23 June 2022

By email and online submission

ASIFMA and ISDA Response to Green Finance Industry Taskforce's Consultation Paper on Development of a Taxonomy for Singapore-based Financial Institutions

Dear Sir / Madam,

The Asia Securities Industry & Financial Markets Association ("**ASIFMA**")[1] and the International Swaps and Derivatives Association, Inc. ("**ISDA**")[2] (together, the "**Associations**"), on behalf of their members welcome the opportunity to respond to the second Green Finance Industry Taskforce ("**GFIT**") consultation paper on "Identifying a Green Taxonomy and relevant Standards for Singapore and ASEAN" ("**Consultation Paper**"). We refer to our views from the last submission dated 11 March 2021 on the first consultation paper on the GFIT Taxonomy.

The Associations welcome the development of a taxonomy in this region and appreciate that the proposed GFIT Taxonomy could be an important step in helping to mobilise capital towards environmentally sustainable activities and in developing a sustainable financial sector, not only in Singapore and ASEAN, but also more broadly in the Asia-Pacific region. The Associations urge the Monetary Authority of Singapore ("**MAS**") and other Singapore officials to coordinate directly and through international platforms with other key jurisdictions in Asia Pacific and beyond to promote interoperability of taxonomies as soon as possible, recognising the international nature of markets, flows of funds, and that global operation of financial institutions which is key to facilitating the development of sustainable finance on the scale required to address sustainability. Once an elevated level of interoperability is achieved, it will be easier for jurisdictions to start the journey toward harmonisation.

ASIFMA believes that alignment with international taxonomy standards is essential for encouraging the adoption and utilisation of the GFIT Taxonomy across ASEAN jurisdictions. International coordination and references to international best practices in taxonomy development are key to ensuring successful and effective regional and national taxonomy development in an international capital markets context.

[1] ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the Global Financial Markets Association ("GFMA") alliance with the Securities Industry and Financial Markets Association ("SIFMA") in the United States and the Association for Financial Markets in Europe ("AFME") , ASIFMA also provides insights on global best practices and standards to benefit the region.

[2] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

Our response has been drafted with the support of our professional firm member Ernst & Young, based on feedback from the wider ASIFMA and ISDA membership. On the following enclosed pages, we provide specific responses to questions posed within the Consultation Paper. We thank GFIT for the opportunity to provide feedback and for considering our comments and would be happy to meet with MAS and GFIT to further discuss any of the issues raised and provide clarity on our response. Should you have any questions, please do not hesitate to contact me Diana Parusheva (dparusheva@asifma.org), Head of Public Policy and Sustainable Finance at ASIFMA or Benoit Gourisse (bgourisse@isda.org), Head of Public Policy, Asia Pacific at ISDA.

Sincerely,

Diana Parusheva
Executive Director, Head of Policy and
Sustainable Finance at Asia Securities Industry
and Financial Markets Association (ASIFMA)

Benoit Gourisse
Head of Public Policy, Asia Pacific
International Swaps and Derivatives
Association (ISDA)

Comments to Specific Questions in the Consultation Paper

Question 1 - General feedback on the environmental objectives identified

The GFIT Taxonomy takes the EU Taxonomy as a key reference point in developing the environmental objectives, while also referencing the ASEAN Taxonomy and Singapore-specific circumstances to ensure local and regional considerations are captured. Members believe the five environmental objectives identified are pragmatic in defining the activities that will facilitate the transition to a low-emissions, climate-resilient economy.

Overall, the GFIT Taxonomy environmental objectives are aligned with the ASEAN Taxonomy environmental objectives, with one additional objective noted – pollution prevention and control. The addition of the pollution prevention control appears to make sense in the context of Singapore's urban environment.

The GFIT Taxonomy environmental objectives are aligned with the EU Taxonomy environmental objectives, excluding one specific objective from the EU Taxonomy on sustainable use and protection of water and marine resources. However, this has been included under the objective either to protect healthy ecosystems and biodiversity or promote resource resilience and circular economy.

The alignment of objectives with the ASEAN and EU Taxonomies is helpful for reducing regulatory fragmentation and achieving interoperability with two key taxonomies which will be of critical importance to Singapore. As the EU is expected to be a key source of capital to fund green projects in the region, aligning with its taxonomy is important for Singapore's aim to be a green finance centre for ASEAN.

