



13 August 2021

Joint response by FIA and FIA EPTA to EC call for feedback on the Platform on Sustainable Finance's draft proposal for an extended taxonomy to support economic transition.

The Futures Industry Association (FIA) and the European Principal Traders Association (FIA EPTA) welcome the opportunity to respond to the European Commission (EC) call for feedback on the Platform on Sustainable Finance's draft proposal for an extended taxonomy to support economic transition.

The EU taxonomy for sustainable activities, also referred to as 'green taxonomy', that came into force in July 2020, was welcomed by FIA and FIA EPTA members. It illustrates the European Commission's commitment to take action and responsibility for the common goal to reach climate neutrality in 2050. The taxonomy regulation is also an important global standard setter for other taxonomy regulations, currently in the making across the world.

FIA and FIA EPTA members largely agree with the assessment by the Platform on Sustainable Finance and recognise the desire to further expand the Taxonomy regulation. That being said, FIA and FIA EPTA members believe it is too early to broaden the scope of the taxonomy too widely as the existing Taxonomy regulation has only just come into force and needs time to demonstrate its impact on the market. When the existing Taxonomy regulation has proved itself, it will be easier to assess how the Taxonomy regulation can be extended most effectively.

FIA and FIA EPTA members believe that companies need to be given time to adjust to the new regulation. Our members believe that policy should aim at encouraging market participants to contribute to a more sustainable environment instead of focusing on discouragement policies. A positive and encouraging approach would be more effective, and will likely produce similar or better results, without disrupting markets, by allowing for an appropriate transition to more sustainable activities. If investment in or financing of potentially harmful activities were discouraged as such, companies that have assets that are not yet, or are perceived not to be, in line with environmental objectives (e.g. coal-fired power plants) will find it very difficult to obtain financing for their commercial groups. Finance is required for their day-to-day operations, but also to adapt their business and transition to a more sustainable business model. Also, companies may have already begun the transition, but the economy relies on a certain product output that perhaps is not yet one hundred percent achievable through sustainable resources, therefore a transition period is required to develop sustainable technologies. As example, in June 2020, the UK stated that it was able to rely entirely on sustainable resources to produce power for a period of 2 months¹. While this is an encouraging development, it also shows that we are not yet in a position to be able to rely solely on renewable sources in order to provide end-users with the standard and quality of life they are used to and thus discouraging

¹ <https://www.bbc.co.uk/news/science-environment-52973089>

or prohibiting investors from financing in current technologies may lead to severe market disruption and a negative impact on end-users and the economy as a whole. If the Taxonomy is extended as proposed, it is the view of FIA and FIA EPTA members that companies could be labelled as 'brown' too soon, which will harm their ability to change and they will lose the opportunity to attract investment to make a transition as asset holders who are looking to green their portfolios will delist companies that are not 'green'.

FIA and FIA EPTA members also believe that before the Taxonomy regulation is extended other parts of the financial markets infrastructure should be further developed. This will positively impact the market as a whole and it will make sure that all parts of the financial infrastructure contribute and diminishes the possibility of a skewed transition.

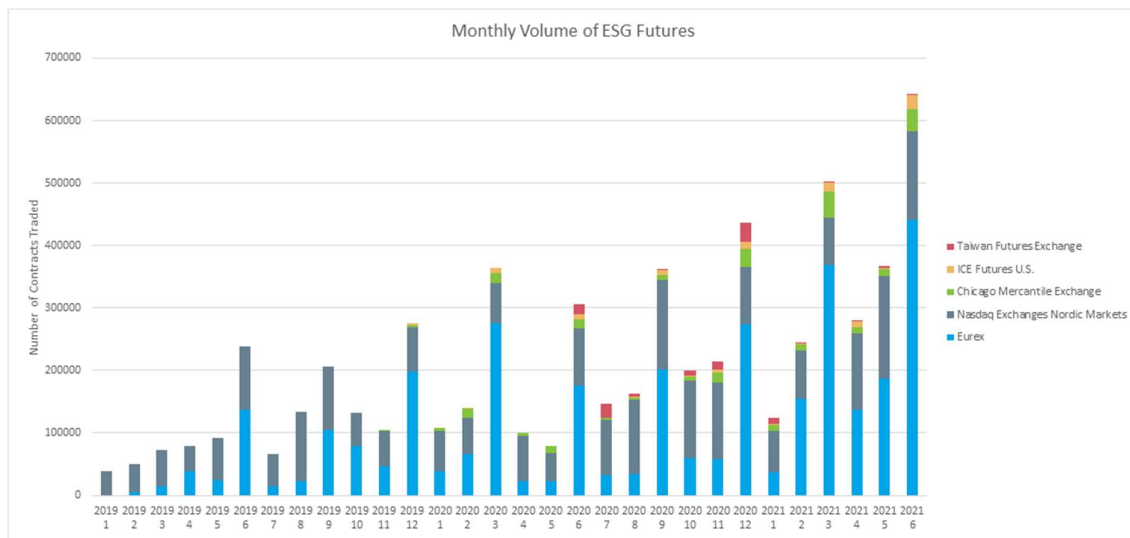
While the focus of the taxonomy regulation is mostly on primary markets, it is the belief FIA and FIA EPTA members that secondary markets are another important part for the success of the green transition, in particular, to enable asset holders to effectively manage their fiduciary duty in regard to their sustainable holdings (e.g. to buy or sell ESG products on behalf of end-investors, insurance holders, or pension participants) and to enable sound financial risk management for these end-investors.

