NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

Handbook Series
February 2021

insights

THE EU SUSTAINABLE FINANCE REGULATION

For investment professionals only
Not for public distribution

NordSIP Handbooks are published by
Big Green Tree Media AB
Kungsgatan 8
111 47 Stockholm
+46 70 9993966

Editor-in-Chief
Aline Reichenberg Gustafsson
aline@nordsip.com

Director, Strategic Relations
Kim Hansson
kim@nordsip.com

Economics Editor
Filipe Wallin Albuquerque
filipe@nordsip.com

Senior Research Director
Julia Axelsson, CAIA
julia@nordsip.com

Design:
Anzhelina Terzieva

For advertising or other sales-related enquiries
email: sales@nordsip.com

FOR INVESTMENT PROFESSIONALS ONLY
Please read important Terms & Conditions on the last page of this document

Photographic Credits © Twenty20, Pixabay, Unsplash, NordSIP

Cover image NordSIP

© 2021 NordSIP all rights reserved

TABLE *of* CONTENTS

5 the editor's word
Time to call a pick nick

34 about our partner

The lay of the land

6 The EU Sustainable Agenda
2021 and beyond

10 The EU Sustainable Finance Action Plan
Accomplishments & delays

13 Taxonomy and Green Bonds
Missed Deadline

Views

16 The Asset Managers' Perspective

20 The Asset Owners' Perspective

Industry matters

24 Taxonomy and Forestry
How the EU Antagonised the Forestry Industry

28 The Nuclear Debate
Why does the Taxonomy not Include Nuclear Energy?

31 EU Real Estate
Too Diverse for Taxonomy

Picture credit: NordSIP

the editor's word

Time to call a picknick

When it comes to regulation, no one is ever particularly excited. As Otto von Bismarck reportedly said, laws are like sausages - good to have but no one wants to see how they are made. Lawmakers are always rushed and those who are regulated find the rules cumbersome and often only accept them begrudgingly.

Although there is widespread societal support for climate change mitigation across Europe, the EU sustainable finance agenda is no exception. The sausage factory was hard at work despite the pandemic. To match the sense of urgency that the EU Commission has imparted, both experts and lawmakers got busy scraping, grinding, blending and stuffing[1] to meet the tight deadlines.

In this edition of NordSIP Insights, we poured over the EU Sustainable Finance Action Plan, reviewing the progress of its initiatives, and taking in-depth looks at the Taxonomy, the EU Green Bond Standards and Disclosures.

We talked to eight asset owner and asset manager experts, from Sweden, Denmark, Finland and beyond to understand what effect the new rules will have on the industry.

For those curious about stakeholder reactions, we also offer deep-dives into forestry, real estate and nuclear energy.

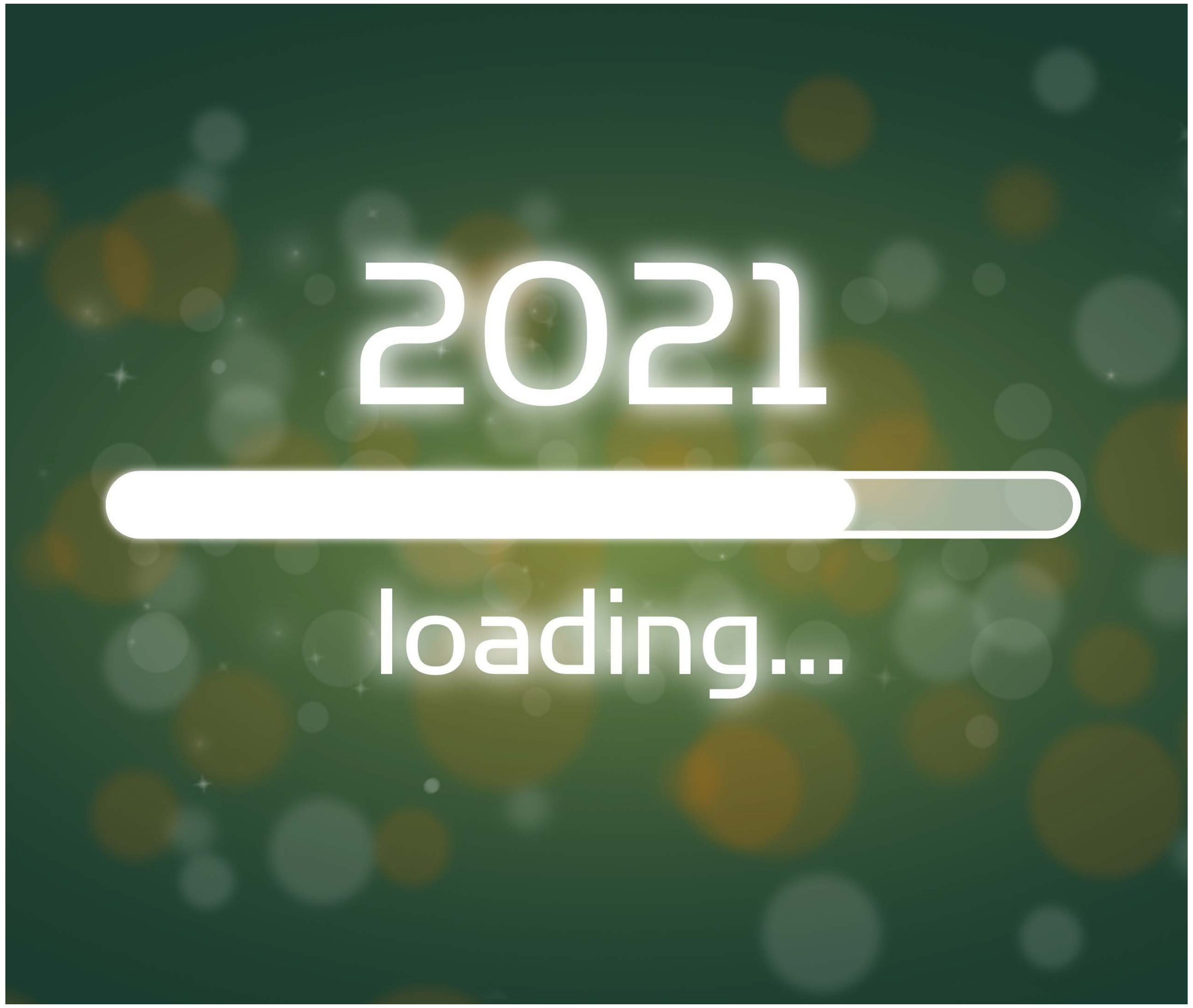
As 2019 and 2020 saw ideas become plans, and the plans turn into texts, 2021 is the year when words become actions. While not everyone has yet arrived at the party and some mustard still needs to be added, the finance industry will soon bite into that sausage.

Aline Reichenberg Gustafsson, CFA

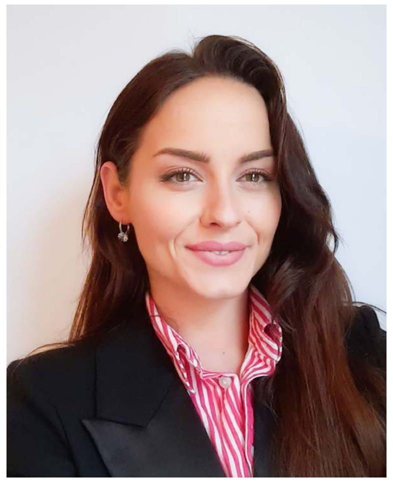
Editor-in-Chief

NordSIP

[1] 100% vegan and plastic-free raw materials were used



Picture credit: Iximus on Pixabay



Ciara Horigan
Vice President, Regulatory, Industry & Government Affairs
State Street

Carlo M. Funk
Head of ESG Investment Strategy
EMEA
State Street Global Advisors

The EU Sustainable Agenda

2021 and Beyond

by Filipe Albuquerque

During the three years since the European Commission (EC) adopted the Action Plan on Financing Sustainable Growth, European institutions have moved at a rapid pace to regulate the nexus between finance and climate change. Between 2017 and 2020, the European Union (EU) went from holding the High-Level Expert Group's first meeting, to adopting the regulations on sustainable finance disclosures and a Taxonomy for sustainable economic activities.

These efforts were emboldened by commitments set out in the Commission's European Green Deal, which, ultimately, aims to achieve climate neutrality by 2050, by tackling climate change in all core policy areas, including biodiversity, agriculture, energy and mobility sectors. The Green Deal makes clear that the EU's policy work is far from over and is in fact likely to extend to a wider set of environmental, social and governance issues.

As a recent insights report published by State Street Global Advisors shows, regulatory developments will continue to predominate the EU's policy agenda in 2021 and beyond, with significant impacts envisaged across the financial services ecosystem, particularly implicating institutional investors and asset managers. Disclosures, the banking union and potential ESG data regulations will be at the top of the bloc's to-do list, according to the note's authors - Dr Michael Huertas, Co-Head Financial Institutions Regulatory Europe at Dentons, Ciara Horigan, Regulatory & Government Affairs at State Street and Carlo M. Funk, Head of ESG Investment Strategy for EMEA at State Street Global Advisors.

Key Dates Ahead

Four main milestones stand out among the many regulatory deadlines scheduled for the next two years. The transparency obligations laid out in the Sustainable Finance Disclosures Regulation (SFDR) will be in place from 10 March 2021, with full application expected from 2022. In parallel, the EU will enact corporate sustainability reporting requirements via the Non-Financial Reporting Directive which had been intended from mid-2021 but is now likely to come earlier. The European Banking Authority (EBA) is also expected to publish technical advice for the EU Commission on the prudential treatment of sustainability risks towards the end of 2021; meanwhile the European Central Bank has already finalised Guidance on the management and supervision of climate-related risks by supervised entities, and recently announced that it would incorporate climate related scenarios in the 2022 stress testing cycle. Finally, although the technical screening criteria underlying the EU taxonomy were due to be adopted by the Commission at the end of 2020, to, they have been slightly delayed thought it is expected that they will still enter from the end of this year before becoming fully applicable in 2023.

European Green Deal: Key Dates

According to Huertas, Horigan and Funk, the SFDR is one of the EU's sustainable finance regulatory package's critical items over the next two years. Investors should be mindful of their new investor duties under the regulation and the tight deadlines ahead.

Disclosure Requirements

SFDR, essentially, also imposes disclosure requirements for activities expected to have a negative ESG impact, according to the report. The onus is on rules to avoid human rights violation, corruption and bribery. The regulation recognises that sustainability-related risks have a potential material impact on the value of an investment and specifies governance requirements for investee companies.

