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Position Paper of the Deutsche Unternehmensinitiative Energieeffizienz (DENEFF e. V.)

on the Taxonomy Technical Report der Technical Expert Group on Sustainable Finance

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Contact

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Summary

The Deutsche Unternehmensinitiative Energieeffizienz (DENEFF e. V.) welcomes the Technical Expert Group's (TEG) Taxonomy Technical Report (June 2019) because the financial sector plays a crucial role in the sustainable transformation of the global economy. Yet, to achieve a quick and timely shift, it is necessary that a majority of investors will prefer to invest in sustainable assets rather than letting them stranding. As a prerequisite, good, reliable, comparable and climate-related information about assets and investments must be available. This approach is taken by the Taxonomy. Nevertheless, in order to secure required effectiveness of such a classification tool, DENEFF suggests the following improvements:

1. **More actors should be obliged to use the Taxonomy.** In the current version, only a selected number of financial market participants offering environmentally sustainable financial products have to apply the Taxonomy. This is insufficient to trigger a comprehensive and quick transition of the financial sector. Therefore, it is necessary to ensure that the Taxonomy will be applied by a majority of financial actors in Europe, private as well as public.
2. **Defined thresholds must be amended to be Paris-compatible**. In the present proposal, the thresholds in the Taxonomy are largely based on existing national and EU standards. This is a pragmatic approach since it facilitates a timely and effective implementation of the Taxonomy. Yet, the goal of the Taxonomy should be to enable investors to identify Paris-aligned investments. Accordingly, the Paris-compatibility of individual thresholds should be reviewed and amended accordingly in the near-term after the Taxonomy will have been introduced.
3. **The Taxonomy should be extended to provide guidelines for investors to include concrete climate-related financial risks**. The Taxonomy should support investors in identifying the share of environmentally sustainable investments in their portfolios. Yet, even more important, investors must increase their awareness and understanding of climate-related risks of their activities. In this regard, the Taxonomy should provide assessment and valuation standards that help investors to quantify these inherent risks (in €). To secure a prompt introduction of the Taxonomy, the Platform on Sustainable Finance should be tasked with these enhancements.
4. **Fake decarbonisation must be avoided to protect all investors from buying pseudo green products**. The common metric used in the Taxonomy is CO_2eq. This runs the risks that emission reductions can be achieved simply by buying renewable energy certificates while ignoring the decarbonisation potential of energy efficiency measures. In this regard, the Taxonomy must avoid consumer deception by ensuring that emission reductions of Taxonomy-eligible activities take place on-site and to respect the efficiency first principle when suitable to achieve better decarbonisation.
5. **Sustainable manufacturing should go beyond ETS- industries and ETS-standards.** The Taxonomy takes into account the production of low emission technologies as well as energy intensive manufacturing sectors. By its strong focus on ETS-industries and ETS-benchmarks the Taxonomy is inadequately equipped to trigger a deep decarbonisation in the manufacturing sector as a whole. Thus, a wider field of manufacturing sectors should be included while thresholds should be defined in accordance with the Paris Agreement.
6. **Comparability and ambition should have the highest priority in real estate activities.** Incorporating major economic activities related to buildings (construction, renovation and acquisition), the Taxonomy is designed to stimulate much needed investments in the sector. However, whether these will be sufficient make the sector Paris-compatible remains questionable. It is highly recommended to set ambitious, EU-wide minimum standards to avoid a green finance bubble in the real estate sector and ensure comparability across the Union.

Further explanations and specific suggestions for amendments are provided below.

General Remarks

1. **More actors must be obliged to use the Taxonomy.**

   The Technical Report envisages that only selected financial market participants who offer financial products as environmentally sustainable investments or investments having similar characteristics will be obliged to apply the Taxonomy. All other financial actors may apply the Taxonomy on a voluntary basis. Hence, the Taxonomy only serves as a tool to prevent greenwashing and does not contribute an effective re-alignment of investment flows.

