International
Capital
Market
Association

17 December 2020

ICMA Response to the draft Delegated Act supplementing the EU Taxonomy Regulation

The International Capital Market Association (ICMA) welcomes the opportunity to provide feedback on the draft Delegated Act ("The Draft Act").

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has around 600 members located in over 60 countries. See: www.icmagroup.org. ICMA's transparency register number is 0223480577-59.

This feedback is given on behalf of ICMA and its constituencies primarily in this case from the GBP Executive Committee (GBP ExCom) with also the input of the Sustainable Finance Committee (SFC).

In addition, we are pleased to inform you that the Association for Financial Markets in Europe (AFME) representing the voice of Europe's wholesale financial markets has also endorsed the feedback we are providing.

The responses below were submitted to the consultation on the European Commission's portal.

Yours faithfully,

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1. Overall process

We understand the urgency of proceeding with the Delegated Act and the implementation of the Taxonomy. However, given the length and technicity of the Delegated Act, we would have welcomed a longer consultation period as well as a marked-up version of the DA annexes highlighting the technical criteria that were changed and/or adjusted by the Commission compared with the final TEG Report on the Taxonomy. Such a presentation of the EC's proposed DA would have greatly facilitated the review and provision of feedback on both the technical screening and DNSH criteria. We have created our own comparison table for "Construction and real estate activities" which can be found in the annex to this response.

2. Technical Screening Criteria for Construction and real estate activities: Green Buildings

Our main concern regarding the technical criteria *per se* relates to the acquisition of buildings. The draft Delegated Regulation for existing buildings limits green buildings eligibility to those with EPC- A labels. For the acquisition of buildings, the draft Act says that any property constructed before the end of 2020 must have an energy performance certificate (EPC) of class 'A' or higher in order to be eligible under the Taxonomy. In contrast, the TEG had recommended that any building whose primary energy demand is within the top 15% most efficient among local stock, should be eligible, i.e. a 15% best in class approach that would become a hard emissions/energy measure before the next review and that threshold would toughen every year until the net-zero goal is reached.

We believe that EPC-A is an imperfect measure because it varies a lot and for buildings before 2021 is not easy to obtain. Furthermore, more harmonization of EPC methodologies across EU Member States is needed. The European Energy Performance in Buildings Directive (EPBD) sets only general requirements for EPCs, giving Member States flexibility to adjust the requirements to their national context. As a result, implementation differs in aspects such as calculation methods used to identify and assess energy consumption; quality control; enforcement and policy goals.

While in theory it might be easier to use an existing EPC-A than calculating the 15% best buildings in a given market, in many countries including the Nordics, which are big issuers in the Green Bond market, the buildings that were to qualify under the proposed EPC-A criteria amount to <1% of stock and effectively zero for financial sector asset portfolios. Moreover, given that most existing Green Bond frameworks would fail to meet the EPC-A criterion, we would welcome further information on the rationale and intended consequences of this change. We believe it is unlikely to lead to the projected potential economic benefits for corporates to fund environmentally sustainable activities.

The Taxonomy is a tool developed especially for activities in Europe and therefore refers to European rules and regulations. The Green Bond market, however, focuses on assets/projects and is a global market with different regions of the world at very different stages of development. Looking at the global Green Bond market to date, buildings are one of the main sectors funded across all issuer types with currently roughly 30% of the use of proceeds being dedicated to that category. Across the property world, Green Bonds are increasingly being used to fund greener buildings and renovation projects. The Green Bond Principles (GBP) are established best practice guidelines for which the eligible project categories are kept deliberately descriptive rather than prescriptive. With green buildings we think it is important to focus on all the different aspects (land use, building materials, resilience, energy use, water use, transportation links etc.), and not just a single dimension.

The Taxonomy in its current state looks at energy efficiency under the aspect of climate change mitigation and adaptation. Using well established building certifications such as LEED or BREEAM and requiring high certification levels might therefore be better to evaluate a building holistically although from a market perspective these labels also not always provide adequate clarity on appropriate E&S performance and benchmarks, as is the case for decarbonisation. The GBP provide two different eligible project categories which are i) energy efficiency, including in buildings (focus on mitigation), and ii) green buildings (holistic approach, taking not only energy efficiency but for example also water- and waste efficiency into account).

We support the ongoing efforts of the Commission to provide clarity to market participants on what qualifies as green in form of the Taxonomy. Regarding the different measures mentioned above – EPC class A, TEG proposal and green buildings meeting regional, national or internationally recognised standards or certifications – we realize that none of them are perfect but would ask the Commission to again consider the implications for the Green Bond market if technical criteria are based on EPC-A only for the acquisition/ownership of buildings built before 2021.

3. Paris Alignment and Transition

The draft Delegated Regulation reiterates the EC's goal for net zero emissions by 2050 which is in line with the Paris Agreement. It would therefore be helpful to market participants to understand the EC's rationale behind some of the changes made and how these changes align with the net zero goal. Moreover, with some of the changes made it seems as if the concept of transition is no longer present in some sectors.

There is concern that this approach may encourage the view that important mitigation measures in certain sectors may be left aside by the Commission in the future, e.g. for energy and resource efficiency in light manufacturing and agriculture, which were identified by the TEG as important next steps. For manufacturing, there are material concerns around treatment of enabling measures that are part of a plan to reach the Substantial Contribution threshold. Regarding the transport sector, shipping criteria would need further assessment to make sure that technical criteria are compatible with net zero objectives - something that could perhaps be assigned to the Platform.