To this end, SFDR's transparency rules target financial products and a wide range of financial market participants and advisors, requiring the disclosure of considerations underlying the assessment of sustainability risks and factors in the investment process, both at the entity and financial product level – i.e. on company websites and in pre-contractual documentation. So-called Article 8 and 9 products, which specifically promote sustainability characteristics or outcomes, will be subject to enhanced transparency requirements. To facilitate pre-contractual disclosures, for example in prospectuses, the European Supervisory Authorities (ESAs) have proposed mandatory reporting templates and a set of principle adverse impact indicators.

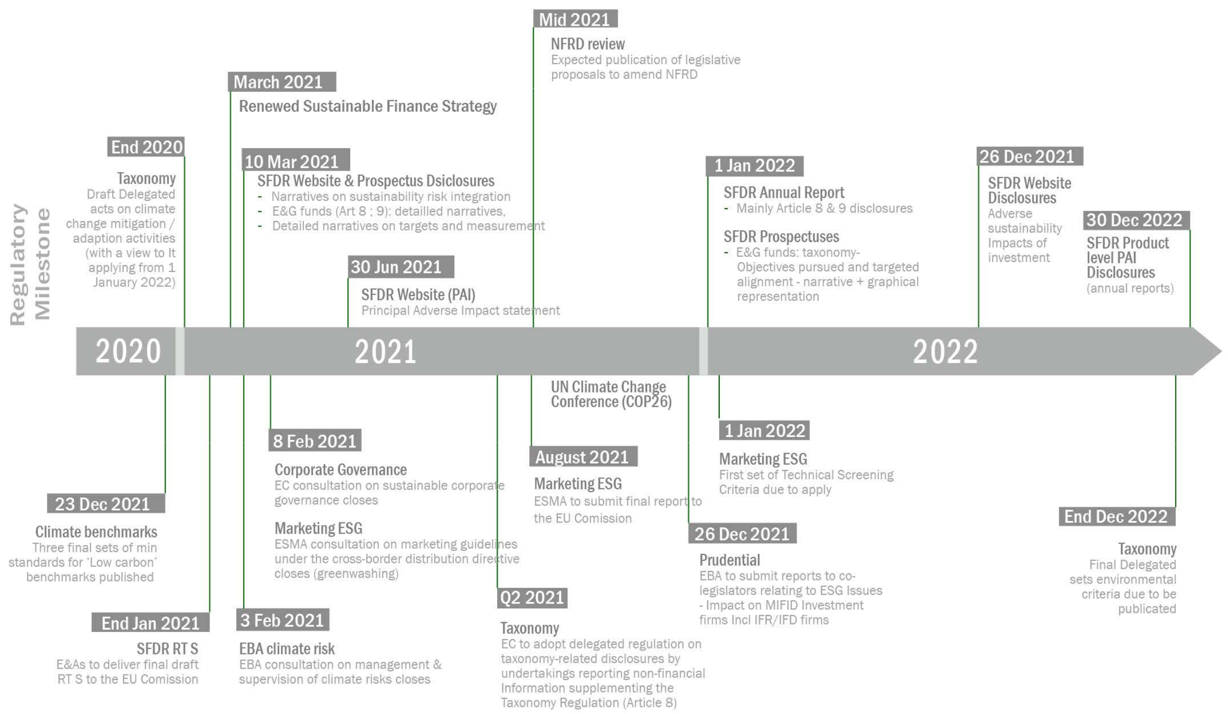
Huertas, Horigan and Funk note that "in practice, at the entity level, financial market participants and financial advisors must make available a statement on the integration of sustainability risks and a statement on adverse sustainability impacts on their websites. In addition, they will have to show how their remuneration policies are commensurate with their sustainability objectives. Financial market participants will further have to state on their websites how their environmental and social characteristics impact on sustainable investments."

Tight Deadlines

An important point of contention emerged at the end of 2020. According to Huertas, Horigan and Funk, SFDR requires disclosing sustainability risks and adverse sustainability impacts in pre-contractual documentation. Products that either promote ESG characteristics or pursue sustainability objectives face even steeper requirements. "Although SFDR enters into force on 10 March 2021, the ESAs have not been able to deliver final technical standards by the [intended] end-2020 deadline. Instead, this is expected to be submitted to the [EU Commission] for adoption by end-January 2021," the authors explain.

With just a few weeks between final requirements being published and compliance, the SFDR timeline has been a long-standing concern for financial market participants. EU authorities have also contended with the ambitious deadline, which even prompted the Chair of the ESAs, last summer, to effectively request that the EU Commission delay the application date. Although the March 2021 deadline has been retained, the Commission has publicly agreed to defer the 'level 2' regulatory technical standards (RTS) until a "later date", which the authors speculate could be 1 January 2022 in line with the application of the EU Taxonomy Regulation. This means that market participants can provide 'high-level' and 'principles-based' disclosures by 10 March where requirements are expected to be further specified in level 2.

The uncertainty in the absence of final requirements, particularly as the ESAs had been expected to substantially rewrite of the draft RTS, set against an already compressed timeline, was heightened when the Chair of the ESAs requested urgent clarification from the Commission on a number of important



Source: State Street Global Advisors, timeline as at January 15, 2021

interpretational issues at the start of January 2021. The queries focused on the application of SFDR to non-EU Alternative Investment Fund Managers (AIFMs) and registered AIFMs, the application of Article 9 of SFDR and the application of SFDR product rules to MiFID portfolios and tailored funds. The letter also sought clarification on the meaning of "promotion" in the context of products promoting environmental or social characteristics, as well as the application of the 500-employee threshold with respect to the principal adverse impact reporting requirement on parent undertakings of a large group.

Following the publication of State Street's insights report, the ESAs have published their final joint report containing draft Regulatory Technical Standards (RTS) on these disclosures, which are now subject to a scrutiny period before being adopted by the EU. The authors were correct in speculating that the ESAs would substantially reduce the total number of key performance indicators to calculate the principal adverse impact of investments on sustainability factors, and, more importantly, that the ESAs would recommend to delay the requirements in the draft RTS until 1 January 2022.

The Banking Union

In parallel with these developments, the European Central Bank (ECB) has also taken steps to push banks to integrate climate change risks into their operations. It has become an avid purchaser of green bonds and accepts them as collateral for repurchasing operations. In its financial and economic analysis, it also highlights the economic case for tackling sustainability challenges head-on. Christine Lagarde's appointment as President of the ECB Governing Council significantly added to the ECB's sustainability credentials. As a candidate for the position, Lagarde made no secret of her intention to push the item into the central bank's agenda as early as her confirmation hearings. However, it is perhaps through its regulatory responsibilities that the ECB's commitment to climate change mitigation will be most felt.

As the ultimate supervisory authority for the EU's Banking Union, the ECB published its Final Guide on Climate-related and Environmental Risks in November 2020. Co-authored together with national supervisors, the Guide sets supervisory expectations with regard to the management and supervision of climate-related risks, which will take center stage when the ECB rolls out its next supervisory stress-test in 2022. According to Huertas, Horigan and Funk, while the Guide is not legally binding, these expectations "serve as a basis for supervisory dialogue, including as part of the Supervisory Review and Evaluation Process (SREP), which, in turn, is binding on directly ECB-SSM (Single Supervisory Mechanism)- supervised institutions.

By incorporating climate change in its stress tests, the ECB has internalised the medium-term risks associated with global warming into its financial stability work. However, the central bank also leads the way through its work in monetary policy and economic analysis. The authors also signal the potential disconnect between EU authorities given the European Banking Authority is also consulting on the management of climate-related risks by banks and investment firms. Interestingly, the EBA points to State Street Global Advisors' proprietary build of R-Factor as an effective example of current risk management practices which the EBA dubs the 'exposure method'.

Next Up: ESG Data Regulation and Carbon Trading

Further along the policy-making route, Huertas, Horigan and Funk suggest that the EU is taking steps to regulate providers of ESG/sustainability data. Although there has been some focus on this at the global level by the international securities regulator, Dutch and French representatives (and now Members of the European Parliament) have called on the Commission to include a legislative proposal that would regulate entities providing sustainability datasets in the EU where they are not currently subject to EU legislation. Hence, the Commission may consider this as part of its upcoming Renewed Sustainable Finance strategy, which had been expected in March but is now likely to slip later in Q2/early Q3.

The Dutch and French proposals seeks to impose "transparency on methodologies, management of conflicts of interest, internal control processes and enhanced dialogue with companies subject to sustainability ratings" to protect investors from greenwashing and avoid conflicts of interest. According to the proposal, the European Securities Market Authority (ESMA) would be granted powers to supervise ESG data providers.

Finally, the authors point to the road ahead and more specifically the global agenda where there may also be hope for international collaboration with the Biden Administration keen to put climate change and wider ESG issues at the top of the agenda, in a start turnaround from the previous Administration. The authors note that President Biden's vision of a 'Green New Deal' "shares conceptual similarities to the EU's efforts around Carbon Border Taxes to prevent offloading from companies in countries with laxer environmental rules." More importantly, they point to the possibility that the EU and the USA may join forces and create a joint carbon trade zone. "Members of the European Parliament are already considering groundwork for a Transatlantic Green Deal, as part of the EU outreach strategy to the Biden Presidency", the authors note.

The EU Sustainable Finance Action Plan

Accomplishments and Delays

by Filipe Albuquerque

Credit: European Parliament

Following an active campaign to address climate change risks, the European Union (EU) starts 2021 with a robust list of regulatory achievements under its belt. Triggered by the 2015 Paris agreement, popular support and a sense of urgency, and thanks to the momentum of its environmental finance agenda, the EU now stands almost peerless as the global regulatory leader in sustainable finance.

However, there have been bumps on the road. Not all initiatives progressed as fast as hoped, and delays now plague some of the most ambitious elements of the EU's sustainable finance agenda: the taxonomy, the green bond standard and the incorporation of sustainability factors into MiFID II.

The Action Plan on Financing Sustainable Growth

Following the 2015 Paris Agreement, the European Commission (EC) mandated a High-Level Expert Group (HLEG) to develop an overarching and comprehensive strategy on sustainable finance for the bloc in December 2016. In its January 2018 report, the HLEG recommended the EU carry out several reforms to fulfil its environmental hopes. The EC endorsed these recommendations in its Action Plan on Financing Sustainable Growth published in March 2018.

Three principles guide the action plan. The first goal was to "reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth". The action plan also sought to create the means to "manage financial risks stemming from climate change, resource depletion, environmental degradation and social issue." Finally, the EC sought to "foster transparency and long-termism in financial and economic activity."

To support these goals, the plan proposed ten actions. To reorient capital flows, the action plan sought five actions. First, the EC's priority was to establish an EU classification system for sustainable activities (the "EU Taxonomy", Action 1). The Commission also declared its intention to create standards and labels for green financial products ("The Green Bond Standards", Action 2). Besides nudging the market along, the EC also sought to foster investment in sustainable projects (Action 3). The Commission also announced it would amend the MiFID II and IDD delegated acts to incorporate sustainability concerns into financial advice (Action 4). Lastly, harmonising benchmarks for low-carbon issuers would also help promote sustainable finance (Action 5).

