

Position

EU Sustainable Finance Framework

Sustainable Transformation of Industry



#weareready

Berlin, May 2022

Introduction

Our goal is climate-neutral mobility in line with the Paris climate goals. It is crucial that European climate policy both becomes an engine of growth and prosperity and creates jobs. On the way to climate-neutral mobility, electromobility has priority among other alternative incentives. To this end, the German automotive industry is investing heavily in the transformation of its business model through research, development and production. We are faced with the challenge of not only decarbonising our products and production processes, but also digitising them at the same time.

The transformation will only be possible with very high private investments involving external investors (banks/capital markets). In particular, these investments will include new production facilities, new grid infrastructures for electricity, gas and long term hydrogen, as well as green power generation facilities and alternative fuels.

In order to ensure the financing of this transformation, the implementation and application of the so-called EU taxonomy is of great importance. With the passing of Regulation 2020/852 of 18.06.2020 ("Taxonomy Regulation"), the EU has launched a series of delegated legislative acts that will be adopted or implemented in the coming months, or that have already partially entered into force. The legislative acts form the core of these measures, to specify the environmental objectives of the Taxonomy Regulation and the resulting sustainability reporting requirements. Both will have a direct impact on the willingness of institutional investors to invest.

Against this background, the VDA represents the following specific positions:

1. Ensure financing of the transformation

Recently, a large number of regulatory processes that have not been well coordinated with one another have also raised considerable concerns, in particular on the part of institutional investors, that the financing of the transformation, in particular, could be made more difficult in regulatory terms by revenues from activities that have to date been relevant to emissions. This could lead to these investors withdrawing from economic sectors that are currently in the process of transforming their business models towards climate neutrality. From the point of view of the automotive industry, it must be ensured that decarbonisation can be implemented and financed as efficiently as possible. However, this is only possible if potential sources of financing (banks/capital markets) do not dry up at an early stage, because confidence in the transformation is disturbed by regulatory measures. On the contrary, this would lead to the closure or emigration of these economic activities at all stages of value creation.

In addition to the Federal Government's Sustainable Finance Strategy (KfW Programmes, Future Funds and Federal Guarantees), additional measures should be taken to finance the economy in support of change (including the provision of subsidies or equity-like instruments) and the necessary structural policy instruments. To this end, the regulatory framework at the German and European levels must be designed accordingly.

In doing so it is important to adopt an approach that promotes the transformation of economic activities towards environmental sustainability, rather than penalising those that are still in a process of transformation towards sustainability. This is of particular importance, since companies in the automotive industry are generally not able to switch to climate-neutral procedures, processes and plants on an ad hoc basis; instead, the transformation happens in stages, sometimes with short-term neutrality targets. This means that new plants and products are developed and created, and at the same time existing plants and products must continue to be partially operated and continuously kept up to date with the best available techniques.

Electric vehicles will play an essential role in reducing greenhouse gas emissions in the transport sector, provided that the electricity required for charging is also generated in a renewable or sustainable manner. The ability of the automotive industry to invest in the further decarbonisation of mobility will have a decisive impact on the necessary transformation of mobility. However, an arbitrary allocation of sector levels to activity-specific screening criteria could cut companies off from the sustainable investment market, hamper the transition to green mobility and violate the underlying taxonomy regulation. Preliminary remark 45 of the Taxonomy Regulation rightly states that "criteria should not unfairly disadvantage certain economic activities over 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 category 3.3 of the delegated taxonomy act¹ of companies that enable the "production of low-emission/zero-emission² vehicles" can in principle be regarded as taxonomically viable.

¹ Commission Delegated Regulation (EU) 2021/2139 of 4.6.21

² loc. cit.; category 3.3 (f).

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 consisting of software and many hardware parts that work together to deliver the final performance in terms of safety, convenience, ease of use, operating costs and emissions. The taxonomy viability of suppliers of low-emission vehicles has also not been sufficiently clarified by the Commission's recently published FAQs.³

Therefore, there is a risk of further distortion caused by the implementation of the EU taxonomy if a distinction is made between own production or vehicle assembly and component production by suppliers. Unfortunately, the descriptions in Annex 1 (Criteria for a significant contribution to climate protection) of the delegated act on the Taxonomy Regulation may lead to auditors distinguishing between vehicle assembly (OEM) and component manufacturing (supplier). It is therefore necessary, as stated above, to require that all economic activities of businesses within the meaning of category 3.3 of the delegated act which enable the "production of low-emission/zero-emission motor vehicles" can in principle be considered taxonomically viable. If an appropriate economic interpretation of category 3.3 is not supported in this way, the production of and trade in automotive parts should be included as a separate economic activity.