4. DNSH

As expressed in our response to the EU GBS consultation, we do appreciate the concept of DNSH, however in its current formulation we have some concerns around its application and usability. More guidance from the Commission is definitely needed on how to apply DNSH at different scales (from large commercial developments to small scale such as individual households). DNSH can be context specific, and a process approach could be more beneficial than a prescriptive criteria approach. The unintended consequence for the market could be to exclude valid "green" activities, due to excessive burden of proof for DNSH or "not so significant" criteria for a specific context. For example, we can see problems for issuers of Green Bonds financing SME and/or retail clients regarding, e.g. technical requirements for the building sector or general adaptation as well as with respect to data availability, IT systems etc.

The need for an individual check of DNSH for smaller projects (threshold still tbd), would bear high additional costs. Consequently, market conditions might become completely unattractive and therefore hinder further growth for green financings within the SME and retail area as well as further growth of the Green Bond market as a whole and specifically issues compliant with the EU GBS. DNSH is particularly challenging where DNSH criteria are different from existing regulations. Even if SMEs enjoy some exemptions from reporting, such as NFRD requirements, indirectly they experience the pressure, as the banks and capital markets financing SMEs do have to report.

We can also see difficulties for non-European issuers or EU issuers intending to finance projects outside of the EU, if local environmental standards and/or regulations significantly diverge from those of the EU. For issuers in other developed markets, there may be a sensitivity/reluctance in doing an actual comparison of company or national environmental rules with EU regulations through a verifier's opinion. This may be particularly problematic when comparing regulatory frameworks across jurisdictions. Additionally, in instances where assessing compliance with DNSH criteria requires significant judgment, there may be difficulties in making such representation or relying on the analysis of a verifier to do so.

When it comes to R&D, we think further clarification on how to assess DNSH is needed. We can also see legal costs increasing when it comes to the DNSH principle.

Furthermore, there may be specific challenges for sovereign EU GBS issuers. These could arise for example from difficulties in assessing the Taxonomy alignment of environmental policy related public expenditures or from the requirements to make representations on DNSH. For public infrastructure financing public sector issuers should be on equal footing with other issuers.

Overall, we believe that while Substantial Contribution and DNSH are recognised as fundamental concepts of the Taxonomy, the Delegated Acts or associated commentary could go further to acknowledge that implementation will take time, even for advanced actors, and that some criteria remain undefined. Further dialogue with the market on usability is desirable to make this a success. The same is true for work needed to establish internationally comparable criteria – something the International Platform could contribute to. Finally, more guidance on the application of the taxonomy, e.g. how to report investments outside the EU referenced by an EU Green Bond, would be helpful.

Annex- Summary comparison table for construction and real estate activities

Activity	TEG's proposed TSC for substantial contribution to CCM	Draft DA	High-level comparison
Construction and real estate activities	• Construction of new buildings: net primary energy demand (**PED**) to be at least 20% lower than the level mandated by national regulations (which refers NZEB in Europe that is applicable to all buildings from 2021 in the EU). The criterion will be subject to reviews in the transitional decade 2020-2030 to ensure convergence with net-zero and 2030 targets.	• Construction of new buildings: PED to be at least 20% lower than the threshold set for NZEB requirements in national measures implementing the EPDB.. Additional criteria for buildings larger than 5000m2 (undergoing testing for air-tightness and thermal integrity, disclosure of deviations, calculation of the life cycle Global Warming Potential);	Similar criteria apart from the additional requirements that apply to buildings larger than 5000m2
	• Building renovations: To meet local/national/regional requirements for "major renovation" as defined in the Energy Performance of Buildings Directive (**EPDB**). Alternatively, renovations that bring at least 30% of savings in net PED are eligible.	• Building renovations: Applicable national/regional major renovations requirements implementing the EPDB. Alternatively, the renovation should lead to a reduction of PED of at least 30%.	Similar criteria
	• Individual measures and professional services: these are measures and services aimed at reducing energy and/or carbon emissions in buildings. Eligibility assessed through technical requirements for each measure and service in the applicable national regulations transposing the EPDB.	• Installation, maintenance and repair of (i) energy efficiency equipment; (ii) charging stations for electric vehicles in buildings; (iii) instruments and devices for measuring, regulation and controlling energy performance of buildings of buildings; (iv) renewable energy technologies	EC has compiled the individual measures and services under sub-chapters/ themes in the DA and added further details of qualification where relevant
	• Acquisition and ownership: the eligibility criteria for buildings built after 2021 is the same criteria as the "construction of new buildings" (above) while for buildings built before 2021, it is the comparable performance with the best 15% of the national stock in terms of net PED which would be converted into absolute thresholds by the end of 2024 by the EU PSF and get stricter for every five years). Additional energy management requirement for large non-residential buildings (built both before and after 2021).	• Acquisition and ownership of buildings: EPC class A for the buildings built before 31.12.2020; for buildings built after such date, the building should meet the criteria for the "construction of new buildings" (PED to be at least 20% lower set for NZEB requirements); and additional energy performance monitoring and assessment for large non-residential buildings.	Substantial difference between TEG's proposed TSC and the DA on the acquisition/ownership of buildings built before 2021