To mainstream sustainability into risk management, the EC announced three courses of actions. It would consider better integrating sustainability in rating and market research (Action 6), clarify institutional investors' and asset manager' duties (Action 7), and explore the incorporation of sustainability into prudential requirement (Action 8). Finally, the action plan suggested two actions to foster transparency, including strengthening sustainability disclosures (Action 9) and accounting rule-making and promote sustainable corporate governance and mitigate short-termism in capital markets (Action 10).

To support these actions, the Commission appointed a Technical Expert Group (TEG) on Sustainable Finance in June 2018t. A year later, the TEG published its reports on the different regulatory proposals.

Taking Stock - Successes

The EC made tremendous progress in 2019 and 2020, carrying out many of these reforms. The launch of the European Green deal at the end of 2019, and the announcement of the €1 trillion European Green Deal Investment plan in January 2020 allowed the EC to address the demands for Investment in sustainable projects (Action 3). The regulatory efforts on climate benchmarks (Action 5) also appear to have run their course during 2020, with the adoption of new rules in July and relevant delegated acts coming into effect in December 2020. In response to demands for strengthening disclosures on ESG factor considerations in ratings and market research (Action 6), ESMA updated its Guidelines on disclosure requirements for credit ratings in July 2019. It began checking how credit rating agencies apply these new guidelines in April 2020. To address the goals of Action 7, the EU also adopted the disclosures regulation (SFRD) in the spring of 2019, which will apply from 10 March 2021. The reform of corporate disclosures (Action 9) was completed in 2019 when the Commission published its guidelines on corporate climate-related reporting. The 2019 guidelines are effectively a supplement to a set of Non-Binding Guidelines on Non-Financial Reporting published by the Commission in June 2017.

Taking Stock - Delays

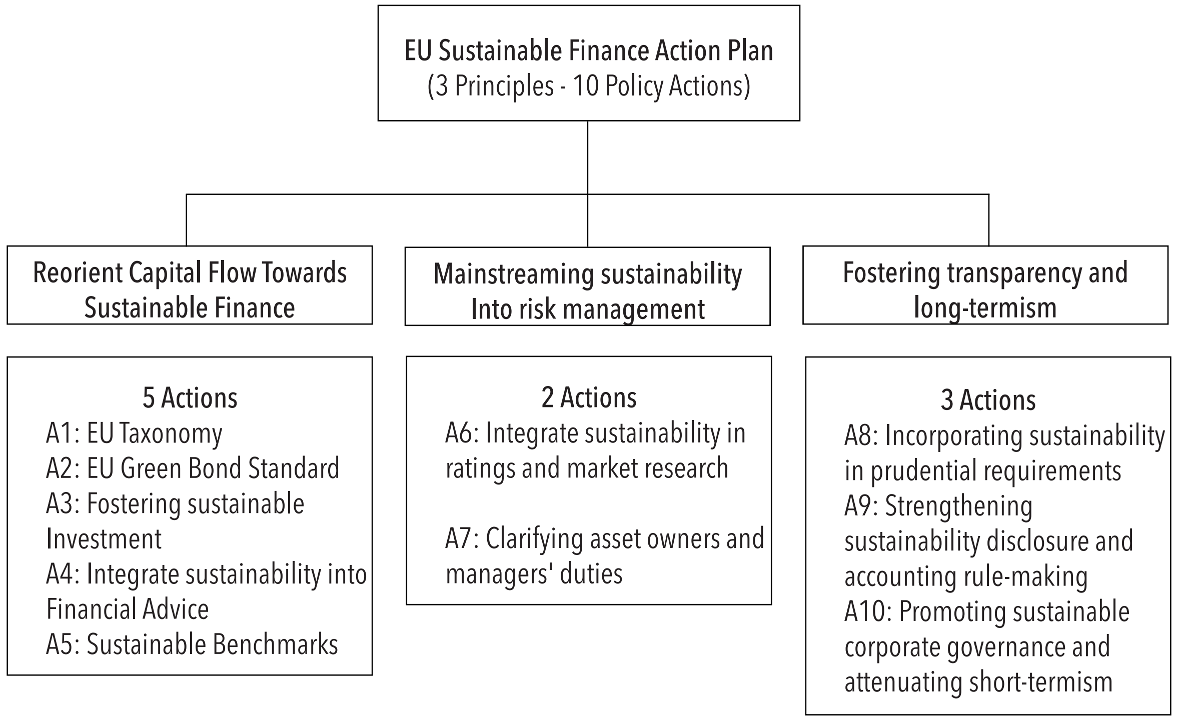
Other elements of the action plan are facing some difficulties. Although the EU adopted the taxonomy (Action 1) in 2019, a backlash against the draft delegated act defining the taxonomy's technical screening criteria caused its adoption to be postponed. Similarly, the green bond standard (Action 2), which was scheduled to be adopted in 2020, is still making their way through the legislative process.

Following technical advice from the European Securities Market Authority (ESMA) In the summer of 2020, the EC launched a consultation on a draft delegated act to amend the MIFID II delegated acts to incorporate sustainability factors into financial advice (Action 4). In their responses to the consultation, the European Banking Federation (EBF) and the Association for Financial Markets in Europe (AFME), expressed concerns about the implementation deadline and the ability of investment firms to adapt their processes to the proposed amendments on time. The amendments to the draft delegated acts do not seem to have been adopted by the original 2020 deadline. Perhaps the reform efforts were postponed in favour of amendments to the MiFID II rules simplifying information requirements to accommodate the COVID19 crisis.

Taking Stock – Early Days

Some other reforms are still at an embryonic stage. Regarding the incorporation of sustainability into prudential requirement (Action 8), the European Parliament and Council mandated the European Banking Authority (EBA) to study these issues. In December 2019, the EBA published its Action Plan on Sustainable Finance, according to which it "is expected to deliver a significant amount of work between 2019 and 2025".

Similarly, the promotion of sustainable corporate governance and mitigation of short-termism in capital markets (Action 10) is still at an early very exploratory phase. In February 2019 the Commission requested advice from ESMA, EBA and EIOPA on undue short-term pressure from the financial sector on corporations. Following the publication of that advice in December 2019, the Commission also received a study on human rights and due diligence requirements through the supply chain and a report looking into directors' duties and sustainable corporate governance in 2020.



Taxonomy & Green Bonds

by Filipe Albuquerque

An inevitable result of the European Union's ambitious sustainable finance action plan and the tight deadlines it set for itself is that on more than one occasion the European Commission (EC) hit a regulatory bottleneck and the process was delayed. Two of the most prominent components of the action plan, the EU Taxonomy and the EU Green Bond Standards, make for emblematic examples of such delays.

Developing the EU taxonomy

The EU taxonomy is a standardised classification system created to facilitate the assessment of the environmental sustainability of a given economic activity in the context of a company. According to the EC, the taxonomy seeks to establish "a common language and a clear definition of what is 'sustainable'."

Following the publication of intermediate preliminary progress reports by the TEG in December 2018 and June 2019, the EC published a draft Taxonomy regulation for consideration by the European Parliament (EP) and the Council by December 2019. The report includes technical screening criteria for 67 activities that can substantially contribute to climate change mitigation across the sectors of agriculture, forestry, manufacturing, energy, transportation, water and waste, ICT and buildings.

The EC's proposed regulation followed the TEG's recommendations quite closely. After institutional negotiations, the European Parliament and the Council adopted the Taxonomy Regulation[1], on time for publication in the Official Journal of the EU in June 2020. Article 3 and Article 9 lay at the core of the regulation and define the four conditions for an economic activity to be considered sustainable, and the taxonomy's six goals, respectively.

Article 9 of the Taxonomy states that the regulation's six environmental objectives are "climate change mitigation", "climate change adaptation", "the sustainable use and protection of water and marine resources", "the transition to a circular economy", "pollution prevention and control" and "the protection and restoration of biodiversity and ecosystems".

According to Article 3 of the taxonomy, an economic activity qualifies as environmentally sustainable if it fulfils four conditions. It must contribute substantially to one or more of the environmental objectives. It cannot significantly harm any of the environmental objectives. It must be carried out in compliance with minimum safeguards[2]. Finally, the activity needs to comply with the technical screening criteria established by the Commission.

Among other details, Articles 10 to 15 provide for the adoption of delegated acts (DAs) by the EC establishing technical screening criteria to determine the conditions under which an economic activity qualifies as contributing to each of the six objectives. Article 8 specifies that the EC will adopt a DA to specify the type of non-financial information that market participants should disclose.

In November 2020, the Commission released a draft DA regarding the technical screening criteria for determining when economic activities can contribute substantially to climate change mitigation and adaptation, and when they can be considered to cause significant harm to other environmental objectives within the context of the EU Taxonomy. The plan was for the DA to be adopted by the end of December 2020 to ensure its implementation from January 2022. However, the DA's adoption was postponed to an undetermined future date following extensive backlash to the draft from member states and stakeholders. The EC is expected to publish another DA describing the content, presentation and methodologies for complying with the disclosure requirements for financial and non-financial statements under articles 5, 6 and 8 of the Taxonomy Regulation, which is scheduled to be adopted by 1 June 2021.

Criticism of the Draft Delegated Act

Following over 46,591 individual responses to the EC's consultation on its November 2020 draft Taxonomy DA, it is not surprising that there were many complaints. In the face of pushback from advisory bodies, industry groups and governments, the EC had to hit the brakes.

The Platform on Sustainable Finance is an expert group that advises the EC on the sustainable finance agenda's ongoing development. In its reply to the consultation, the Platform warned that I had "identified several aspects of the draft Delegated Act which may impact the usability of the Taxonomy". Provisions for transition and enabling activities to Taxonomy alignment. The Platform warns that problems may emerge from using the NACE statistical classification system for categorising economic activities.

"NACE is a statistical classification system and was not designed for the sole purpose of classification of activities based on environmental contribution, as is the intent of the EU Taxonomy. Consequently, not all activities set out in the draft Delegated Act have NACE codes, and NACE codes may not adequately match the boundaries of an activity for the purposes of analysing the activity's environmental footprint," the Platform's response explains. The Platform notes that the activity of conservation of wetlands mentioned by the Taxonomy regulation does not have any NACE code associate with it. The platform also identified issues to do with credibility, consistency and predictability.

The European Fund and Asset Management Association's (EFAMA) response to the consultation noted problems with the applications of the criteria for real estate. "The stringency and reduced economic viability of the criteria would be particularly counterproductive for the covered bond and green mortgage bond markets. As a result, the potential of the Taxonomy to lower the costs of sustainable housing and real estate development would be significantly reduced. Furthermore, the linkage of TSC for 'building acquisition and ownership' to Energy Performance Certificates could, due to their different absolute energy thresholds in Member States, create an unlevel playing field in the EU internal market for green bond issuance."