In addition to capital market infrastructures, we note that derivatives exchanges increasingly engage in sustainable finance to address the increased demand in sustainable products from an exchange traded derivatives point of view. Collaboration among benchmark providers, and market participants, has resulted in successfully introducing sustainable derivatives products. Derivatives exchanges are playing an important role in developing exchange traded derivatives contracts to support sell- and buy-side firms with additional tools to implement sustainability-driven mandates and complement their efforts on the capital allocation angle, with ESG instruments in the risk transfer markets as well. The derivatives have a clear potential to optimise allocation of capital to support or complement investment into sustainable projects and activities and represent a flexible solution to attend the demand from investors towards new sustainable investment strategies, but also at the same time manage undesired sustainability risks, trade longer-dated maturities, align their ESG investment mandates and to manage the granularity of the client's risk exposure while reducing trading costs.

To support this, a mature and healthy secondary markets ecosystem of exchange-traded derivatives and ETFs, based on underlying assets, is in the process but needs time to be developed alongside the primary and secondary market for sustainable shares and bonds. This will foster a liquid market for sustainable investment and risk management which is needed to ensure that Sustainable Finance is fully embedded into the mainstream of the financial markets ecosystem.

Markets will innovate towards this demand for sustainable alternatives with adapted risk-managing products. The financial policy framework should use this momentum to ensure markets can adjust efficiently. They have already begun a transition to more sustainable products with the various exchanges having listed sustainable contracts in parallel or in addition to traditional contracts. However, there is room for more products and innovations. Markets react to supply and demand from investors and market participants, who have recently been much more focused on sustainable products.

Several major exchanges in Europe, North America and Asia have begun developing these products. Since late 2018, when Nasdaq introduced the first ESG equity index futures contract on its Nordic exchange, the volume of trading in ESG futures has grown steadily. In June 2021, trading in these products set a record of more than 640,000, more than double the amount traded in June 2020. Currently there are several dozen ESG futures listed on at least eight exchanges. Eurex is currently the largest market for ESG futures, with more than 3 million ESG futures traded on its exchange since it launched its first contract in February 2019. These contracts tend to be used by institutional investors that are pursuing ESG investment strategies. Much like conventional equity index futures, these contracts provide an efficient way for portfolio managers to adjust their exposure to an ESG index and benefit from the liquidity that centralized markets can provide. In June 2021, this innovation was extended to the fixed income markets through the launch by Eurex of futures on two ESG bond indices.



Our members are committed to support the shift towards more sustainable products. FIA EPTA members have the ability to support buy-side participants with the migration towards a green investment portfolio. To achieve the green transition, financial participants including asset managers, pension funds, and hedge-funds will want to significantly reduce or completely close their holdings in products that, over time, will be deemed “brown”. As FIA EPTA members are an important source of liquidity they can play a vital role in this evolution, making sure there is still a market to sell these products while facilitating a smooth transition towards “green” products.

Before the taxonomy regulation is expanded, FIA and FIA EPTA members believe that the quality of available ESG data should be improved and harmonised. FIA and FIA EPTA members observe a large variety of ESG ratings in the market and would like to express their concerns on the comparability of the data. More standardisation is needed, there is an average correlation of .61 [‘Aggregate confusion: the divergence of ESG ratings’, Berg, Koelbel and Rigobon, 2019]). We also refer to the current IOSCO consultation on ESG ratings², which aims at assisting IOSCO members in understanding the implications of the activities of ESG ratings and data providers and in establishing frameworks to mitigate risks stemming from these activities.

² <https://www.iosco.org/news/pdf/IOSCONEWS613.pdf>

This is mainly because of measurement divergence, meaning that agencies ‘measuring the same attribute using different indicators. Next to measurement divergence, weight, scope, and aggregation of indicators play a role in the lack of correlation between the different ESG ratings. This makes it difficult, if not impossible, to come up with truly meaningful and harmonised ESG ratings between the different rating agencies. FIA and FIA EPTA members would like to encourage more standardisation so that the comparability of these ratings increase.

We believe that incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient. The taxonomy, sustainable finance disclosure regulation, and climate benchmarks, all representing cornerstones of EU action, have only recently been adopted and now we need to observe how these frameworks work in practice, if there are gaps, and where synergies can be increased, before the scope of the taxonomy is expanded. Our members further believe that global coordination will be key to the success of any policies, not only to ensure a positive global impact on our climate, but also to avoid arbitrage opportunities or the industry moving away, thereby jeopardising the commitment of EU citizens and dislocating markets.

FIA and FIA EPTA are committed to supporting policymakers in ensuring the success of the sustainable finance project at all levels of the capital market ecosystem. We would welcome the opportunity to provide further background information to the European Commission on the issues raised in our letter.

About FIA EPTA:

FIA EPTA represents 30 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs.

Our members are independent market makers and providers of liquidity and risk transfer on trading venues and end-investors across Europe. Market making and liquidity provision (also referred to as principal trading or dealing on own account) is a distinct activity that is undertaken by non-systemic investment firms rather than banks, in a highly dispersed and varied ecosystem of independent Principal Trading Firms. These firms operate in an innovative and competitive fashion leading to a vibrant, dynamic and diverse ecosystem which massively reduces interconnectedness and increases substitutability. This fundamentally reduces systemic risk whilst improving market quality and lowering costs for retail and institutional investors alike.

About FIA:

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. <https://www.fia.org/>