INSTITUTE OF INTERNATIONAL FINANCE

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Mr. Nathan Fabian
Director of Policy and Research
Principles for Responsible Investment
25 Camperdown Street,
London, E1 8DZ,
United Kingdom
Technical Expert Group on Sustainable Finance - European Commission

Re: Sustainable finance taxonomy principles

Dear Mr. Fabian,

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry ("industry"), appreciate the opportunity to provide high-level comments on the European Commission's legislative proposals on sustainable finance based on the EU's Action Plan for Financing Sustainable Growth. We have identified six primary principles, which center on the need for a practical, internationally applicable approach to taxonomy that can be readily adapted to the needs of users in different jurisdictions. We believe that the scope of these important proposals should capture the full landscape of sustainable finance activities, and that taxonomy should not be a "binary" framework for defining what is or is not green. Rather, a good taxonomy should promote robust engagement between financial firms and the companies they support. More broadly we support a principles-based rather than prescriptive approach to the development of taxonomy.

The IIF strongly agrees with the importance of the underlying policy goal of galvanizing the transition to a low-carbon economy. Public policy has an essential role in creating a strong framework to mobilize private sources of sustainable finance, and we welcome the focus the EU has placed on bringing forward proposals in this area—proposals that will have an impact on the thinking of policymakers around the world. By sharing the perspectives of our membership, we hope to make a meaningful contribution to the evolution of an effective policy framework, and ultimately to the transition to a low-carbon economy.

The IIF is the global association of the financial services industry, with close to 450 members from 70 countries. Its mission is to support the industry in the prudent management of risks, to develop sound industry practices, and to advocate for regulatory, financial and economic policies that are in the broad interests of its members—towards the common goal of fostering global financial stability and sustainable economic growth. The comments in this letter have been informed by discussions of the IIF Sustainable Finance Working Group (SFWG), chaired by Daniel Klier (Group Head of Strategy and Global Head of Sustainable Finance, HSBC). Membership of the SFWG includes commercial and investment banks, asset managers, and insurance companies from a broad range of jurisdictions. As an overview of our mandate and goals we have attached a letter addressed to the Central Banks and Supervisors Network for Greening the Financial System

(NGFS). The members of the IIF SFWG are very pleased to be numbered among NGFS stakeholders and look forward to engaging with this important initiative.

The Commission's proposal concerning regulation on the establishment of a framework to facilitate sustainable investment (taxonomy) is an important legislative initiative, since taxonomy will become a foundational element of other work including risk measurement and disclosures. Successful implementation of a taxonomy framework by policymakers—and its adoption by the market—will be crucial both to growing the market for green finance, and to greening the broader market for finance. It is thus vital that the taxonomy works for all. Accordingly, we would like to offer the following high-level principles—from the users' perspective—on how taxonomy might best be developed and implemented going forward.

There are six high-level principles for stakeholders—banks, investors, issuers, and regulators—to consider when assessing their taxonomy to ensure it crowds finance in:

1. **International coordination**

   Climate change is a global risk. Therefore stakeholders should develop a taxonomy at the international level before finalizing jurisdiction-specific approaches. Taxonomies that diverge significantly at the national level may inhibit comparability and create fragmentation. An internationally-consistent taxonomy that is harmonized to the fullest extent possible is therefore imperative. As seen in the area of cyber security[1], **fragmented taxonomies can impede policy implementation and should be avoided.**

   Policymakers in different jurisdictions can build on official sector taxonomy initiatives already taking place at the international level. These include frameworks that the G20 and the Network for Greening the Financial System (NGFS) are developing or considering, as well as efforts that the European Investment Bank (EIB) is pursuing in partnership with China's Green Finance Committee. The G20 and the NGFS can play valuable roles in fostering international cooperation in this area, and the IIF Sustainable Finance Working Group would be pleased to share private sector perspectives as stakeholders develop an internationally-consistent taxonomy.

