International
Capital
Market
Association

ICMA

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ICMA Response to the IPSF Common Ground Taxonomy Consultation

The International Capital Market Association (ICMA) welcomes the opportunity to provide feedback on the IPSF Common Ground Taxonomy.

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 more than 600 members located in 65 jurisdictions (www.icmagroup.org). ICMA's transparency register number is 0223480577-59.

This feedback is given on behalf of ICMA and its constituencies.

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

Yours faithfully,

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Response to the IPSF Common Ground Taxonomy Consultation

ICMA welcomes the International Platform on Sustainable Finance (IPSF) providing through the Common Ground Taxonomy (CGT) a comparison of leading sustainable finance taxonomies, starting with those from the EU and China. We believe this will be a very useful reference for other jurisdictions creating their own taxonomies and for the sustainable bond market.

The responses below focus on the points in the consultation that are most relevant to the global sustainable bond market, as well as ICMA's membership.

1. The CGT as a reference for the market

We believe that the CGT meets its stated objectives and will especially be valuable to market participants in:

- providing an analysis on approaches of the EU taxonomy and China taxonomy, and a methodology for comparing them;
- identifying commonalities and differences between key features of the two taxonomies; and
- over time a tool that will help different actors understand the types of activities that could be covered under the respective taxonomies within the scope of the comparison exercise.

From a methodological standpoint, we support the CGT's focus on substantial contributions (SC) and technical screening criteria (TSC). The EU Taxonomy's wider scope including do no significant harm (DNSH) criteria and minimum safeguards (MS) is not reproduced in China's taxonomy and provides no current points of comparison. We also believe more generally that the extension of DNSH and MS considerations to other jurisdictions will prove challenging and may not reflect wider shared policy priorities.

DNSH and MS also already raise usability issues in the European context. Successful market practice and track record need to be developed in the European market before these concepts should be considered as references for taxonomies in other jurisdictions.

2 Usability issues raised by the CGT

Limitations of an activity based classification approach

Use-of-proceeds bonds currently represent 90% of sustainable bond issuance globally and are designed to finance actual eligible projects rather than activities. Adaptation and interpretation efforts can therefore be required to confirm the alignment of projects that may involve several activities and may need to refer to several codes whether as in the EU Taxonomy to those provided by NACE (a French acronym for *Nomenclature statistique des Activités économiques dans la Communauté Européenne*) or as proposed in the CGT by ISIC (International Standard Industrial Classification of All Economic Activities) as a "bridging code" between the EU and Chinese taxonomies.

The Instruction Report rightly underlines further the limitations of an approach based on classification through economic codes when it states in a footnote on p20 that: "*Although EU Taxonomy is based* *largely on NACE, there is no possibility of directly using single NACE codes in all cases. Many activities cut across several NACE codes, some NACE codes have multiple activities under them and some, such as building construction, are actually applicable across almost any NACE codes sector…Some mitigation activities have no NACE codes."*

It is important to note that the Chinese taxonomy adopts a less granular methodology with respect to activity based classifications that is closer to a "whitelist". This is more accessible and usable for participants in the sustainable bond market. <u>We would therefore recommend further emphasis in the CGT on usability and on identifying classification methodologies that work better or worse depending on the end user</u>. Further granularity of classification is not necessarily a priority for the development of sustainable finance flows.

Challenge of defaulting to narrower or more stringent criteria

The CGT aims to be a reference for other jurisdictions when developing their own taxonomies. The proposed six scenario designations in the CGT are helpful in that they not only show where the EU and China taxonomies are similar or diverge but also highlight where criteria are more stringent and / or detailed. <u>This should be helpful guidance for other jurisdictions by providing a sense of what criteria are considered ambitious. However, it can also create real usability challenges for a wider group of countries when this approach leads to narrower or more stringent criteria</u>.

For example, the category from the EU Taxonomy *7.3. Installation, maintenance and repair of energy efficiency equipment* is much wider in scope than the corresponding *CGT F3.1 Green lighting upgrades*. By adopting the CGT category, installation of other equipment such as insulation and heating, ventilation and air-conditioning (HVAC) and water heating systems that meet the TSC of the EU Taxonomy are no longer in scope.