Question 2 – General feedback on the sectors identified

Of the 8 sectors included in the GFIT Taxonomy, 5 represent 90% of GHG emissions across ASEAN and are key sectors for the region (Agriculture and Forestry/Land Use, Construction/Real Estate, Transportation and Fuel, Energy, Industrial). The remaining 3 (Information and Communication technology, Waste/Circular Economy, Carbon Capture and Sequestration) have been identified by GFIT as climate change mitigation enablers. So, members agree with their identification.

Members do not have any adverse opinion on the three prioritized sectors during the initial phase of the Taxonomy's development: energy, transport and buildings.

GFIT's adoption of the ISIC classification system is a sound approach given the system has comprehensive coverage of economic sectors worldwide and is also used in the ASEAN Taxonomy and the Common Ground Taxonomy ("**CGT**"). Further, although the EU Taxonomy is using the NACE economic activity classification system, the structure of that classification is aligned with ISIC. Collectively, this will ease the use across EU, ASEAN and Singapore and will facilitate interoperability.

Question 3 - Feedback on this proposed approach – ease of navigation and usability

Members generally consider the approach adopted by the GFIT Taxonomy as relatively usable and easy to navigate. Aligning with the EU and ASEAN Taxonomy assists with interoperability and reduces regulatory fragmentation. Incorporating a transition framework into the GFIT Taxonomy allows those locations in APAC that are not as developed as the EU to have a pathway to transition. However, members have a few concerns that we would like to bring to your attention.

Considering the process in light of the Taxonomy's purpose and needs of users

The purpose for which the Taxonomy is to be used should be considered when designing how to apply it. The process must be appropriate for the purpose and the Taxonomy must be practically useable by those who will have to apply it. Given that, in future, other Singapore regulations are likely to refer to the Taxonomy, e.g. when it comes to disclosure and reporting obligations, our members are concerned about the complexity and cost that this might imply.

Where other regulations seek to use the Taxonomy to define green activities for other purposes, the geographic scope of application must be carefully considered to ensure the application is appropriate and in line with the original intention of the taxonomy.

In considering the utility of the taxonomy, we would suggest GFIT to consider the usability for both investors and issuers, and to balance the trade-offs from taxonomy alignment. The availability of necessary data and the ability to verify taxonomy alignment remain important issues for facilitating implementation.

To ensure that the Taxonomy's process for application is appropriate in considering the needs of end users, we encourage GFIT (and MAS where it intends to create other regulations referring to the Taxonomy) to ensure that the issues that will be encountered in the Taxonomy's application are carefully considered with the needs of users in mind.

Traffic light approach

A taxonomy is a means of assessing an economic activity, asset or a project against defined criteria and baselines and then labelling it accordingly. Members are concerned that some economic activities that do not meet the GFIT Taxonomy's criteria for "Green" or "Amber" might not necessarily cause significant environmental harm or should not automatically fall into the "Red" category. GFIT notes that not all economic activities have been assessed yet for their categorisation under the GFIT Taxonomy and that this does not imply they are red, but rather these activities are unclassified yet.

The EU Platform on Sustainable Finance ("**PSF**") has advised the European Commission on designing future "Amber" and "Red" categories that would complement the currently "Green" EU Taxonomy to shift it towards a traffic light system. The PSF is also proposing to create a new category of "low environmental impact" activities, which do not have the potential to make a substantial contribution to any of the environmental objectives, and are not at risk of causing significant harm and meet minimum safeguards. However, the PSF recommends that priority be given first to developing the red and amber categories.

Recognising this, members suggest GFIT to consider a more flexible traffic light system. GFIT could also carefully consider how these activities are included in other frameworks, such as the other taxonomies in the region including the ASEAN Taxonomy, with a view to maximise harmonisation. In the meantime, we would encourage GFIT to monitor the developments in the EU to determine impact to interoperability and alignment to the GFIT Taxonomy.

*Do no significant harm principle ("**DNSH**")*

Members consider that GFIT should carefully consider the DNSH principle, which whilst used in the EU and other taxonomies, can create interoperability and other implementation difficulties. In the GFMA submission on the Common Ground Taxonomy ("**CGT**")[3], it was discussed that the DNSH principle is challenging to fulfil in practice as it requires both the definition and the measurement of a secondary set of objectives. Further, some activities are difficult to compare and map across jurisdictions, such as the construction of buildings. Additional complexity arises when the DNSH principle is tied to compliance with local regulations as these criteria may not be applicable in other jurisdictions. Lastly, the principle can add complexity and costs to users particularly when considering the lack of consistency in how the principle is defined and the data available to satisfy it.