   The TEG estimates that investments in low-carbon, climate-resilient activities must be scaled up by 175 bn. to 290 bn. € annually (p. 13) to achieve the European Union's climate and energy target (p. 85). To close this investment gap and to ensure a speedy sustainable transition, all financial actors must be encouraged to re-direct their financial flows from high- to low-emitting activities. **By minimizing the mandatory application of the Taxonomy to investors who are already integrating sustainability criteria in their investment decisions, the Taxonomy runs the risk of regulating a green financial niche market only whereas the other (and larger part) of the financial market continues to invest in brown and unsustainable activities.**

   A first step to trigger more investments would be to raise awareness on climate-issues of further financial actors than those that already offer environmentally sustainable financial products. Therefore, all financial sub-sectors as listed in Figure 8 on page 60 of the Technical Report should be obliged to use the Taxonomy and introduce Taxonomy-screenings in their investment decision-making processes and to disclose Taxonomy-related information about their portfolios.

   Proposed Amendments (page 57)

11. 1 Defining the user The Taxonomy regulation requires that 1. All member states or the EU when adopting measures or setting requirements on market actors in respect to financial products or corporate bonds and 2. **Financial market actors active in asset management, insurance, corporate and investment banking or retail banking and** 3. **The public sector** mandatorily undertake a Taxonomy-screening in their decision-making processes and disclose these information.

2. **Thresholds must be amended to be Paris-compatible**.

   To keep the goals defined in the Paris Agreement within reach the global economy must be decarbonised as quickly and efficiently as possible. By greening its investments, the financial sector can play a key role in supporting the transformation towards a climate-friendly economic system. In this regard, the Taxonomy is a good starting point to help investors aligning their capital flows more easily and better with a low-emission pathway.

   In numerous cases, the thresholds incorporated in the Taxonomy are based on existing EU- and national standards. These, though, may not be ambitious enough to keep the Paris climate targets within reach. Consequently, in various sectors the Taxonomy is unsuitable to effectively re-orient capital flows towards Paris-aligned activities.

Therefore, proposed individual emission criteria should be reviewed on their Paris-compatibility and amended accordingly. Simultaneously, while defining best performing practices, the Taxonomy should be advanced classifying investments from very unsustainable to very sustainable. Only a comprehensive benchmarking system that is based on a 2050-emission-and-energy-reduction pathway will ensure comparability of distinct assets and financial products with regard to their climate-impacts. Assessing investments along a reduction curve will help investors to calculate monetary climate-risks and respective investment needs required to align their portfolios with the Paris goals.

Proposed Amendments (page 20)

Article 14 (4) where appropriate **and Paris-compatible**, [the Taxonomy shall] build upon Union labelling and certification schemes, Union methodologies for assessing environmental footprint and Union statistical classification systems, and take into account any relevant existing Union legislation.

3. **Taxonomy should be extended to provide guidelines for investors to include concrete climate-related financial risks (in €)**.

Economic losses from extreme weather events rose by 86 % globally between 2007 and 2016 (EU Commission, Action Plan on Financing Sustainable Growth). Due to its close interconnection with the economic sector and through policy regulations, the financial sector is more and more exposed to the impacts of climate change. However, a majority of investors still do not carry out climate-risk screening as part of their investment evaluations neither does climate performance of an economic activity drive investments decisions.

In order to achieve a full greening of the financial sector and to reduce its climate vulnerability, identifying the Taxonomy-eligible share in portfolios and holding pertaining to companies carrying out environmentally sustainable activities is not sufficient (see p. 61). Instead, the Taxonomy should support investors in fully understanding climate-related risk of their investments.

In this regard, the Taxonomy should provide further guidance to investors in mainstreaming climate-risk assessment as part of their regular risk assessment processes. Eventually, this will enable investors to quantify and disclose monetary climate-related risks and respective investment needs. Proposed enhancement of the Taxonomy should be developed by the Platform on Sustainable Finance once established.

Proposed Amendments (page 61)

The Taxonomy should enable investors to identify 1. The percentage of holdings pertaining to companies carrying out environmentally sustainable economic activities. 2. The share of the investment funding environmentally sustainable economic activities as a percentage of all economic activities. 3. **Monetary climate-related risks and respective climate-related investment needs**.