The short schedule with which the EC was working was also a farsighted concern of EFAMA. "Given the ESG data challenge, the current timeline for application of Taxonomy disclosures continues to pose a serious challenge. We recommend readjusting the disclosure timelines to ensure a more practical

[1] Formally known as "Regulation (EU) 2020/852 of the European Parliament and of the Council"
[2] Article 18 of the Taxonomy specifies these are procedures that ensure the ecoonomic activity is aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights

"The stringency and reduced economic viability of the criteria would be particularly counterproductive for the covered bond and green mortgage bond markets."

-- EFAMA

and seamless sequencing between the reporting done by companies and asset managers. As users of these information, asset managers must be able to rely on reliable and comparable company disclosures. We are concerned that most companies will not be ready to implement the new disclosure requirements by 1 January 2022, leaving financial market participants with no option but to rely on estimates and third party screenings."

The Swedish government also expressed more institutional and localised concerns. It warned that "the technical screening criteria for the principle of 'do no significant harm' (DNSH) should not go beyond existing EU legislation." Sweden's response also highlighted concerns about innovations and omissions affecting the forestry, energy and transport, real estate, agriculture and manufacturing, which were problematic.

The EU Green Bond Standard

The inclusion of fixed-income markets into the sustainable finance agenda is an acknowledgement of the scale of growth recently witnessed in this corner of the bond market. With over US$300 billion worth of cumulative green bonds issued by 2020, the EU green bond standard would feed into this momentum by providing the market with clearer and more consistent standards.

Following a year of preparation, the June 2019 TEG report endorsed the creation of a voluntary EU Green Bond Standard (GBS) and the use of the EU Taxonomy to determine which activities should be eligible for funding via EU green bonds. Other proposals included the publication of a green bond framework, fund allocation reporting and third-party monitoring of the framework and projects progress.

The topic of the EU GBS came up next in the European Green Deal Investment Plan published in January 2020, when the Commission announced its goal to establish an EU GBS during 2020. In March 2020, the EC published a Usability guide for the EU GBS, followed by a consultation on the topic between June and October 2020.

Among the 11 responses it received, IHS Markit warned that "any standards introduced around green bonds incorporate and are consistent with industry standards (such as the ICMA Green Bond Principles) and existing or incoming regulation (such as the EU taxonomy, Sustainable Finance Disclosure Regulation or ESG disclosures for benchmarks)."

"Duplication and forcing market participants to comply with multiple standards and regulations must be avoided," IHS Markit added. Among other points, Triodos agreed, noting that "a new standard may cause extra confusion and fragmentation" while cautioning that while reference to the EU Taxonomy was understandable, "not all criteria under the taxonomy are specified."

It appears that, not unlike the draft DA, the EU GBS also missed its 2020 deadline. According to the EC, "the ultimate decision on how and in what legal form to take forward the EU GBS, will be made on the basis of the outcome of the targeted consultation on the EU GBS, and will be taken in the context of the Renewed Sustainable Finance Strategy," which is scheduled to be adopted in the first half of 2021.

The Asset Managers' Perspective

by Aline Reichenberg Gustafsson, CFA

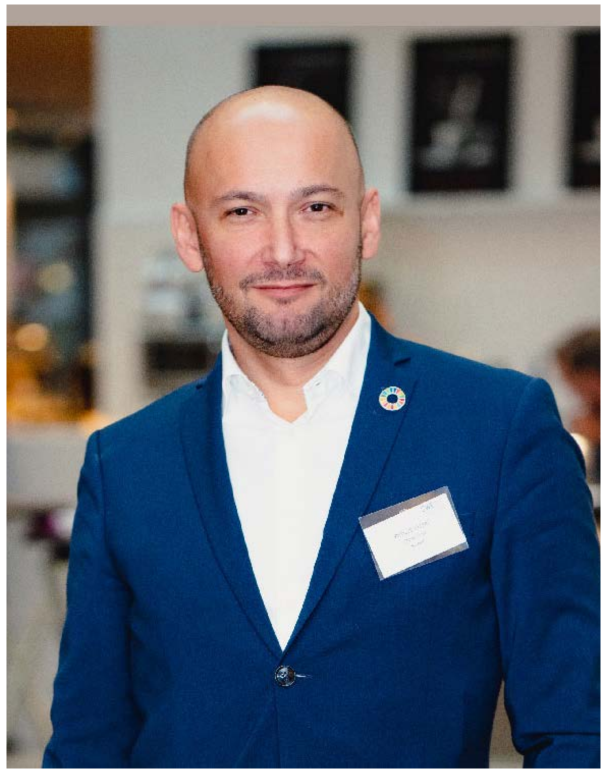
The European Commission's efforts to produce a body of regulation to guide the European Union's financial markets through their journey of sustainable investments is sure to affect, first and foremost the bloc's asset management community. To understand the effects of the regulations in the Nordic region, we reached out to local asset managers to take their temperature on the EU's sustainability efforts.

We were fortunate to hear from Erik Eliasson, Head of Sustainable Investments at Danske Bank; Karin Askelöf, Head of Responsible Investments at Handelsbanken Asset Management; Karolina Skog, Project manager for EU Sustainable Finance at Swedbank Robur; Robert Vicsai, Senior ESG Investment Specialist at SEB and Fredric Nyström, Head of Responsible Investment at Öhman. Most were supportive of the regulatory changes, but not all.

Helpful or Onerous Reporting Requirements?

Generally speaking, the asset managers agreed that the new regulatory framework helps the industry gather reliable, consistent, and comparable sustainability-related indicators from investee companies. Although this exercise will be onerous, it is nothing short of a revolution.

Describing the EU's agenda as a "regulatory tsunami", Eliasson argues it "is potentially the biggest financial regulatory intervention on an EU level so far. There is no doubt, that his sustainable finance agenda will emphasize and expand the market for sustainable finance. The availability of high quality and standardised sustainability data requires a collaborative effort from investors, companies and policy makers."



Robert Vicsai
Senior ESG Investment Specialist
SEB

"The regulatory framework implies that we as investment managers have a duty to gather and report on sustainability indicators on an aggregate level for all our holdings. This means that there will be a clear and increased pressure on corporates to report on these specific indicators," says Askelöf. Skog agrees, noting that she expects "the new regulations will provide useful tools in the analysis of the sustainability strategies of external managers and underlying companies. The new regulatory framework will lead to new climate-related company reported data becoming available to investors. The investment community will get access to more comparable sustainability indicators."

However, the new disclosures will come at a cost. "It may take some time, however, before the data will be completely robust, as this is a new framework to include in company reporting processes," Skog says. "Initially there will be challenges with the coverage of data for each and every individual holding but over time it is likely that there will be more comprehensive data reported and this will lead to better comparability over time," Askelöf adds.

Nyström was less sanguine. "In general, we believe that transparency is very positive for the industry, however, we got concerned when we saw the first draft of the technical standard. "When regulation is highly prescriptive it makes things more difficult. The reporting burden is costly. The challenge now is to make something of it that adds value to the end investor. It doesn't make any major difference to the way we manage our capital . I hope that the value will become more visible over time" Nyström says.

Vicsai takes a more structural view. "The new regulatory framework reinvents how investment managers have been working with sustainability-related risks and opportunities and will help investment managers from three perspectives. First, it will guide investors along their sustainability journey given that it sets a strategic direction. Secondly, it will specify the level of granularity required of sustainable investors. Lastly, it will also affect value-creation, by redesigning current sustainability management processes and fostering product innovation, for example," he says.

Bridging the Data Gap

Overall, the asset managers have begun preparing to incorporate the new data into their investment processes and fulfil strategic objectives. Whether the transition will be easy or not is not entirely clear.

"We believe that the new data derived from the taxonomy will be an additional tool to use in both our investment decision and risk management processes. Climate-related analysis and tools, such as the taxonomy, will support us in measuring the impact and progress of our investee companies and in achieving our ambitions goal of being carbon neutral by 2040," Skog says.

Fredric Nyström
Head of Responsible Investment
Öhman

"Robust and consistent data will be crucial, which may be challenging to obtain for non-EU companies, who do not have regulatory requirements to report their taxonomy alignment numbers. To a certain extent, investors will need to rely on estimated data, especially at first when the regulation enters into force," Skog adds.

"Incorporating sustainability risk into the investment process is part of our fiduciary duty to identify the sustainability factors that may pose a risk and affect financial performance," Eliasson explains. "We rely on the concept of Financial Materiality to assess which sustainability risks have a potentially negative impact on the value of an investment. Moreover, risks are also evaluated on their effect on society."

Askelöf is confident that the data gap will be easy to fill. "Sustainability data is already an integral part of our investment analysis. It also constitutes an important part of the risk control of our portfolios. Indicators that have not yet been followed on an aggregated level will now be integrated into our systems," she explains.

However, Vicsai has some concerns. "Data quality has improved lately. However, there is still a large gap that needs to be bridged by the reporting companies. We have been working diligently on implementing already available information into current decision-making processes, especially around environmental factors, and collaborating intensively with third-party sources on missing data. We have also been using best-effort estimates when the available data is inconclusive or unavailable to fill all remaining gaps," he says. According to Eliasson, "developing a sustainability accounting will require the standardisation of ESG disclosures to address financial materiality, accessibility, comparability and reliability of sustainability data."

Taxonomy Challenges: Educating End Investors

Focusing on the Taxonomy, there is a consensus that communication is key and that it is crucial to be clear to asset owners about the fact that the taxonomy only covers environmental investments, not the whole spectrum of sustainable assets.

"One challenge will be the communications efforts surrounding the taxonomy. We see a potential risk in the taxonomy becoming synonymous with sustainable activities while it only, as of right now, covers climate-related activities. Environmental issues more broadly as well as social issues will not in reality become less important with the launch of the taxonomy, but there is a risk that those issues will get less attention," Askelöf warns.

Karolina Skog
Project manager
EU Sustainable Finance
Swedbank Robur

Erik Eliasson
Head of Sustainable Investments
Danske Bank

Skog focused on reporting. "At this stage, there is no clear guidance on how to report on taxonomy alignment when investing in asset classes such as government bonds, not covered by the upcoming EU Green Bond Standard. The framework does not cover all economic activities that are important for the climate transition and investments in those activities will not result in taxonomy alignment. However, as this is the first version of the taxonomy, we believe these issues will be resolved over time, as the framework is expected to be continuously developed, " she notes.