*Minimum Social Safeguards ("**MSS**")*

Members suggest GFIT to consider the practical implementation of assessing, measuring and reporting on MSS requirements as this could pose implementation challenges. Members suggest keeping the safeguards as simple and practical as possible so that they are easy to apply with some flexibility built in, and recognising that the data to assess compliance may not always be readily available.

Metrics

The alignment of the metrics for the TSC for Real Estate, Transport and Energy with the EU Taxonomy metrics will help with interoperability.

Question 4 - Feedback on the level of ambition for each criterion, whether TSC are clear, usable, or any other alternative metrics, policies and documents should be used as reference?

Members support that the TSC are science-based and objective. Members have no negative comments about the metrics, thresholds, policies and documents referred to by GFIT in developing the TSC.

The TSC referenced in the GFIT Taxonomy is similar to the EU Taxonomy, except under certain circumstances (e.g. transport and building renovations), where the TSC have been determined or adjusted considering Singapore's regional situation and taking into consideration the alignment with Singapore's long term sustainable economy goals.

This approach should help with interoperability, reduce regulatory fragmentation, while permitting recognition of Singapore specific circumstances (where appropriate) and utilizing objectives, credible standards.

As the Taxonomy is designed to address the current situation in relation to climate, activity thresholds and technologies, we encourage GFIT to periodically review the TSC so they remain relevant in changing circumstances.

Question 5(a) - Feedback on the proposed practice: the transition process from amber to green for economic activities

Members commend inclusion of a transition framework as an important consideration for APAC locations. The alignment with the ASEAN Taxonomy will help with adoption by other APAC locations and assists with interoperability.

---

[3] GFMA Response to the IPSF Consultation on Common Ground Taxonomy, Dec 2021

Members do not have adverse opinion on the transition process proposed by the Taxonomy, it is sensible and applicable to both quantitatively (i.e. how it meets the relevant TSC) and qualitatively (i.e. the relevant operational plan for how the activity will aid in transition) measured activities.

Question 5(b) - Feedback on the proposed practice: the aggregation of activities by category at a fund/portfolio level

As Singapore-based financial institutions are expected to be the primary users of the Taxonomy. The level of detail and disclosure required of financial institutions must be carefully considered to ensure that the value of the information provided justifies the burden of the costs (e.g. compliance costs, data costs) required to produce these. Members are concerned that there is a risk of significant cost being added without benefit to investors if the Taxonomy is too complex, such as requiring financial institutions to disclose the percentage of their balance sheet that is taxonomy aligned.

Question 5(c) - Feedback on the proposed practice: the requirements for disclosure from both companies and financial institutions

Members agree aligning climate-related disclosures under the Taxonomy is important. This will help to produce a consistent application of the Taxonomy, ensure quality/useful data is readily available and reduce subjective assessments being made when trying to meet taxonomy requirements by financial institutions. But we note the point made above about adding significant complexity under question 5(b).

It will be helpful to map the GFIT disclosure standards to international standards to help the different stakeholders understand the requirements and demonstrate compliance with the Taxonomy. Companies should also be held to the same level of reporting requirements across countries and industries to ensure a level playing field for all.

ASIFMA urges GFIT to consider the company disclosure issue in parallel with the implementation of the Taxonomy. Corporates should be persuaded to disclose high quality and comparable ESG data. However, it should be noted that taxonomy disclosure requires significant auditing and information system changes, training for employees, staff bandwidth, external support, etc. Coordination between jurisdictions and regulators, coupled with capacity building initiatives will help facilitate implementation of these disclosure standards.

Question 5(d) - Feedback on the proposed practice: any other feedback on the proposals contained within this section

1. Members are concerned that the geographical scope of the GFIT Taxonomy must be clear and appropriate for the purposes for which the Taxonomy will be applied.