4. **Fake decarbonisation must be avoided to protect all investors from buying pseudo green products**.

The mission of the Taxonomy is to trigger substantial emission reduction by re-directing capital flows. Next to economic activities that are already low in carbon also activities that contribute to a transition to a zero net emission economy in 2050 and activities that enable low carbon performance or emissions reductions are included in the Taxonomy. The general measurement used in the Taxonomy is CO_2eq.

Critical remains that by buying renewable energy certificates unsustainable and inefficient economic actives may become Taxonomy-eligible without actively implementing emission reduction measures on-site. Hence, ignorant or poorly-informed private investors may be misled in their investment decisions.

Per definition the Taxonomy must ensure that for being Taxonomy-eligible, decarbonisation measures are implemented on the ground, either by installing renewable energy or by implementing energy efficiency measures. In this context, a double threshold including GHG emission as well as energy consumption targets can help to prevent the greenwashing of assets. This would be beneficial to promote the Union's energy efficiency targets with the help of the Taxonomy, too.

Proposed Amendments (page 29)

'Greening of' activities: For these activities, the technical screening criteria focus on improving the environmental performance of the economic activity. Where the environmental performance of the activity is consistent with the technical screening criteria **and emissions reductions can be traced back to on-site renewable energy installations or energy efficiency measures**, its revenues or expenditures may be considered eligible within the Taxonomy.

<u>In Detail</u>

In addition to the above outlined general remarks on the Taxonomy, DENEFF has taken a closer look at two economic sectors that are especially relevant to DENEFF members: manufacturing and real estate activities. Both sectors can play a key role in reducing Europe's GHG emission. The Taxonomy has potential to trigger much-needed investments in these sectors, however, room for improvement remains.

5. **Manufacturing**
The greening of manufacturing activities is an important step to reduce greenhouse gas emissions in the European Union and simultaneously increase climate resilience and thus competitiveness. In the proposal at hand, mostly industries that are part of the ETS are included in the Taxonomy.

5.1. **Broadening the field of manufacturing industries**
With its strong focus on ETS-industries, the Taxonomy is unable to encourage a low-emission pathway of the manufacturing sector as a whole. Whereas ETS-industries are already encouraged to reduce their carbon emissions, non-ETS industries and low-emitting industries still lack incentive to improve their carbon performance. Excluding the latter from the Taxonomy will hamper their decarbonisation as it removes the opportunity from these industries to borrow capital for green projects with the same (preferential) conditions

as industries that are included in the Taxonomy. To better support a broad green transition, the Taxonomy must be extended and include a wider field of manufacturing industries.

Proposed amendments (page 184)

Setting criteria and thresholds Therefore, the first round of sectors included in the manufacturing section of the Taxonomy are either those energy intensive and hard-to-abate sectors that emit the most greenhouse gas emissions or those enabling manufacturing sectors that are clearly necessary for Europe's low-carbon economic transformation. **In the second round, the Taxonomy will be extended to cover further manufacturing sectors, also outside the EU-ETS. In the long-term, the goal is to include all manufacturing sectors in the Taxonomy because it must be ensured that all sectors are equally eligible as a green investment when undertaking sustainable activities.**

5.2. **Setting ambitious thresholds**

ETS benchmarks are set at average standards and hence are not checked for their Paris-alignment. In order to reduce the climate-vulnerability of the financial sector, the Taxonomy should classify economic activities that go beyond established standards. Accordingly, thresholds should be amended and include only good practice examples of a respective sector.

Proposed amendments (page 185)

Setting criteria and thresholds The [EU ETS] benchmarks are based on EU historic trends rather than global data. **Therefore, in a next step, the Platform on Sustainable Finance will review emission criteria in the Taxonomy on their alignment with the Paris climate targets and amend them if necessary.**

5.3. **Promoting energy efficiency**

As stated above already, focusing the Taxonomy's metrics on CO_2eq thresholds runs the risk that companies replace fossil energy sources with renewables without reducing their total energy use. This undercuts the "efficiency first" principle of the Energy Union. To ensure that companies reduce their emissions <u>and</u> improve their energy efficiency performance boundaries of economic activities should be defined as below.