Vicsai agrees. "One of the most significant challenges is the perception of end-investors. There is a risk they will think anything without taxonomy-related revenues is unsustainable, which could create false investor expectations." He explains that the taxonomy may constrain diversified strategies if complete taxonomy alignment takes off, an approach he would recommend against. "Even though it's important to take into account as part of the evaluation of companies, solely chasing taxonomy aligned economic activities may create a chain of problems when trying to integrate taxonomy information into investment decision making processes and themes. It's important to remember that the taxonomy covers and sets environmentally friendly technical criteria for economic activities in most emission-intensive sectors," he says.

"Diversified investment portfolios that have allocations outside of the scope of the current taxonomy will not have a high percentage of aligned investments even if the investment manager has an advanced sustainability integration model when evaluating companies. It is difficult to aim for a high Taxonomy alignment without putting unmanageable constraints on the investment manager, extorting the diversification's aim within the portfolio. The biggest challenge will be to manage investor expectations and educate them about the process, aim and use of the taxonomy, and consequences on portfolios," Vicsai adds.

Karin Askelöf
Head of Responsible Investments
Handelsbanken Asset Management

Nyström makes a similar point from a different angle. "Not all perspectives are important for all types of financial products. For us, it has been mostly a matter of explaining and documenting our investment processes, as we have already implemented sustainable investment practices internally for the past few years." He also notes that there is only so much that can be done at the moment. "The taxonomy isn't fully developed yet. Last summer, we ran a dedicated project on mapping the Swedish large cap index to the taxonomy to understand how the regulation would impact our funds. We have gone as far as we could, given the available information," he explains.

SFDR Challenges – Financial Materiality and Data Gathering

Beyond the taxonomy, investors are also facing the sustainable finance disclosures regulation (SFDR). "The SFDR sets out detailed requirements on sustainability disclosures and reporting for investment products for which there have been no such standards or requirements in the market previously, " Eliasson explains. "The regulation focuses on transparency to combat greenwashing and enhance the comparability of environmental and social (Article 8 products) as well as sustainable investment (Article 9 products) characteristics across products for end-investors."

Askelöf explains that "the disclosure duties that now follow mean that we will provide more detail on the integration of sustainability risks into the investment process and how we asses and prioritize principal adverse sustainability impacts. We will also categorize all our funds according to the regulation. Increased disclosure includes pre-contractual information, web page information and our policy."

While welcoming of the SFDR, Skog notes that it will impose further burdens on asset managers. "As both process descriptions and quantitative data disclosures are required under SFDR, resources need to be allocated to fulfil the relatively extensive reporting requirements," Skog says

Vicsai notes that there's an easy part and a hard part to the SFDR. "We need to manage qualitative and quantitative disclosure information. The qualitative aspects need to be fulfilled by the 10th of March. They describe the investment process and identify the sustainability characteristics applicable to the relevant products. That's the easy part."

"The challenging part will be to gather the relevant data according to the recently published Regulatory Technical Standards (RTS2) and fulfilling the requirements from a quantitative perspective. The sustainability process and the integration level regarding investment decision-making will need to change in many cases to meet the requirements. It will be necessary to reinvent many procedures and data gathering and increase the size of the budget allocated to sustainability-related information," Vicsai explains.

A New Focus for External Manager Selectors

Despite the necessity to educate markets about the limited coverage of the EU sustainable finance regulation, the new rules cannot but impact the external manager selection process.

"The EU regulations will put further pressure on external managers to report according to the new frameworks and be transparent on how their portfolios and the underlying investments score on the new indicators," Skog says. Askelöf makes a similar argument noting that products categorized in accordance with the regulations will be prioritized.

Vicsai agrees. "There will probably be enhanced focus within selection processes on sustainability related factors, whether we are talking about evaluation of investment process or determining if an investment manager lives up to the categorization chosen under the SFDR regulatory framework," he concludes.

"We already have our own principles when selecting and evaluating external managers. New regulations or frameworks will be a natural part of that process."

-- Marie Giertz, Kåpan

The Asset Owners' Perspective

by Julia Axelsson, CAIA

Marie Giertz
Chief Investment Officer
Kåpan

Institutional investors are the link between the real economy, where families plan for the future and save their income, and the financial markets, where those funds are redirected to profitable projects, often through external managers. The EU's sustainable finance regulations enshrine in law factors that are consistent with the long term investment horizons of these investors. As such, it is not surprising to find asset owners embracing the new legislation.

To understand the effects of the regulations in the Nordic countries, NordSIP reached out to local asset owners to hear their concerns and how they are preparing for the EU's incoming sustainable finance regulations. We were fortunate to discuss the issue with asset owners and external manager selectors from Sweden, Finland and Norway. Marie Giertz, Chief Investment Officer at Kåpan, Hanna Kaskela, Director for Responsible Investments at VARMA and Kamil Zabielski Head of Sustainable Investments at Storebrand, were of one mind. A strong set of well-established sustainability criteria will minimise the adjustment required from the industry by the new rules, they argue.

Kåpan is an asset manager focused on the occupational pensions for Sweden's central government employees. VARMA is a leading Finland's largest pension providers, also believes that well-established and strict demands will require less of an adjustment. Headquartered in Oslo, Storebrand is one of the largest pension and insurance manager in the Nordics.

Better Data

Despite recognizing that they will increase the reporting burden put on companies and asset managers, the asset owners were optimistic at the prospect of the new regulatory framework and its ability to improve the quality of reporting.

"Mitigating climate change is one of Varma's key sustainability targets," Kaskela says. According to her, transparency at the company level will inevitably improve reporting at the investor level. "The more openly investee companies disclose their climate-related financial risks and the opportunities created by climate-change mitigation, the better investors' reporting on climate-related issues will be. When investors need to report by taxonomy also investees should report the same way. In general, data on responsible investment tends to be backward-looking, but fortunately forward-looking data is also developing."

"We aim for a carbon-neutral investment portfolio gradually by 2035, and we work every day to achieve this goal. A concrete example of this is our revamped sustainable equity portfolio, which focuses on climate-friendly investments and reducing its carbon risk quarter by quarter," Kaskela adds.

"The new regulatory framework is definitely putting pressure on data provides to serve the market and develop further with input from managers," Zabielski says. "It will help level the playing field for all. This will also in turn put pressure on companies not only to deliver on that data. Storebrand has the goal of net zero emissions long-term. This ambition needs to match short-term strategies. For instance, by 2025, emissions for Storebrand Group's total equity, corporate bond and real estate investments will be reduced by 32%. We also have an ambition to have an investment portfolio that does not contribute to deforestation by 2050. For us to achieve these goals we need better data from companies and that they deliver according to expectations," he adds.

Sustainable Managers Will Succeed

Institutional investors recognize that asset managers are on the front lines of the shock wave of sustainability regulations and that their readiness and

Kamil Zabielski
Head of Sustainable Investments
Storebrand

historical commitment to ESG will determine their ability to navigate the new regulatory environment successfully.

"Responsible investment is a core aspect of Varma's strategy," Kaskela says. "Varma's Principles for Responsible Investment provide a framework for incorporating environmental, social, and corporate governance criteria into investment operations and ownership policies, acknowledging that these will have a major impact on investment returns in the long term," she adds emphasizing the importance of existing ESG practices.

"We hope that all the asset managers have incorporated ESG-data into their investment decision and risk management. In our externally managed investments, ESG is integrated to the manager selection and monitoring processes," Kaskela adds.

Zabielski agrees. "We already have a robust system in place to measure ESG risk in companies and perform screens on all of the companies in our portfolios. However, more transparency and better reporting from the companies we invest in, will enable us to make even better and more informed investment decisions. As the regulation will put pressure on companies to report in more detail, this reporting will feed into our Sustainability Score assigned to our investee companies, and fund managers then have an even better tool at hand when they set strategies for their specific fund," he adds.

"The impact of the sustainable finance disclosures regulation, for example, will depend on the asset managers focus on sustainability," Zabielski adds. "For those like Storebrand that have an integrated approach to ESG and have been working with this for a while, the task will not be as challenging."

For Giertz a pre-existent commitment to sustainability is crucial. "We already have our own principles when selecting and evaluating external managers. New regulations or frameworks will be a natural part of that process. However, it is too early to say if and how regulatory changes will impact that process," she says.

Definition, Compatibility and Missing Data Challenges

As the rules have not been finalized, asset owners are holding their judgement until they see the final product. However, there are some concerns that already stand out at this early stage in the reform process.

"We are following the regulatory issues on a national and EU level and are taking the necessary steps for us as a pension fund," Giertz adds. "However, we are not in the front line of the EU regulatory package discussion. We implement the regulatory changes as they evolve. When it comes to the taxonomy it's still very much in motion. First and foremost it's the companies that need to apply the taxonomy," she says.

Hanna Kaskela
Director for Responsible Investments
VARMA

"The overall intention and the aim of a standardized framework is good," Giertz says. However, there may be issues regarding the strictness rigidity and compatibility of the new rules. "One concern is that the definition of for example green activities could be too strict and maybe even misleading. However, it's still an ongoing discussion and I think we should not be too worried. Moreover, there are many frameworks trying to deal with the same issues. Another concern, in my opinion, is the extent to which EU regulatory framework would substantially differ from other frameworks. We are also aware that there are important debates and concerns about some aspects of the regulations, but we are waiting to see how things unfold at this stage," Giertz explains.

Kaskela reminds us that ESG integration varies across asset types. "Varma requires that all funds, where ESG-topics are relevant, should have their own ESG-policy. For a multi-asset investor with a global portfolio the taxonomy helps to analyze climate change related data of the listed equities and bonds in Europe. But that may only be a part of the total portfolio. For example, private loans and private equity in many cases lack the taxonomy data," she explains.

Despite these difficulties, Kaskela argues that the problem can still be addressed. "If the fund doesn't have a policy, it has to be able to provide evidence that ESG is taken into account in investment decisions. We also prefer asset managers who have signed UN's Principles for Responsible Investment, or equivalent set of principles. EU regulatory changes are also incorporated into selection and monitoring process."

Kaskela illustrates her point with an example. "When selecting real estate funds, we take into account how the fund manager has integrated sustainability matters in the investment process. We encourage fund managers to consider sustainability in their investment decisions and to set concrete targets, such as reducing the CO_2 emissions and increase the energy efficiency of the portfolio's investments. We monitor the development at regular intervals through the Global Real Estate Sustainability Benchmark (GRESB) or through similar reporting and our own surveys," Kaskela says.

"We understand that given the environmental emergency we are in, urgent action is needed to mobilise capital not only through public policies but also by means of the financial services sector," Zabielski adds. "We applaud the EU for taking this important step regarding climate and environmental issues. We see however that inequalities also keep growing lately especially as an effect of the pandemic. These issues will not go away by just mitigating them, we, the financial sector also need to take a proactive approach to these social issues. We know there is a working group working to further develop the social issues within the EU plan and we are looking forward to see how the EU will also further the agenda for these issues," he concludes.