Another example is *CGT H1.4 Passenger interurban rail transport*. While the EU Taxonomy and the CGT categories address zero direct tailpipe CO_2 emission, the Chinese activity category is also about intelligent transportation system which contributes to climate change mitigation by avoiding traffic congestion.

Restrictions on the applicability of local industry standards

Some activity categories mentioned in the CGT directly reference the EU or Chinese industry standards that are included in their respective regional/national taxonomies. Taking CGT C2.4 Production of solar generators as an example, it would not be possible or necessarily meaningful for a corporate established outside mainland China to comply with China's national industry standard of "Specifications for the Photovoltaic Manufacture Industry (2021 Edition)", which is not only about the products or the process of manufacturing them, but also about the enterprise which has to be incorporated in China and that must spend no less than 3% of its total sales revenue in research and development.

3 Future development of the CGT

Concerning future developments of the CGT, we would recommend prioritising the workstreams listed below.

- **Additional objectives:** Work should continue for Climate Change Adaptation followed by the EU's four other environmental objectives with arguably a priority to biodiversity in light of the strong correlation with addressing climate change.
- **Integrate transition through target setting**: Activity based taxonomies suffer from being structurally binary. Integrating transition considerations can be achieved to some extent by identifying economic activities that promote transition. We believe however that transition is better understood in terms of goals rather than activities. As a result, taxonomies need to be more explicit about setting dynamic targets and thresholds for problematic activities and sectors.
- **Enhance interoperability through the availability of SC criteria**: The detail of the technical thresholds and requirements of EU and Chinese SC criteria should be made easily accessible online in English whenever possible.

We would otherwise not recommend extending at this stage the scope of the CGT to other regional and national taxonomies as the priorities above should take precedence considering the international relevance and influence of both EU and China taxonomies.

4/ Wider remarks on the development of taxonomies

There have been numerous calls to ensure a harmonised approach for national taxonomies. The EU's Technical Expert Group (TEG) presented 4 common design principles for international harmonization and mutual recognition of taxonomy frameworks in March 2020. In September 2021, the UNDESA/IPSF Input Paper to the G20 SFWG contained high-level principles and recommendations proposed among other for jurisdictions aiming to develop their own taxonomies.

As a general remark, we would underline that all jurisdictions should not consider that it is necessary to develop full taxonomies. One of the key benefits of the CGT is to identify the degree of commonality of existing leading Taxonomies. These can be usefully referenced by other jurisdictions to save time and effort and enable complementary and adaptive initiatives rather than overlapping ones. It is also crucial to determine at the outset what a taxonomy is being designed to do. Taxonomies can serve a variety of different purposes beyond simply classification, as financial product qualification, disclosure, or risk assessment tools (or a combination of several or all of these). For each of the above-mentioned purposes, careful considerations and clear guidance for implementation is needed.

Drawing on the "success criteria" proposed in ICMA's *Overview and Recommendations for Sustainable Finance Taxonomies* published in May 2021, we would add more specifically:

- Taxonomies are often designed primarily for use by financial institutions such as banks, for classification of their portfolios and loan books. For that purpose, and to ensure that the taxonomy is sufficiently understood by banks and their potential advisors, the taxonomy should be clear on both the embedded methodology as well as how to implement it.
- If the taxonomy is to be used as a reference for sustainable finance products such as sustainable bonds, it should consider that the green, social and sustainability bond market functions with a project-based approach rather than one referring to economic activities. As a result, a category or sectoral "whitelist" classification will be more usable than a highly granular activity-based one. Further requirements relating to DNSH or social criteria may also create fundamental challenges for issuers relating to data availability or the necessary representations to confirm alignment.
- Finally, if a taxonomy is to be adopted for regulatory purposes as we are seeing in the EU, it is important to think about the risk of unintended consequences from its implementation and

incorporation into law such as excessive rigidity or interpretation challenges, as well as the availability and provenance of the required data.