the financial sector, to support the transition to a sustainable economy. However, we stress that this **must be complemented by government action** in the form of investments and policies which support industry efforts. We believe that the best way to leverage the private sector is **to empower investors by ensuring they have options that suit their ESG and risk appetite**, as well as the tools they need to pursue these goals. By contrast, constructing inflexible and complex regulatory frameworks around sustainable finance which limit investors' choice and remove their tools, will curtail the reorientation of investment towards ESG solutions.