Credit: Robert Balog from Pixabay

Taxonomy and Forestry

How the EU Antagonised the Forestry Industry

by Filipe Albuquerque

Although not a widely known fact, forestry is an important segment of the green bond market, worth a little over SEK74 billion in issuance since 2016, according to Bloomberg data. Thanks to issuance by Finland's UPM Kymmene, Stora Enso and Tornator and Sweden's Sveskog and Sodra Skogsargarna, the Nordic region accounts for 19 of the 32 outstanding green bonds, equivalent to SEK31 billion, or approximately 42% of the market.

The salience of forestry-related bonds echoes the importance of forestry-related activities in the Nordic region. According to the UN's Food and Agriculture Organisation (FAO), forestry employed between 2% and 4% of the total labour force in Sweden and Finland in 2011, where the sector represented 3% and 4% of GDP, respectively. However, the same does not hold true for Denmark and Norway where the share of labour force was much smaller (0.7% and 0.9%, respectively).

Despite our best efforts, in the absence of a commercially viable and widely adopted method for carbon capture, forest maintenance, reforestation and afforestation remain the best means we have to recycle the CO_2 we emit into the atmosphere. At the same time, the UNEP estimates, halving deforestation would require an annual investment of US$17-33 billion by 2030.

The inclusion of the sector in the EU Taxonomy sparked hopes for renewed investment in forests

"The act manifests a lack of flexibility in relation to already existing national forestry laws with strict sustainability requirements."

-- Kristofer Dreiman
Länsförsäkringar

across the continent. However, the details concerning forestry included in the draft EU Taxonomy Delegated Act (DA) published at the end of 2020 were not particularly popular.

The Problem with Additionality and Improved Forest Management

Reviewing stakeholder reactions to the forestry elements of the draft DA, the foremost source of focus is the European Commission's (EC) focus on additionality. According to the technical screening criteria of the draft DA demands that qualifying "afforestation"[1], "reforestation"[2], "improved forest management" and "conservation forestry" activities show additionality.

According to draft DA, additionality requires that "the activity is not compulsory or customary and that, without the activity being accepted for financing as a sustainable investment, (...) (a) the activity would not have been implemented or its economic, environmental or social aspects would have been significantly altered; (b) the activity would have not been possible due to knowledge or behavioural barriers; (c) the area would be converted and used for other activities, having negative impacts on climate mitigation."

Kristofer Dreiman, Head of Responsible Investments at Länsförsäkringar questioned the draft DA's focus on 'additionality' as well as whether the replacement of 'Existing forest management' by 'Improved forest management' "is aligned with the objectives of the Regulation." According to Länsförsäkringar, the draft DA "is a significant deviation from the final recommendations of the TEG in March 2020."

"The additionality criteria significantly narrow down the scope of eligible activities in countries with strict forest management laws, including requirements of re-planting after harvest," Dreiman says. "Removing Existing forest management will have negative effects for forest owners, companies and investors. It will unrightfully exclude sustainable forest management practices."

Länsförsäkringar notes that in its present form the DA will overlook substantial contributions to climate change mitigation by the forestry industry. "Existing forest management in Sweden alone absorbs CO_2, net (after harvest) over 40 million tons CO_2e annually. This is as a substantial contribution to climate change mitigation. (...) "In addition, the substitution effect of renewable raw material produced from the forest is even more substantial and replaces, importantly, fossil fuel-based and/or CO_2-intense products. The substitution effect, if anything, can be viewed as an enabler for transition in line with EU's climate objective."

At Swedish Forest Industries, Magnus Berg's objections are similar to those of Länsförsäkringar. "The Commission has arbitrarily changed the setup versus the Technical Expert Group report and now disqualifies ordinary management practices from being classified as sustainable. (...) Excluding ordinary forest management will have major negative consequences for the Swedish forest industries. It will undoubtedly affect the financial sector's attitude towards us."

The European Fund and Asset Management Association (EFAMA), also echoes Länsförsäkringar

[1] The draft DA defines ''afforestation'' as the ''establisment of forest through or deliberate seeding on land that, until then, was under a different land use or not used. Afforestation implies a transformation of land use from a non-forest to forest, in accordance with the Food and Agriculture Organisation of the United Nations('FAO') definition of afforestation''

[2] The draft DA does not provide a single definition of ''reforestation'', leaving it to each national law. However, in the absence of a national definition, the default definition should be the FAO's which defines reforestation as the ''re-establishment of fores through planting and/or deliberate seeding on land classified as forest,'' acccording to the draft DA.

Credit: Swedish Forest Industries

concerns, noting that "the Commission's request for 'additionality' in forest management means that only measures above or beyond 'ordinary' forest management can be classified as sustainable."

"This requirement would mean that all ordinary sustainable forest management would be excluded," EFAMA adds. "For example, 90 % of forests used for commercial purposes in Finland are certified by the Program for the Endorsement of Forest Certification, implying that sustainable forest management is already an established standard.

Institutional Overreach?

As a result of the seemingly arbitrary and paradigmatic exclusion of a wide range of forestry practices from the taxonomy, stakeholders have also raised more institutional concerns of political overreach on the part of the EC.

The Confederation of European Forest Owners's (CEPF) expressed this concern most clearly in its feedback about the draft DA. "Delegated act should not be used as a tool to shift away from the Member State competence on forestry. It has been a common consensus for decades that the competence on forest management belongs to Member States. The solution for better coherence of policies would be working together with the Member States and sectors involved," CEPF's reply warns. "In addition, delegated act should not be used to introduce new concepts to EU legislation."

On the other hand, Dreiman is concerned about the proportionality of the detail of the draft DA. "The content and form of a Union action must not go beyond what is necessary to achieve the intended objectives. The measures proposed under forestry in the draft seem disproportionate since they do not recognise customary sustainability practices of 'existing forest management'."

"Any legislation on European level regarding forestry must consider the different natural conditions and timeframes of forests," Dreiman argues. "In the Nordics a forest's life cycle is around 60-80 years, at least. Thus, a climate benefit analysis of only 20 years for an individual forest is too short and misleading. That analysis should at least cover one life cycle of forests."

"The detailed requirements for reporting and review put on forest owners is another example. Furthermore, the act manifests a lack of flexibility in relation to already existing national forestry laws with strict sustainability requirements. To summarise we believe that the proportionality aspects of this proposal needs to be reassessed," Dreiman adds.

Why so strict?

The cause of this overreach is another mystery. When probed as to the motivation behind such a strict standard, Berg admitted he was at a loss. Insularity and expediency may have played a role according to him. "The proposal for the delegated act has been developed within the Commission, without consultation with any stakeholders prior to the proposal presented in late November." The CEPF's reply echoed Berg's comments when it expresses a concern "that the Commission is working with too much ambition and too little time to make legislative proposals."

"The proposal for the delegated act has been developed within the Commission, without consultation with any stakeholders prior to the proposal being presented in late November."

-- Magnus Berg

Alternatively, the EU may have become the hostage of its own methodological approach to the taxonomy. This is one of the concerns expressed in the feedback to the draft DA provided by the Platform on Sustainable Finance, an advisory body subject to the EC's horizontal rules for expert groups.

"The draft Delegated Act recognises that activities can make a substantial contribution to climate change adaptation in two ways: either through being adapted or by enabling adaptation in other parts of the economy." The Platform notes however that the draft DA takes a different approach to this dichotomy than the TEG.

According to the Platform, "the TEG recognised that many activities could perform either, or both functions and (...) proposed that users of the Taxonomy have the option to select whether their contribution should be recognised as 'enabling' or 'adapted activity'. However, he notes that "the draft Delegated Act takes a different approach, separating enabling activities from the economic activities being adapted", while at the same time providing very specific criteria for what constitutes enabling and adapting criteria.

"Generally, users will find it easier to demonstrate compliance where criteria are more precise and tailored to the activity in question. However, in the case of enabling activities for adaptation, the benefits are currently outweighed by the drawbacks. This approach leads to an excessively narrow scope of enabling adaptation activities included in the Taxonomy, which in turn heavily limits the usability of the Taxonomy for financing adaptation across the economy," the Platform's feedback adds.

This appears to be at the heart of the problem for the forestry industry. Using the example of afforestation and natural capital restoration to illustrate the point, the Platform notes that both activities "can be an important enabling adaptation for coastal regions, slope stabilisation in transport networks, water basin protection and addressing heat island effects in cities, amongst other uses. In the draft Delegated Act, only adaptation of these activities is recognised as Taxonomy-aligned, and not the role of afforestation in enabling adaptation."

Correcting Course

As it stands, Berg warns that "over time there's absolutely a risk that this will affect the investments in forestry and forest industries. During the last decade, the Swedish forest industry have invested more than €10 billion, which corresponds to approximately 20% of all Swedish investments in manufacturing industries."

"With the current proposal for delegated act, very few – perhaps none - of these investments would be classified taxonomy compliant. The taxonomy would thereby not have been a help to direct investments to sustainable forest management or the forest industry." Instead, "the Taxonomy will punish those who already have come far and are at the forefront, which is completely the wrong signal to send for the EU to reach climate neutrality."

Länsförsäkringar goes on to recommend that the EC "re-include the TEG report's proposed activity Existing forest management" and remove the activity of Improved forest management". Meanwhile, EFAMA recommends "removing or adjusting the additionality criteria for forestry management, in order to make eligible also existing forestry activities that are conducted in accordance with highest existing sustainability standards." The Platform, for its part, argues that the DA "should substantially expand the scope of enabling activities which can make a substantial contribution to climate change adaptation."

The Dissenting View

It should be noted that these recommendations stands in stark contrast with the views advanced by the World Wide Fund (WWF), which argues that the delegated act is too permissive. "Afforestation or reforestation of forests is insufficient to replace forests lost to deforestation or which are highly degraded. It is important to protect existing natural forests, restoring and enriching biodiversity as well as the carbon storage potential to generate forests that are resilient."

"A highly referenced April 2019 study published in Nature concluded that restoring natural forests is the best way to remove atmospheric carbon'. The Commission should accordingly tighten forestry criteria."

The Nuclear Debate

Why does the Taxonomy not Include Nuclear Energy?

by Filipe Albuquerque

Credit: Anji Terzieva for NordSIP

Nuclear power has always been a contentious issue, in no small part due to its birth from the ashes of Hiroshima and Nagasaki. Since then, the images and accounts of what came to pass at Chernobyl and Fukushima and the potential fallout from uncontrolled nuclear disasters haunt the industry and have led to a pull-back by national governments, not least in Germany.

Other concerns, regarding safety protocols at power plants, radiation poisoning and corruption claims at mining operations, lack of investment in safe storage of radioactive waste, not to mention the complexity of the technology itself are also a critical impediment to its adoption.