The FAQs also confirm once again⁴ that products in a value chain could not automatically take on the classification of the end product as taxonomically viable, for example in the case of motor vehicles. Rather, the parts and components would have to fall under the specific categories of 3.2 and 3.4 (batteries and hydrogen) or under 3.6. Even if the FAQs define category 3.6 as broad and explicitly subsume "tyres and semiconductors", this does not cover the diversity of supply for low-emission vehicles.

Automotive suppliers are responsible for up to 75% of the investments and added value related to electric vehicles. The implementation of the EU taxonomy will only efficiently direct capital towards the decarbonisation of the transport sector if suppliers are subject to screening criteria similar to those applied to vehicle manufacturers, thus enabling them to access the sustainable investment market on equal terms. The activities of subcontractors must therefore also be covered by category 3.3.

3. Uniform interpretation of the legal basis and comparability of the parameters

Particularly with regard to the reporting obligations under the Taxonomy Regulation, there are currently still uncertainties regarding the interpretation. Here, as before, each company must make its own interpretation of the requirements – in practice usually together with the auditor – and there is uncertainty as to the extent to which the requirements are met. As a result, comparability of the reported parameters is no longer possible due to the different interpretations of the underlying legal text. Divergences between companies thus arise from the interpretation of the legal foundations, but not from differences in sustainability ambitions.

³ Draft Commission notice on the interpretation of certain legal provisions of the Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of eligible economic activities and assets, 22 February 2022.

⁴ loc. cit., p. 9f.

From the point of view of the VDA, a uniform interpretation of the Taxonomy Regulation and the associated Delegated Regulations is essential in order to achieve comparability of the reported key figures and to prevent reputational risks on the part of the creators.

With regard to small and medium-sized enterprises that are also represented in the automotive industry, efforts should be made that these are not overwhelmed by documentation requirements.

4. Formulate realistic and feasible requirements (e.g. TSCs and DNSH)

The design of the technical screening criteria (TSCs) for the environmental objectives defined in the Taxonomy Regulation should be ambitious but realistic and ensure legal certainty and clarity. Requirements regarding “Do no significant harm” (DNSH) should have no room for interpretation and should be equated with the fulfilment of (possibly local) legal requirements. In addition, DNSH requirements for all economic activities related to the automotive industry/OEMs should be uniform (e.g. requirements for efficiency of tyres not required for EA 3.3., but required for EA 6.5.). 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 adopted so far in this context have led to uncertainty for many companies instead of more clarity and certainty. On the one hand this is due to the sometimes indeterminate wording of the rules, which must now be interpreted jointly with the respective cooperating auditors. On the other hand the regulations⁵ were only adopted 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. It would therefore be welcome if the development of the TSCs for the remaining four environmental objectives, which is currently being discussed by the Platform on Sustainable Finance and the EU Commission, leads to clearer results and is adopted in good time so that the affected and committed companies can adapt to their application. Uniform descriptions of the economic activities, uniform DNSH criteria for the individual economic activities for each individual environmental objective, which clearly relate to the fulfilment of (possibly local) legal requirements, as well as complete and consistent data, are absolutely necessary.

It must be possible to apply the criteria and demonstrate compliance with them in the simplest possible way and with reasonable effort (see Compliance with legal requirements). It is important not to overwhelm the companies in fulfilling the disclosure obligations in connection with the Taxonomy Regulation. This applies in particular to cases where data requests are addressed to small and medium-sized enterprises. In the case of large group structures, it must be taken into account that a reporting obligation can often include several hundred subsidiaries. Here, materiality considerations should be recognised as a legitimate part of the reporting.

⁵ Commission Delegated Regulation 2021/2139 of 4 June 2021 on technical criteria for the environmental objectives of climate protection and adaptation to climate change; Commission Delegated Regulation 2021/2178 of 6 July 2021 specifying the content, presentation and methodology of the disclosure obligations pursuant to Article 8 of the Taxonomy Regulation

Reference documents for best available techniques (BREFs)⁶ are an important part of the European environmental regulatory framework. They refer to technical solutions which offer their advantages and whose use is widely accepted. However, we do not agree with the way in which BREFs are to be used within the framework of the Taxonomy Regulation. Requirements that plan for all emission levels to be below the mean value of the BAT-AEL ranges, i. e. below a very low threshold, should be significantly softened; they are basically a contradiction in themselves, as BREFs are already the best possible technologies.

5. Extensive exclusions of materials – Contradictions to the EU REACH Regulation

The automotive industry – manufacturers and suppliers – also uses materials/substances that are subject to legal supervision for their automotive products, in particular the EU REACH Regulation of 2006, which provides for the registration, evaluation, authorisation and restriction of chemicals. The aim of the REACH Regulation is to ensure a high level of protection for people and the environment against unintended exposure to chemical substances. The REACH Regulation does not aim for a blanket substance ban, but rather the registration and supervision of certain materials.