2. Members are concerned with the implementation of mandatory regulatory disclosure and its timeline. Currently Taxonomy-aligned disclosure is not a regulatory requirement, however, it has been proposed that financial institutions should commence reporting on Taxonomy alignment from 2023. The GFIT Taxonomy will probably be used by regulators as the basis for mandatory regulatory disclosures in alignment with the Taxonomy.

Members would appreciate further clarification on proposed reporting timelines, such as the period of data in scope for the first reporting timeline and whether there are any specific formats or templates to be used for such reporting.

Other Comments – Role of Derivatives in Sustainable Finance

In the joint response submitted in March 2021, the Associations already preliminarily discussed the important role derivatives can play in transitioning to a more sustainable economy. Derivatives enable more capital to be channelled towards sustainable investments, help market participants hedge risk related to ESG factors, facilitate transparency, price discovery and market efficiency, and contribute to long-termism.[4]

The transition to a low-emissions, climate-resilient economy spans multiple segments of the financial industry; and a successful transition can only be achieved if regulators are collectively aware of the aggregate roles and strategies of various actors in the financial market. While we understand that derivatives are not in scope of this consultation, we would encourage the taxonomy to be drafted with an awareness of the use of derivatives and the emerging challenges.

1. Challenges in the application of taxonomy-alignment KPIs

   The introduction of the Green Asset Ratio (GAR) through Article 8 of the EU Taxonomy Regulation poses both operational challenges for banks to report and is potentially misleading for investors. This is primarily because the ratio (the denominator) refers to total assets, including asset classes that will never be covered by the Taxonomy's criteria, while the numerator refers to eligible assets. In essence, there is a mismatch between the numerator and denominator. Therefore, the resulting reportable metrics are primarily driven by the operating model of the bank, rather than accurately highlighting taxonomy aligned financing activities. In particular, the Associations are of the view that taxonomy-alignment KPIs applying to credit institutions such as GAR would negatively impact active derivative dealers and should therefore not be considered in the context of the in the context of the MAS GFIT Green Taxonomy.

   The GAR is defined as the proportion of the credit institutions' assets invested in taxonomy-aligned economic activities as a share of total covered assets. While the European Commission and the ESAs have acknowledged that they may be legitimate cases for derivatives to be recognised for directly contributing to taxonomy-aligned economic activities, out of an abundance of prudence, they have excluded derivatives from the GAR's numerator in the absence of clear methodologies to assess their sustainability alignment and have promised to reconsider this issue in the future once there may be more evidence in this area to allow a different conclusion.

   The inconsistent treatment of including derivatives in the denominator while they are excluded in whole or in part from the numerator for credit institutions is not optimal from a methodological consistency standpoint as it could potentially lead to banks having structurally poor GARs due to under reporting of derivatives. This in turn would make G-SIBs less attractive issuers and counterparties for GAR-sensitive investors, and accordingly undermine their capital and funding costs at the very same time as global policymakers are relying on those same banks to provide financing for the transition to a net zero economy.

---

4 ISDA published a paper that discusses the role of derivatives in ESG markets and provides an overview of ESG-related derivatives products. https://www.isda.org/a/qRpTE/Overview-of-ESG-related-Derivatives-Products-and-Transactions.pdf

It is thus important that consistent methodological practices to assess the taxonomy alignment of the credit institutions' assets should first be developed before such KPIs are agreed upon as differing interpretations could create confusion for investor or result in fragmented outcomes, thereby limiting the potential for evolution of risk management practices in the ESG space.

2. Reiterating the role that derivatives can play to achieve net zero targets

As mentioned in the Associations' joint response in 2021, derivatives perform a critical role in economic activity by enabling and helping businesses and investors better manage their risk exposure, and also plays a major role in enhancing transparency by providing forward information on the underlying commodities, securities or assets.

In this regard, we would also like to take the opportunity of this second consultation to inform the GFIT of the 2 key areas of ESG related derivatives markets that ISDA has been focused on since last year: (i) developing a framework for trading in sustainability-linked derivatives and (ii) clarifying the legal treatment of voluntary carbon credits. We hope that you may take these ESG related derivatives into consideration when building the taxonomy framework, so that stakeholders can determine how much their products and services are aligned with the proposed taxonomy and meet the disclosure requirements over the long term.