Proposed amendments (page 186)

Setting criteria and thresholds **To ensure that the reduction of greenhouse gas emissions is accompanied by an improvement in energy efficiency, only the following companies are taxonomy eligible:** **(1) companies that are ISO 50001-certified** **(2) SMEs which at least run regular energy audits (acc. to DIN 16247)** **(3) companies with a very low energy consumption level (< 100.000 kWh) which at least run regular energy audits (acc. to DIN 16247).**

6. **Construction and Real Estate**

The Taxonomy acknowledges the role of the building sector to reduce greenhouse gas emissions in Europe and hence, the sector is well reflected in the Taxonomy. Critical remains, however, the lack of ambition and harmonisation in the building sector.

6.1. **Ensuring comparability of investments across member states**

The Taxonomy's ambition to increase and facilitated comparability of green investments across the Union is undermined because in the real estate sector Taxonomy thresholds are anchored in national standards. As a consequence, investments between member states will not be easily comparable. In fact, individual assessment processes for buildings' investments in different member states have to be developed. This will not only discourage investors to apply the Taxonomy in the building sector, but also impede an effective and timely implementation of the Taxonomy.

Proposed amendments (page 364)

Market Coverage In its current formulation, the Taxonomy criteria will impact EU Member States differently [...] due to the varying levels of ambition underlying NZEB requirements and EPC ratings. In practice this means that during the transitional period, meeting eligibility criteria would be easier for some Member States. **To ensure comparability and adequate level of ambition, EU-wide minimum standards for best performing buildings such as passive, net zero or plus energy buildings will be defined.**

6.2. **Avoiding a green finance bubble**

While being designed to re-direct capital flows towards more sustainable investments, thresholds in the building sector are based on national minimum standards. Accordingly, while complying with these minimum requirements as an obligation defined in national building regulations, investments therein would automatically be Taxonomy-eligible. This is critical because national minimum standards are not necessarily in line with the targets defined in the Paris Agreement. As a consequence, all at once, large quantities of investments could be labelled sustainable without being Paris-compliant. This runs the risk that the green financial market will be artificially blown up without an effective re-direction of capital flows towards ambitious and Paris-aligned projects.

Proposed amendments (pages 366, 372, 382)

Newly constructed buildings – Thresholds A new building is eligible when it **exceeds** national minimum requirements **as defined in the national transposition of the EPBD or meets at least commonly defined EU-wide minimum standards for passive, net zero or plus energy buildings or has a level of energy performance equivalent to EPC rating A.** Renovation of existing buildings – Thresholds (*also applicable for subsequent improvement of purchased buildings*) A renovation is eligible when it meets either of the following criteria: a) The renovation is compliant with energy performance standards **exceeding** applicable building regulations for major renovations transposing the EPDB or b) The renovation achieves energy savings of at least **50 %** in comparison to the baseline performance of the building before the renovation.

6.3. **No abandoning of energy metrics**

The continued usage of a combination of both energy performance and greenhouse gas emission metrics is strongly encouraged because a focus on GHG emissions alone runs the risk that energy efficiency measures in the building sector are undermined in favour of fake decarbonisation and that energy efficiency is neglected along the whole supply chain. For example, by replacing combustion boilers in poorly insulated houses by inefficient electric heating systems and greening them by renewable electricity certificates instead of applying holistic renovations (including the building envelopes and the individually best heating solutions (including high-efficient electrical and direct renewable) would contradict the “efficiency first” principle. As a result this would lead to an inefficient energy system at economic level and make achieving the GHG reductions targets extremely expensive, unsustainable if not impossible.

Proposed amendments (page 363)

Why construction and real estate are addressed in the Taxonomy […] Against this background the TEG has decided to adapt a transitional approach based on the initial decision to use energy metrics, which will be extended to include GHG emissions once sufficient data for the latter is available. **In the long-term, both primary energy and GHG emission metrics will be applied complementarily.**