



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Sir William Cash MP
Chair
European Scrutiny Committee
House of Commons
London
SW1A 0AA

Dear Bill,

3rd October 2018

9348/18 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

9355/18 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the establishment of a framework to facilitate sustainable investment

9357/18 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

Thank you for your report dated 18 July regarding scrutiny of the proposals the European Commission have published in relation to the Sustainable Finance Action Plan. This follows our Explanatory Memoranda sent in June and July concerning the proposals for 'Establishment of a framework for sustainable investment' (taxonomy), 'Disclosures relating to sustainable investments and sustainable risks' (disclosures), and 'Low carbon benchmarks and positive carbon impact benchmarks' (benchmarks). The Government notes the Committee's assessment of these files, and that the files remain under scrutiny.

The Committee asked for clarity on a number of issues surrounding these proposals.

Concerning the obligations the taxonomy would impose on market participants, you rightly identified in your report that market participants will not be restricted in what type of investments they can make, rather those participants offering financial products labelled as environmentally sustainable will need to disclose "how and to what extent the criteria for environmentally sustainable economic activities are used to determine the environmental sustainability of the

investments selected”¹. We understand the intention is that the taxonomy will help define what is meant by an environmentally sustainable investment. This definition will then also be used in the disclosures proposal. However, it is not yet clear how the taxonomy will be linked to the benchmarks proposal. Although the Commission has identified that the scope of the taxonomy proposals is narrow, they have noted that, in time, financial institutions could be “incentivised” to use the taxonomy. The Commission has not been clear however, as to how this would be done.

On the matter of whether there are any UK regulatory initiatives which would be impacted by the taxonomy, we are not currently aware of any regulatory projects – existing or planned – by the FCA or Bank of England that would be impacted by the taxonomy. The Government is currently in the process of drafting a response to the Green Finance Taskforce report, which will include a range of new initiatives in Green Finance, and further analysis will be needed to identify which, if any, of those initiatives could be affected by the proposal.

In relation to the Committee’s question concerning the views of other Member States on issuing disclosure requirements as guidance rather than by means of a Regulation, this has not been raised by members in Council meetings to date. Similar to the UK, other Member States have been broadly welcoming of the proposals but maintain a scrutiny reservation. We are supportive of the aims of improving Environmental, Social and Governance (ESG) disclosures for investors and are not opposed to a new Regulation if that is the best method through which we can achieve best practice across industry for the benefit of investors. We will continue to engage with other Member States in upcoming Council Working Groups and work with them to influence the proposals so that they create workable requirements for firms which lead to meaningful disclosures.

It is possible that ESG disclosure requirements could affect the regulatory baseline against which the European Commission makes its equivalence assessments of third countries under the Alternative Investment Fund Managers Directive (AIFMD) and the Markets in Financial Instruments Regulation (MiFIR). Such decisions are for the Commission to make, and we are not able to comment on the exact approach the Commission may take to the criteria used to determine if a third country is equivalent under AIFMD or MiFIR. Furthermore, it is still to be agreed whether or not the UK will fall under the existing equivalence regimes following its departure from the EU. As laid out in the recent White Paper on Brexit, we are confident of our ability to negotiate a bilateral future economic and regulatory arrangement in financial services that goes beyond the

¹ As per section 6.1.3 (II) of the impact assessment accompanying the proposals

current equivalence regimes, whilst respecting the autonomy of the UK and EU's legislative process.

The Government is content to support the current draft Delegated Regulations published in parallel to the above proposals, requiring amendments to the Insurance Distribution Directive and MiFID II. These amendments require investment firms and insurance distributors to, when relevant, proactively ask investors about their ESG preferences, and take them into consideration when recommending suitable investment products. We note that these amendments have not yet been finalised and adopted, and therefore the drafts may be subject to change.

I am copying this letter to Lord Boswell of Aynho, Chair of the House of Lords European Union Committee; Philip Aylett, Clerk to the Commons Committee; Chris Johnson, Clerk to the Lords Committee; Les Saunders, Department for Exiting the EU; and Barbara Armstrong and Daniel Jones, HM Treasury.

with very best regards

John

JOHN GLEN