That being said, nuclear energy is a significant source of electricity in Europe. In the Nordic region, Sweden and Finland still rely relatively heavily on nuclear power, according to the International Atomic Energy Agency (IAEA). Sweden's five sites (Ågesta, Barsebäck, Forsmark, Oskarshamn and Ringhals) produced 34% of its electricity in 2019. Finland's two locations (Loviisa and Olkiluoto) produced almost 35% of the country's electricity in 2019.

The Benefits of Nuclear Energy

This issue was on display during the debates that informed the EU Taxonomy. The European Fund and Asset Management Association (EFAMA) noted that "Nuclear energy is not listed amongst Taxonomy-eligible activities despite its important contribution to decarbonisation of the energy mix in certain EU Member States and, increasingly so, in industrialising G20 countries."

Nuclear energy is a very politically charged issue in Europe. While France has embraced the technology the most and relies on it for a majority (71%) of its energy mix, Germany is opposed to it and has completely eliminated nuclear energy, following the Fukushima disaster.

"Nuclear energy is clean and a benefit to humanity," says Jean-Philippe Brette of the French Association of Environmentalists for Nuclear Energy (EFN). "It would be incomprehensible if a few countries were able to isolate Europe from the rest of the world and act against an environmentally friendly energy capable of quickly decarbonising any national emissions mix in less than 25, as was the case in

France. The consequences of radioactive materials are manageable. This energy can be considered clear since the metals are managed in definitive manner that does not threaten the health of fauna or flora," Brette adds.

Mindful of these opposing views, EFAMA warned that the "possible inclusion of nuclear energy as a taxonomy-compliant transitioning activity should evolve from a science-based approach, devoid of partisan or ideological considerations."

The TEG was did not deny the benefits of nuclear energy. "Evidence on the potential substantial contribution of nuclear energy to climate mitigation objectives was extensive and clear," the TEG noted. "The potential role of nuclear energy in low carbon energy supply is well documented." However, there with the criterion of "do no significant harm" (DNSH).

Nuclear Energy – The TEG's view

In its response to a question from the European Parliament on this topic, the European Commission quoted the March 2020 Taxonomy report by the Technical Expert Group (TEG) on Sustainable Finance. "One potential significant harm to other environmental objectives, including circular economy and waste management, biodiversity, water systems and pollution, the evidence about nuclear energy is complex and more difficult to evaluate in a taxonomy context," the TEG says. "Evidence often addresses different aspects of the risks and management practices associated with nuclear energy. (...) Despite this evidence, there are still empirical data gaps on key DNSH issues."

The TEG could "not conclude that the nuclear energy value chain does not cause significant harm to the other five environmental objectives, in the absence of sufficient expertise in the group. It therefore recommended that further technical assessment by experts with in-depth technical expertise be undertaken concerning the existing and potential impact of nuclear energy on the other environmental objectives," the EC said.

One fact not very well known outside of the field of nuclear energy, which the TEG picked up on, is that the storage of toxic waste remains a dangerously

"Nuclear energy is clean and a benefit to humanity,"

-- Jean-Philippe Brette

unaddressed problem. "For example, regarding the long-term management of High-Level Waste (HLW), there is an international consensus that a safe, long-term technical solution is needed to solve the present unsustainable situation," the TEG argued. "A combination of temporary storage plus permanent disposal in geological formation is the most promising, with some countries are leading the way in implementing those solutions. Yet nowhere in the world has a viable, safe and long-term underground repository been established. It was therefore infeasible for the TEG to undertake a robust DNSH assessment as no permanent, operational disposal site for HLW exists yet from which long-term empirical, in-situ data and evidence to inform such an evaluation for nuclear energy."

Nuclear Waste Disposal – Problems and Solutions

The nuclear storage facility of La Hague in France provides a case study of problematic waste management. In 2000, Greenpeace argued that the facility dumped "over one million litres of liquid radioactive waste per day is dumped into the ocean". On the safety front, French journalist Geoffrey Le Guilcher considered the toxic waste storage situation at the site to be so problematic it served as inspiration for a science-fiction novel, where a terrorist attack on the site threatens all of Europe.

While there are some solutions for low and medium-level radioactive waste storage, near-surface disposal is only viable for low-level waste. For more problematic, long-lives waste, advanced storage sites hidden up to 5,000 metres deep underground are the rule. However, the sites have to be specifically built. Although repurposing abandoned mines can help to address the least toxic nuclear waste, they are not enough for the most problematic types of nuclear waste. The only site in the world capable of handling the most high-level waste will be the Posiva Oy facility in Finland, scheduled to become operational in 2025.

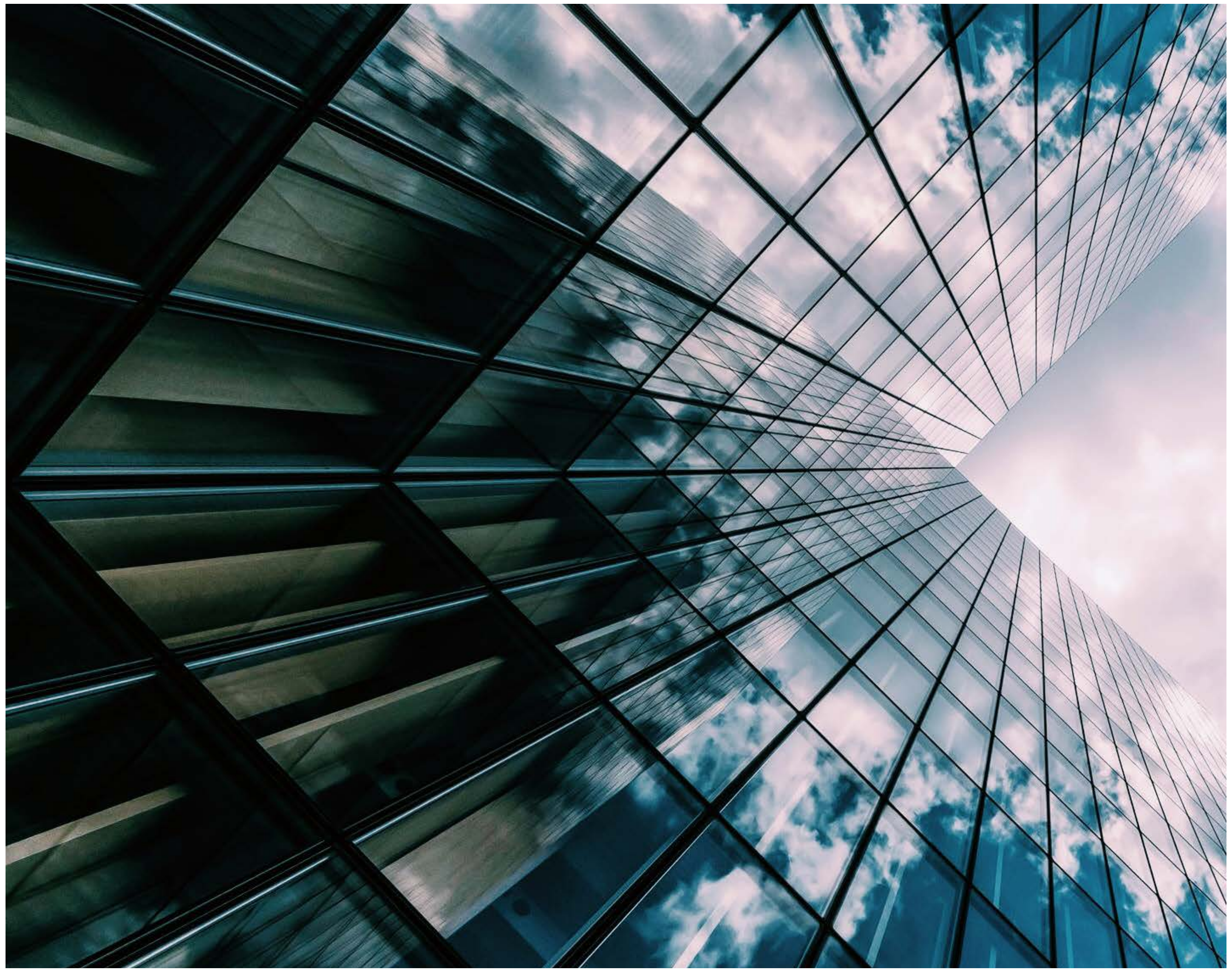
The Japanese Angle

Ironically, Japan itself seems on the verge of embracing nuclear power once more. In the aftermath of a particularly cold winter accompanied by a shortage of liquified natural gas, which led Japanese energy prices to sky-rocket, energy minister Hiroshi Kajiyama re-emphasised Japan's need to return to nuclear energy if it is to achieve carbon neutrality by 2050.

Kajiyama's comments on nuclear energy echo those made by his boss, Prime Minister Yoshihide Suga during his inaugural address to the Japanese parliament at the end of October 2020. On that occasion, Suga announced the establishment of "a stable energy supply by thoroughly conserving energy, introducing renewable energy to the maximum extent, and advancing nuclear energy policies with safety as our top priority."

Should Japan continue on this policy path, it could provide a very appealing alternative to the EU's take on nuclear energy. If it develops a framework that competes with the EU taxonomy or the bloc's green bond standard, Japan could give its nuclear energy companies a funding advantage over Nordic competitors such as Vattenfall (Sweden) and Fenovoima and TVO (Finland) whose hands are tied.

Could the EU's exclusion of nuclear energy become the fuel for the nuclear awakening of sustainable finance in Japan?



Credit: fje for Twenty20

EU Real Estate

Too Diverse for Taxonomy

by Filipe Albuquerque

According to the Climate Bonds Initiative, borrowers in the global real estate market issued 318 green bonds worth US$157 billion between 2014 and 2020, a non-trivial share of the total US$1.2 trillion in cumulative sustainable bonds issued by the end of last year. The volume of this market makes it an essential source of assets for investors in sustainable bonds. The issue is also crucial in the Nordics, where real estate issuance in Swedish Krona is one of the dominant sources of primary market flow.

As was the case in other industries, the real estate market and its investors met the November 2020 draft delegated act (DA) with resistance. In this case, the concern is not necessarily that the DA goes too far, but that it appears to assume a homogeneity of practices that does not exist while also creating incentives against renovations.

Problems with the Draft DA

The technical screening criterion that most irked market participants referred to the "Ownership and acquisition of buildings". According to the draft DA, the Taxonomy classifies this activity is under NACE code L68 and the technical screening criteria specifically split the treatment of the asset by year of construction. To qualify as a green economic activity, buildings built before 31 December 2020 must have "at least Energy Performance Certificate (EPC) class A."

