ESG agenda: EU priorities

Andrew McDowell

Vice President, European Investment Bank (EIB)

In defence of climate

The Germans famously have expressive words for everything, so it should come as no surprise that they have a great one for efforts to fight climate change: 'klimaschutz', or climate protection. What we usually call climate action, mitigation and adaptation are all about protecting the climate from our consumption and defending ourselves from the climate change we are unable to reverse.

What we call things is important. Since the beginning of the year, there have been increasing calls to establish a European Climate Bank, notably by French President Emmanuel Macron and by the new president of the European Commission, Ursula von der Leyen.

Well, the European Investment Bank, the EU bank, is also Europe's Climate Bank, in all but name. The EIB is one of the largest multilateral financers of climate action (or climate protection) projects globally. Last year, we exceeded our target for financing climate action for the ninth year running, providing more than €16 billion (30% of all our financing). We are well on our way to fulfilling our $100 billion commitment to the implementation of the Paris Agreement between 2016 and 2020.

> *"Just and additional trillions for climate protection".*
>
> \- ANDREW MCDOWELL

The EIB launched the world's first green bond in 2007, ushering in a market for sustainable finance and environmentally responsible investment. We learned quickly that confusion on the capital markets regarding what constitutes 'green' can hamper private investment – yet leveraging private investment is crucial. Public investment will never suffice to achieve our climate objectives or any of the sustainable development goals. Thus, in addition to being the largest multilateral issuer, we have been trying to harmonize the taxonomy, and promote transparency and accountability. EIB is a proud contributor to the European Commission's Technical Expert Groups on this.

Sustainable finance is not just about climate, so last year we launched Sustainability Awareness Bonds to fund other UN Sustainable Development Goals. We started with goal number 6 ('Ensure availability and sustainable management of water and sanitation for all'), and this year we want to expand to cover other goals like healthcare or education. >>>

>>> Over the past months, we undertook a comprehensive review of our energy lending criteria, with inputs from a range of NGOs and other stakeholders. The outcome will soon go before our board and will set our energy trajectory for the coming years.

One thing that is increasingly clear is that a move away from fossil fuels must be a "just transition". Currently, dozens of regions in EU member states actively mine coal, providing jobs to about thousands of people. For these people to find alternative employment, we need to invest in giving them new skills and make sure there are other opportunities in these regions.

The EIB is also reviewing how we measure our "additionality", the way we ensure our financing does not replace others who would have invested anyway. Our new additionality framework will make sure our investments address well-documented investment gaps resulting from market failures and positively influence the investment in terms of the scale, scope, structure, quality or speed, complementing other sources of financing.

The EIB and other international finance institutions cannot – of course – turn the tide on sustainability efforts by themselves. But we have the essential task to build the conditions and design the instruments that pave the way for other investors to increase their support for the sustainability agenda. And we will soon propose to our shareholders ambitious new objectives, because we need to step up investment for climate protection from billions to trillions. Alternative ways to structure climate finance certainly exist, such as separate entities or off-balance sheet financial instruments, and we are ready to develop these, building on our existing experience.

At the root of this, there is another evocative German word that we all know which will help us accomplish a more ambitious climate defence plan. It's "zeitgeist", the spirit of our times, driving an increasing consensus that more must be done in defence of climate. ●

Jordi Gual

Chairman, CaixaBank

Banks and the transition to a low-carbon economy

The European agenda to promote sustainable finance is advancing. The taxonomy framework for sustainable activities is a necessary step to improve transparency, establish benchmarks and facilitate appropriate risk assessments. To that end, the framework should be applicable to a broad range of economic activities– so as to recognise those that help in the transition to a low-carbon economy-and be flexible enough so that it can evolve if necessary.

The financial system, as an intermediary between savings and investment, has a key role to play in the mobilisation of the necessary resources to tackle climate change and mitigate its effects. We must foster the transition towards a low-carbon economy without causing great distortions or unnecessary inefficiencies. To do so, we should ensure that the appropriate incentives are in place.

"The financial system will support an efficient and fair transition to a low-carbon economy."

\- JORDI GUAL

Firstly, enhancement of transparency and disclosure levels should be prioritised. This would facilitate the inclusion of environmental and transition risks in market prices, and help economic agents to incorporate environmental externalities into their investment decisions. This, in turn, would increase market efficiency while discouraging investment in the most carbon intensive industries. Improved transparency and disclosure levels would also help investors to assess returns on investments in green projects, >>>

>>> reduce costs and facilitate comparability between investments.

Secondly, regulatory policies should be technologically neutral. Picking winners is unlikely to lead to good outcomes. Both the optimal mix of energy sources to address the challenges posed by climate change and the technology associated are likely to evolve over time. Therefore, we should establish a framework that encourages competition and does not discriminate in favour of specific solutions.

Thirdly, the battle against climate change should also take into account the distributional effects of the policy-driven transition to a low carbon economy. In particular, some regions and industries will be impacted in terms of jobs and allocation of resources, and it will be necessary to compensate the social groups that may suffer the most in order to maintain social cohesion and avoid a political backlash.