(i) Developing a Framework for Trading in Sustainability-Linked Derivatives

Since the first sustainability-linked derivative ("SLD") was executed in August 2019, market participants have entered into a variety of SLDs, mainly in Europe but more recently in Asia and the US. SLDs embed or create a sustainability-linked cashflow using key performance indicators ("KPIs") that are designed to monitor compliance with ESG targets. In simple terms, they are typical derivatives transactions but with an ESG add-on that impacts payment flows.[5]
As SLDs are novel to derivatives markets, ISDA has produced two white papers covering these products.[6] The papers identify and describe different types of ESG-linked KPIs and how they are typically being used today; provide a set of guidelines or best practices that could guide market participants in creating and drafting KPIs for SLDs; and analyse potential regulatory issues related to SLDs under US and EU regulations respectively. In the meanwhile, we are planning to adopt the same approach and explore the regulatory considerations of SLDs to Hong Kong and Singapore. ISDA is also currently conducting a market-wide survey[7] to learn more about common SLD contractual terms and determine whether there is an appetite for standardization through legal definitions and documentation.

---

5 We have observed that there are, generally, two types of SLDs: (1) The KPI(s) and the related impact on cashflow(s) are embedded within the derivatives transaction (e.g., a cross-currency interest rate swap (IRS) that provides additional payments, spread ratchets or a preferential exchange rate when the KPI is met); and (2) The KPIs and cashflows related to them are set out in a separate agreement that references underlying (generally vanilla) derivatives transactions for setting the reference amount to calculate the KPI-linked cashflow. The terms (including pricing) of the underlying transactions (which may include transactions with other affiliates of the parties) would generally not be affected (e.g., an agreement to make a payment if a counterparty meets its KPIs, with the payment calculated as a percentage of the notional amount of unrelated, separately documented derivatives transaction).

6 https://www.isda.org/2021/09/07/sustainability-linked-derivatives-kpi-guidelines/; https://www.isda.org/2021/12/01/regulatory-considerations-for-sustainability-linked-derivatives/

7 The survey is open to both ISDA and non-ISDA members.

By establishing best practices and encouraging standardization, where appropriate, to improve legal certainty, we hope to encourage participation and enhance the integrity of this developing market.

(ii) *Clarifying the Legal and Regulatory Treatment of Voluntary Carbon Credits*

A robust voluntary carbon market plays an important role in delivering a reliable, market-based approach for investment opportunities that reduce greenhouse gas emissions and remove carbon from our atmosphere.

As a derivatives trade association, ISDA has a strong interest in the development of a robust voluntary carbon offset market that will strengthen the functioning of the carbon credit derivatives markets and enable the continued development of liquidity in derivatives products so that market participants can appropriately manage their business risks. Facilitating trading in carbon credit derivatives that serve as hedge for climate mitigation projects will contribute to the development of deep and liquid voluntary carbon credit markets.

One of the obstacles to advancing voluntary carbon trading is a lack of clarity about the legal nature of voluntary carbon credits ("VCCs") across jurisdictions. Very few jurisdictions provide legal certainty about how credits can be created, bought, sold, and retired, thus making it unclear what type of security may be taken and enforced against VCCs and how that can be achieved, as well as how VCCs would be treated following an insolvency (including with regards to netting). Such determination may also have an impact on broader considerations, such as the regulatory, tax and accounting treatment of VCCs. In sum, understanding the legal treatment of VCCs is necessary to create robust voluntary carbon credit markets, which, in turn, will enable the development of a clear price signal for carbon and allow funds to be efficiently channelled towards emissions-reducing projects.[8]

More recently, ISDA also has published a whitepaper[9] on the regulatory landscape of US voluntary carbon markets to: (i) discuss some legal and regulatory questions relating to voluntary carbon markets; (ii) describe the oversight of primary and derivatives markets under Commodity Futures Trading Commission (CFTC) rules; and (iii) explain why VCC derivatives are considered commodity derivatives by the CFTC.

As discussed, derivatives are being used increasingly in sustainable finance and there have been increasing efforts for standardising derivatives in their application to sustainable finance. While the Associations understand that derivatives are not the key focus for this consultation, we hope the observations and analysis shared above can facilitate discussion within GFIT. We look forward to engaging further with GFIT on these important issues and to provide more feedbacks.

[8] https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/

[9] https://www.isda.org/2022/06/02/voluntary-carbon-markets-analysis-of-regulatory-oversight-in-the-us/?_zs=PPFaQ1&_zl=MrNk6