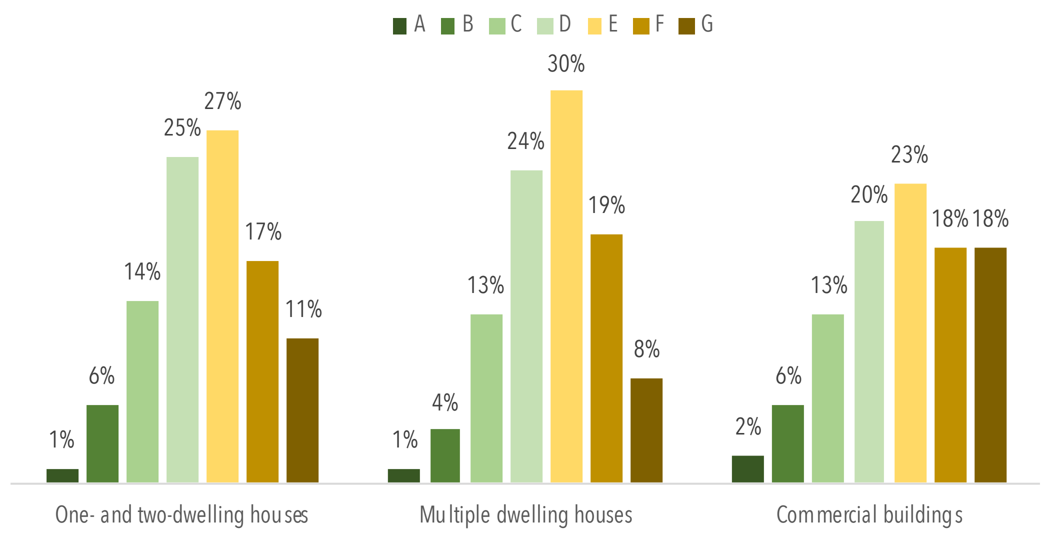
According to the European Fund and Asset Management Association (EFAMA), "the proposed threshold would be counterproductive to the renewal of EU´s building stock by limiting the issuance of Taxonomy aligned green bond volumes by banks and the real estate sector." According to EFAMA, there is too much heterogeneity in EPC implementation across Europe. "We see the EPC Class A certification, at its current state of national implementation, as an inappropriate proxy for identifying the substantial contribution of a building to climate change mitigation. For example, in the Nordics, only very few buildings have a certificate class A or higher (in Finland only 1% of buildings have energy class A and in Denmark, this criterion would reduce the number of eligible buildings by 40%), whereas in other countries the proportion of eligible building stock can be tenfold." Data from Sweden's Real estate and Bank Associations1 suggest the Scandinavian country is similar to its neighbour.

In its response, the Swedish government agreed with EFAMA, arguing that using a "reference to EPC is unfortunate: not all MS apply EPCs, and those MS that do, define EPCs in different ways. The rationale behind the preceding TEG proposal (that COM now has deviated from), i.e. to refer to the top 15% most efficient among local building stock, was to ensure an accurate and fair comparison between MS with a clear calculation basis compared to using the EPCs

For buildings constructed after 2020, the technical screening criteria require the energy performance of the building resulting from the construction, to be "at least 20 % lower than the threshold set for the nearly zero-energy building (NZEB) requirements". EFAMA argues that "the requirement to undercut the national Net-Zero Energy Buildings (NZEB) threshold by 20% [for post-2020 buildings] is in the view of our members too ambitious, given that the development of such buildings would become economically unviable."

"The 20% Primary Energy Demand (PED) reduction could be particularly detrimental to the covered bond and green mortgage bond markets in countries with stricter levels of Energy Performance of Buildings Directive (EPBD). We are concerned that in many instances, renovation of existing buildings which would lead to a reduction of PED by at least 30% may not be technically feasible, nor economically viable," EFAMA added.

Shares of Real Estate Stock by Energy Performance



Source: Fastighetsägarna och Svenska Bankföreningen

"We see a significant risk that investment capital will move away from Sweden and to the countries that set a different limit."

Regarding the renovation of existing buildings, the draft DA's technical screening criteria require the building's renovation to "lead to a reduction of primary energy demand (PED) of at least 30%". Noting that the proposed criteria for existing buildings are more demanding than those for new buildings, the Swedish Government also warns that the rules would "discourages investment in existing buildings, in favour of building new ones where the requirements are lower". This consideration is important in light of the construction process and the direct and indirect forms of pollution generated before energy consumption.

Solutions

The technical screening criteria differ from those initially proposed by the TEG. Indeed the original proposal recognised "energy- and resource-efficient and low-GHG emission buildings as eligible under the mitigation criteria, considering as a minimum benchmark the top performing 15% of the stock as representative of the best level of energy and resource efficiency that can be achieved in a local context."

The TEG also envisioned a more progressive regime with a "transitional period" from the Taxonomy's implementation until 2050, the deadline for the EU to become emissions neutral. "To reflect the level of ambition for the Taxonomy, this percentage will subsequently be tightened to set the sector on a net-zero carbon trajectory by 2050. In practice, this means that during the transitional period, meeting the eligibility criteria would be easier for some Member States. However, once absolute thresholds are identified through benchmarking the performance 365 of the top 15% of each national building stock, a more consistent level of ambition can be established across all Member States."

According to Sweden's Real estate and Bank Associations, the use of EPC Class thresholds "is a sudden, significant and unfounded change from what the Technical Expert Group (TEG) proposed, where the criteria were proposed to be that the buildings would belong to the top 15% within the existing local stock in terms of energy performance. The TEG proposed, after careful consideration, that the criterion for existing buildings should be set at the top 15% of the local building stock, as this would ensure a correct and fair comparison with a clear calculation basis compared to using the energy declarations. In fact, most banks and real estate companies already use the more or less established 'top 15%' for issued green bond frameworks, and this has been accepted by investors. (...) We see a significant risk that investment capital will move away from Sweden and to the countries that set a different limit."

The Swedish Government proposed "that the criterion should be changed (back) to the TEG proposal, i.e.: For buildings built before 31 December 2020, the building has at least Energy Performance Certificate (EPC) class A energy performance that is within the top 15% most efficient among local building stock." EFAMA seconded this recommendation.

Nevertheless, EFAMA argues that "should EPC Class A requirement be retained, the European Commission must address the problems of divergence in terms of quality, credibility, and usefulness of EPCs across Member States. We see a need for more legislation and guidelines for the implementation of EPCs at national level, aiding the standardisation of national EPC systems. It would be also desirable to have a uniform basis and guidelines for issuing the EPCs, which should be publicly available in functional ECP databases in all Member States. Alternatively, to ensure that the criterion can be easily and directly applied, buildings with at least EPC Class B should be considered eligible."

about our partner

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 31 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's third-largest asset manager with US $3.47 trillion* under our care.

* This figure is presented as of December 31, 2020 and includes approximately $75.17 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

Expiration Date: 1/31/2022

Tracking: 2918035.8.1.GBL.RTL

Credit: Sarah Dorweiler for Unsplash

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

EU Sustainable Finance Regulation

Handbook Series
February 2021

GENERAL TERMS AND CONDITIONS

These are the terms and conditions which govern the use of NordSIP Insights, an online magazine edited and distributed electronically and owned, operated and provided by Big Green Tree Media AB (the "Editor"), Corporate Number: 559163-7011, Kungsgatan 8, 111 43 Stockholm, Sweden.

DISCLAIMERS AND LIMITATIONS OF LIABILITY

1. The Content may include inaccuracies or typographical errors. Despite taking care with regard to procurement and provision, the Editor shall not accept any liability for the correctness, completeness, or accuracy of the fund-related and economic information, share prices, indices, prices, messages, general market data, and other content of NordSIP Insights ("Content"). The Content is provided "as is" and the Editor does not accept any warranty for the Content.

2. The Content provided in NordSIP Insights may in some cases contain elements of advertising. The editor may have received some compensation for the articles. The Editor is not in any way liable for any inaccuracies or errors. The Content can in no way be seen as any investment advice or any other kind of recommendation.

3. Any and all information provided in NordSIP Insights is aimed for professional, sophisticated industry participants only and does not represent advice on investment or any other form of recommendation.

4. The Content that is provided and displayed is intended exclusively to inform any reader and does not represent advice on investment or any other form of recommendation.

5. The Editor is not liable for any damage, losses, or consequential damage that may arise from the use of the Content. This includes any loss in earnings (regardless of whether direct or indirect), reductions in goodwill or damage to corporate.

6. Whenever this Content contains advertisements including trademarks and logos, solely the mandator of such advertisements and not the Editor will be liable for this advertisements. The Editor refuses any kind of legal responsibility for such kind of Content.

YOUR USE OF CONTENT AND TRADE MARKS

1. All rights in and to the Content belong to the Editor and are protected by copyright, trademarks, and/or other intellectual property rights. The Editor may license third parties to use the Content at our sole discretion.

2. The eader may use the Content solely for his own personal use and benefit and not for resale or other transfer or disposition to any other person or entity. Any sale of Contents is expressly forbidden, unless with the prior, explicit consent of the Editor in writing.

3. Any duplication, transmission, distribution, data transfer, reproduction and publication is only permitted by

i. expressly mentioning Nordic Business Media AB as the sole copyright-holder of the Content and by

ii. referring to the Website www.nordsip.com as the source of the information provided that such duplication, transmission, distribution, data transfer, reproduction or publication does not modify or alter the relevant Content.

4. Subject to the limitations in Clause 2 and 3 above, the reader may retrieve and display Content on a computer screen, print individual pages on paper and store such pages in electronic form on disc.

5. If it is brought to the Editor's attention that the reader has sold, published, distributed, re-transmitted or otherwise provided access to Content to anyone against this general terms and conditions without the Editor's express prior written permission, the Editor will invoice the reader for copyright abuse damages per article/data unless the reader can show that he has not infringed any copyright, which will be payable immediately on receipt of the invoice. Such payment shall be without prejudice to any other rights and remedies which the Editor may have under these Terms or applicable laws.

MISCELLANEOUS

1. These conditions do not impair the statutory rights granted to the readers of the Content at all times as a consumer in the respective country of the reader and that cannot be altered or modified on a contractual basis.

2. All legal relations of the parties shall be subject to Swedish law, under the exclusion of the UN Convention of Contracts for the international sale of goods and the rules of conflicts of laws of international private law. Stockholm is hereby agreed as the place of performance and the exclusive court of jurisdiction, insofar as there is no compulsory court of jurisdiction.

3. Insofar as any individual provisions of these General Terms and Conditions contradict mandatory, statutory regulations or are invalid, the remaining provisions shall remain valid. Such provisions shall be replaced by valid and enforceable provisions that achieve the intended purpose as closely as possible. This shall also apply in the event of any loopholes.