Following the Taxonomy Regulation of 2020, the European Commission issued a delegated act, namely Regulation 2021/2139 of 4.6.21 on the technical criteria for the environmental objectives of climate change protection and adaptation to climate change. Annex C contains requirements regarding substance bans, of which sections f) and g) are not reasonable.

The delegated regulation is in force and has been valid since 1.1.22. In order to prove that a vehicle as well as its components and parts do not constitute significant damage to the environment (DNSH), substance restrictions must be observed in the topic block “Prevention and reduction of environmental pollution”.

However, the restrictions proposed in Annex C (f) and (g) are so far-reaching, not even justified, and undermine the existing and established approach of the REACH Regulation.

The substance restrictions referred to in point (f) include all substances included in the candidate list in accordance with the procedure laid down in Article 59(1) of the REACH Regulation. The inclusion of a substance in the candidate list takes place on the basis of the classification of the substance in one of the hazard classes listed in Article 57 of the REACH Regulation and a dossier according to Annex XV that justifies the inclusion. Whether and which risk management measure (authorisation, restriction or limit value) is appropriate for the substance is only determined below.

Both substance restrictions are based only on the consideration of the inherent hazard of the substance and not on the risk associated with the substance. However, in order to be able to assess the risk, the use of the substance must always be taken into account. A substance can be dangerous, but its use (e. g. encapsulated in a built-in part) does not pose a risk.

⁶ Under the Industrial Emissions Directive (IED), the European Commission organises an exchange of information with Member States, industry associations and environmental organisations. The result is the extensive BREFs (BAT reference documents; BAT is the abbreviation for “best available techniques”) and the summarised BAT conclusions derived therefrom and adopted in the Art. 75 Committee.

A restriction of the substance is then only justified if its use involves a corresponding risk to people or the environment. For the risk management measures defined in the REACH Regulation, this consideration is carried out and the appropriate measure is applied. This should also become the basis of the Taxonomy Regulation.

On the other hand, the criteria a) to e) of Annex C are acceptable and implementable.

From the VDAs point of view, points (f) and (g) should be deleted without replacement, since substance restrictions should not be based on the hazardousness of the substance, but on the regulatory approach of the REACH Regulation and thus on its risk during use. The EU Taxonomy Regulation and EU-REACH Regulation should adopt a uniform approach, especially in the area of substance use policy.

6. Postpone extension of green taxonomy – evaluate experiences with the current text

The original objective 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 green taxonomy as soon as the concrete legal acts have been passed. We see no need to introduce an extension of the taxonomy, as proposed by the PSF in its report published in March 2022⁷.

The ability of the green taxonomy to support the transition could be improved by adapting the technical screening criteria for transition activities. These adjustments would preserve the positive character of the green taxonomy without fear of negative side effects. In addition, it should be noted that adherence to its original structure would also increase the chances of the green taxonomy being used internationally as a template, as this would limit its complexity and eliminate problems (e.g. exclusion list) that, politically, are difficult to solve.

Essentially, the focus should be on the full development and implementation of the ecological taxonomy before considering extensions to the EU taxonomy. The creators should also be given sufficient time to implement the existing taxonomy.

7. Postpone Social Taxonomy

The introduction of the obligation to report on the environmental objectives of the Taxonomy Regulation from the reporting year 2021 leads to considerable effort (in terms of both personnel and IT) for the companies obliged to do so. With that in mind, we would welcome the EU Commission's decision to postpone a discussion on rules for a "social taxonomy" for the time being. Before introducing further obligations, companies must first be given the opportunity to adapt their reporting to the rules that have just been adopted in order to avoid overload.

With a view to a future discussion on the inclusion of social factors, the additional burden on businesses should be limited as much as possible, regardless of which instrument the European Commission chooses.

⁷ PSF report on "Taxonomy extension options supporting a sustainable transition", March 2022

A social taxonomy, as proposed by the PSF in its final report published in February 2022,⁸ is not the right way forward. As the report shows, the development of criteria for social issues is very complex because it has to take into account a variety of national and business peculiarities. In addition, the lack of measurability, evidence and evaluation of social dimensions constitutes a major difficulty — the reason why there are only minimum social standards that should be met. The introduction of three different dimensions would further increase the complexity.

Finally, the definition of social criteria cannot be based on scientific evidence and correlations, as is the case with green taxonomy. Instead, there is an inherent risk that social KPIs will be defined according to political views.

⁸ Final Report of PSF Subgroup 4 “Social Taxonomy”, February 2022

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