2. **Harmonize existing taxonomies**

   Building on existing practices that market participants currently implement is preferable to creating new taxonomies. **Any new initiatives should help harmonize the existing taxonomies and definitions in the market.** These approaches include, but are not limited to, those under the auspices of the Green Bond and Green Loan Principles, the Equator Principles, the FSB's Task Force on Climate-related Financial Disclosures (TCFD), the UN Sustainable Development Goals (SDGs), Global Sustainable Investment Alliance definitions,

[1] The Financial Stability Board (FSB) has created an internationally-agreed lexicon resulting from its emphasis on the importance of cross-sector common understanding of relevant cyber-security and cyber-resilience terminology.

and the Principles for Responsible Investment definitions in their reporting framework. To develop an internationally-significant taxonomy framework—one that will effectively set a worldwide standard—stakeholders should carefully review existing initiatives and clearly distinguish the new taxonomy as over-arching, broad-based, and global in scope.

3. **Mainstreaming sustainable finance**

   A taxonomy should bring sustainable finance into the mainstream, rather than fostering a two-tiered financial system. To avoid this type of bifurcation, a taxonomy should emphasize the need for transition but may otherwise lead to a widening divide between "brown" and "green."

4. **Implementable, dynamic and adaptable for users**

   Dovetailing off the previous principles, **market participants are more likely to adopt a taxonomy that users can easily implement**. Many members of the IIF SWFG are concerned about the excessive complexity of taxonomies currently proposed in some jurisdictions. **An easily-implementable taxonomy would also ensure that the financial industry can establish verification mechanisms and auditing frameworks with reasonable amounts of time and resources**. In addition, any definitions made in the taxonomy framework should be based on international standards. For example, taxonomy should not use region-specific industry classification codes but should use internationally recognized codes. This will allow firms to collect reliable data to assess and compare the quantum and performance of green financial assets with confidence.

   Policymakers, as well as other stakeholders including market participants, as users of taxonomy should account for rapid changes in the sustainable finance field by **monitoring and reviewing the taxonomy approach periodically to ensure that the framework functions as expected.** Maintaining such operational governance will help preserve flexibility and support adaptation to evolving market environments. A dynamic taxonomy can cause activities to be reclassified from taxonomy-compliant to non-compliant (or vice versa) as research and policy evolve, and it is necessary to establish clear ex-ante mechanisms for how such changes will affect stakeholders.

5. **Captures a broad range of economic activities and financial products**

   The taxonomy should capture the full breadth of the sustainable finance landscape because a narrowly-defined framework restricts the financing options for investors and lenders, and a taxonomy with a broad scope is more likely to have a larger beneficial impact in helping to achieve SDGs or Paris Agreement goals. The framework should include activities that have a zero or very low net adverse environmental impact (i.e. green/2050-compliant) and activities that do have a net adverse environmental impact, but which are significantly lower than the current approach to delivering essential utilities to society (i.e. transition/on the path to 2050).

An activity-based rather than entity-based approach is more applicable because many firms conduct business activities that would likely vary significantly in terms of compliance with taxonomy definitions and thresholds, especially if such a framework evolves over time.

The taxonomy's formulation should aim to work across all asset classes and encompass all relevant financial products, services, and providers that support and facilitate financial activity: deposit and security services, bank lending, capital raising, transactional support, risk management, investment management, and market structure.

6. **Stewardship—engagement in support of transition and sustainability**

An effective sustainable finance taxonomy should foster dynamic and forward-looking engagement with companies. As stakeholders in companies in which they invest and/or lend, financial institutions can help businesses transition to more sustainable practices by engaging on ESG issues. Many members of the IIF SFWG were founding signatories of the Climate Action 100+ initiative[2], a five-year initiative led by investors to engage systemically important greenhouse gas emitters and other companies across the global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement. **A taxonomy framework that includes such stewardship and a variety of existing ESG strategies and practices** (e.g. exclusionary screening, sustainability-themed investing, integration of ESG factors etc.) **would be an effective approach to further incentivize the financial industry to mainstream sustainable finance, impact investing, and other activities that support the SDGs and Paris Agreement goals**.

Conclusion

On behalf of the IIF Sustainable Finance Working Group, we hope that these private-sector perspectives will contribute to your work on developing a taxonomy framework for sustainable finance. We would appreciate the opportunity to discuss any of these matters further and invite you to contact us should you have questions or comments.

Sincerely,

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[2] http://www.climateaction100.org/