Position

Implementation and application of the EU Sustainable Finance Framework

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Introduction

Our industry is committed to climate-neutral mobility in line with the Paris climate goals. It is crucial that European climate policy simultaneously becomes a driver of growth and prosperity and creates jobs. On the way to climate-neutral transport, our priority is electric mobility alongside other alternative drive systems. To this end, the German automotive industry is investing massively in the transformation of technology, products, production and its business models through research and development in particular. In doing so, we face the challenge of not only having to decarbonize products and production processes, but also to digitize them at the same time.

This transformation will only succeed if substantial private investments including from external capital sources (e.g. banks and capital markets) continue to flow into new products, production facilities, new grid infrastructures for renewable electricity, gas and, in the long term, hydrogen, as well as green energy generation plants and alternative fuels.

To ensure the financing of this transformation, the EU Taxonomy has to give the best support possible to the availability of private capital for companies. With the adoption of Regulation 2020/852 of 18.06.2020 ("Taxonomy Regulation"), the EU has given the starting signal for a series of delegated acts that will be adopted or implemented in the coming months, or which have already entered into force. The core of these measures are the legal acts to specify the environmental goals of the Taxonomy Regulation and the resulting requirements for sustainability reporting. Both will have a direct impact on the willingness of institutional investors to invest in the transformation of the transport sector.

Against this background, the VDA advocates the specific positions listed below:

1. Ensure the availability of financing for the transformation

Recently, due to a multitude of regulatory processes that seem to be not well coordinated, considerable concerns have been expressed, especially by institutional investors. There are apprehensions that the financing of the transformation through revenues from activities that are still emissions-relevant could be made more difficult. This could result in these investors withdrawing from economic sectors that are currently in the process of transforming their business models towards climate neutrality. From the automotive industry's point of view, it must be ensured that decarbonization can be implemented and financed as efficiently as possible. However, this is only possible if potential sources of financing do not dry up prematurely because confidence in the transformation is disrupted by regulatory measures. This would result in shutdowns or migration of these economic activities at all stages of the value chain.

Beyond the sustainable finance strategy of the German government (KfW programmes, Future Fund and federal guarantees), additional measures should be taken to finance the economy and the macroeconomic instruments that support the transformation. This includes the provision of subsidies or equity-like instruments.

To this end, the regulatory framework at German and European level should be designed accordingly. It is important to adopt an approach that promotes the transformation of economic activities, rather than penalizing those that are still in the process of evolving their businesses towards sustainability. This is of particular importance because companies in the automotive industry cannot usually switch to climate-neutral procedures, processes and plants in a single step. In our industry, transformation is happening in stages. This means that new, climate-friendly products and production facilities are introduced while existing plants and products continue to be operated and are continuously optimized with the best available technologies, sometimes with short term carbon reduction targets.

Electric vehicles will be able to play the most significant role in reducing greenhouse gas emissions in the transport sector, as long as the electricity required for charging is generated from renewable sources. The ability of the automotive industry to invest in the decarbonization of production and products will have a decisive influence on the transformation of mobility. However, assigning overly narrow sector levels to activity-specific screening criteria could cut companies off from the market for sustainable investments, hinder the transformation towards green mobility and violate of the underlying Taxonomy Regulation. Recital 45 of the Taxonomy Regulation 2020/852/EU rightly states that "criteria should not unfairly disadvantage certain economic activities compared to others if the former contribute to the environmental objectives to the same extent as the latter". The VDA therefore recommends that all economic activities within the meaning of No. 3.3 of the Delegated Taxonomy Act[1] of companies that enable the "production of low-emission/free[2] motor vehicles" can in principle be considered Taxonomy eligible. This is supported by the following reasons:

2. Consideration of contributions in the automotive value chain

An electric vehicle is more than four wheels on a battery with an electric motor. Rather, it is complex systems made up of software and many hardware parts that work together to deliver the final performance in terms of safety, comfort, ease of use, operating costs and emissions.

Therefore, there is a risk of distorting the market between producers of cars (OEM) and suppliers if a distinction is made between in-house manufacturing or vehicle assembly and component manufacturing by suppliers as the descriptions in Annex 1 (criteria for a significant contribution to climate protection) of the Delegated Act to the Taxonomy Regulation may result in auditors treating identical activities differently depending on whether they are carried out by an OEM or a supplier. Therefore, as stated above, it is necessary to require that all economic activities of companies within the meaning of No. 3.3 of the Delegated Act can be considered Taxonomy eligible if they enable the "production of low-emission/free motor vehicles". Should such an interpretation of No. 3.3 not be supported, the production of and trade in automotive parts and components should be included as a separate economic activity.

Automotive suppliers are responsible for up to 75% of the investments and value creation related to electric vehicles. The implementation of the EU Taxonomy will only efficiently channel capital into the decarbonization of the transport sector if similar screening criteria are applied to similar activities of suppliers and vehicle manufacturers, allowing them to access the market for sustainable investments on equal terms. The activities of suppliers must therefore be covered by in No. 3.3.

3. Aim for international harmonisation

At the global level, it is important to work towards ensuring that newly developed reporting standards, such as taxonomies for sustainable economic activities, are harmonised internationally and defined in a way that is technology open.

This will ensure uniform implementation and create a level playing field that does not put European companies at a disadvantage. In particular with regard to the reporting obligations within the framework of the Taxonomy Regulation, there are currently still uncertainties regarding the interpretation. Each company has to interpret the requirements - in practice, together with the auditor - and there is uncertainty as to the extent to which the requirements are met.

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[1] Delegated Regulation (EU) 2021/2139 by EU-Commission of 4-6-21
[2] Del. Reg. 2021/2139, catgegory 3.3 letter f).

With regard to small and medium-sized enterprises, which are an important part of the automotive industry, it should also be ensured that they are not overburdened with documentation obligations.

4. Formulate realistic and feasible requirements (TSC's)

The design of the technical screening criteria (TSC's) for the environmental objectives defined in the Taxonomy Regulation should be ambitious but realistic and provide legal certainty and clarity. The degree of usefulness of the Taxonomy - also with regard to transformation financing - will essentially depend on the ambition levels of its requirements. The regulations[3] adopted in this context so far have rather created more uncertainty This is aggravated by the fact that the regulations were only passed shortly before the end of the first reporting year to which they apply.

This leaves hardly any time for companies to adequately examine how the new regulations are to be interpreted. The TSCs for the remaining four environmental goals, which are currently being discussed by the Platform on Sustainable Finance and the EU Commission, should provide for more legal certainty and should be adopted in time so that companies have time to prepare. Uniform descriptions of the economic activities, uniform DNSH criteria for the individual economic activities for each individual environmental goal, as well as complete and consistent data are imperative.

Application of the criteria and proof of compliance must be as simple as possible. It is important not to overburden companies. This applies above all where data requests are directed at small and medium-sized enterprises. In the case of large company group structures, it must be taken into account that a reporting obligation can often include several hundred subsidiaries. Here, materiality considerations should be recognized.

Best available techniques reference documents (BREFs)[4] are an important part of the European environmental regulatory framework. They refer to optimum technical solutions and their use is widely accepted. However, we disagree with the way BREFs are to be used under the Taxonomy Regulation. Requirements that all emission levels must be below the mean of the BAT-AEL ranges - i.e. remain below a very low threshold - should be significantly softened; they are basically a contradiction in terms, as BREFs already represent the best possible technologies.

5. Evaluate experiences with the current text before considering expanding it

The original aim of the Taxonomy was to provide markets, governments and other stakeholders with a tool to identify green investments. This objective will be achieved by the

[3] Delegated Regulation 2021/2139 of 4th June 2021 about technical criteria; Delegated Regulation 2021/2178 of 6th July 2021 about to disclose how and to what extent their activities are associated with environmentally sustainable economic activities according to Art. 8 Taxonomy Regulation.

[4] In the framework of the Industrial Emissions Directive or IED the European Commission is conducting an exchange of information with member states, Industry and NGOs. The results are numerous BAT-reference documents (BREFs are the abbreviation of best available techniques).

Green Taxonomy once the delegated acts have been adopted. We see no need to introduce an extension of the Taxonomy as proposed by the PSF in its July 2021 report[5].

The ability of the Green Taxonomy to support the transition could be improved by adjusting the technical screening criteria for transitional activities. These adjustments would maintain the positive character of the Green Taxonomy. Sticking to its original structure would also increase the chances of the Green Taxonomy being used as a template internationally, because this would limit its complexity and eliminate problems (e.g. exclusion list) that are politically difficult to solve.

In principle, however, the focus should be on the development of the Ecological Taxonomy before extensions to the EU Taxonomy are considered. Businesses should be given sufficient time to implement the existing Taxonomy.

6. Benefits and costs of Social Taxonomy should be thoroughly evaluated

The introduction of the reporting obligations on the environmental objectives of the Taxonomy Regulation from the reporting year 2021 onwards will lead to considerable additional burdens for companies (in terms of personnel and IT). Against this background, we welcome the EU Commission's decision to postpone a discussion on rules for a "Social Taxonomy" for the time being. Before further obligations are introduced, companies must first be given the opportunity to adapt their reporting to the regulations that have just been adopted in order to avoid an overload that, in case of doubt, would have a counterproductive effect on the entire "Sustainable Finance" initiative.

With regard to a future discussion on the inclusion of social factors, the additional burden on companies should be limited as much as possible - regardless of which instrument the EU Commission decides on.

A specific Social Taxonomy, as proposed by the PSF in its draft report published in July 6th, would entail various problems. As the draft report shows, the development of criteria for social issues is very complex because it has to take into account a multitude of national and business specificities. Furthermore, the number of targets and sub-targets is too high. The introduction of two different dimensions would further increase the complexity. We reject the idea that the definition of socially sustainable enterprises is limited to those that provide “additional” social benefits. Finally, the definition of social criteria cannot be based on scientific evidence, as is the case with the green Taxonomy. Instead, there is an inherent danger that social KPIs would be defined according to specific political preferences.

[5] Report of PSF about “Taxonomy extension options linked to environmental objectives”, July 2021

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