Finally, the transition towards a more sustainable economy is a responsibility shared by all economic agents and it crucially involves the financial sector. Beyond providing financing, banks ought to integrate environmental responsibility criteria into their strategic priorities. Financial institutions which embrace these criteria will be able to generate more value in a more sustainable manner.

Climate change is a global challenge that demands global solutions; high levels of coordination between the various agents involved; and clarity on the strategic roadmap of public policies. There is still a long journey ahead.

However, we must keep moving forward and find the right balance between the need to make urgent progress tackling climate change and facilitate the energy transition in an efficient and socially sustainable way. ●

Snorre Storset

Head of Asset & Wealth Management,
Nordea Bank Abp

Finance needs to play its part towards a more sustainable economy

Nordea has been committed to sustainable finance for a long time. We are fully prepared to play our part and serving our customers when sustainable finance becomes more and more the mainstream of finance. A growing number of citizens are requesting that their bank offers advice and products for saving and investing sustainably.

As the largest bank and the largest asset & wealth manager in the Nordics we take on the responsibility for offering our clients sustainable solutions. Because we should. Because we can. Because we want to.

Nordea fully supports the Commission's Action Plan for Financing Sustainable Growth and believes that the specific actions will have the effect of moving capital flows towards sustainable investments and ultimately bringing ESG into the mainstream of financial markets. The finance sector should indeed do its part and support the sustainable transition in the general economy. Setting the right incentives for the financial industry and at the same time to other parts of the economy will be key.

> *"There is a strong momentum to bring sustainable finance into the mainstream of financial services."*
>
> \- SNORRE STORSET

Given the urgent need to transform the global economy into a more sustainable, resource efficient low carbon economy, it is important to move forward with speed. At the same time, we need to recognize the potential transition risks for certain segments of the economy.

A stepwise and measured approach is needed alongside with an early communication of regulatory priorities, so that the transition risks can be proactively managed, and thereby as orderly transition as possible to be ensured.

So far legislators and supporting expert groups have made impressive progress to make the action plan a reality. This gives the ambitious plan a lot of credibility both inside and outside the EU. We welcome the recent agreement on disclosures to increase the level and quality of ESG information to the market. This will enable investors to make better informed decisions.

We would also welcome agreement on a taxonomy. Having the same definitions on what is sustainable creates a solid foundation for all other actions in the plan. The taxonomy should be dynamic and consider how existing taxonomies and ESG strategies might be integrated.

The taxonomy likewise needs to be easy to use and reflect the reality of different sectors, which the Commission is trying to ensure by consulting stakeholders.

Financial markets need to learn to identify the environmental impact of various economic activities. This learning process has started with green bonds and it will accelerate with the measures being agreed based on the action plan. For Nordea, our customers and our investors, understanding the ESG risks will become an increasingly critical area. An approach of integrating ESG risk factors into our risk management process and methodologies is ultimately the right way forward and where to initially focus in terms of prudential regulation.

There is a strong momentum to bring sustainable finance into the mainstream of financial services with an increasing customer demand, industry supply and public interest.

An open dialogue between policymakers, the industry and the users of financial services can make this transition a reality in the next few years. ●

Dominic Rossi

Senior Advisor, Fidelity International

Sustainable finance - A game changer for industry

ESG is a dominant theme within the asset management. It is now central to the business models of all the large asset managers as ESG is one of the few areas within the active industry that is growing. This was not the case more than a decade ago. Active managers are responding principally to client demand in Europe and increasingly in Asia, and now see ESG criteria as a logical extension of their stewardship and engagement activities. It is important that regulators understand the market place is moving rapidly in the direction of sustainable finance. A taxonomy that clarifies and enhances non-financial disclosure can help.

The real driving force behind the asset management industry's adoption of ESG are its clients. This movement started in northern Europe over a decade ago, now covers the entire continent. More recently, an increasing number of Asian clients, particularly in Japan, are assessing asset managers on their ESG credentials. In the Institutional market place, it is not uncommon for an asset manager to face over 50 questions on its ESG capabilities from a potential client during due diligence. In the retail market, mutual funds are actively sold on providing access to sustainable areas of the economy rather than on fund performance and asset managers - including Fidelity - are launching new sustainable funds to meet increasing client demand.

These external forces are requiring asset managers to re-think and re-engineer their internal resources. At Fidelity International, our 140 strong equity analyst team is being re-trained to scrutinise investee companies globally on ESG performance. We are developing our own proprietary ESG rating system. Today our analysts link health and safety records at energy companies to executive compensation. We seek answers to questions we have on Scope I and Scope II Greenhouse Gas (GHG)emissions. Our work is hampered, however, by the voluntary nature of non-financial corporate disclosure and the lack of standards that would otherwise assist our ability to measure corporate performance on a relative basis.

"A global regulatory approach is vital, and the EU can play a key role in international coordination."

- DOMINIC ROSSI

Regulation will need to keep pace with this radically and rapidly changing market place. A timely and sensible taxonomy that can bring a common dictionary to the ESG landscape would be a valuable first step. We do not see how we can move to a system of reliable labels and benchmarks until we do. The sequencing of the EU Sustainable Finance Action Plan will be key to its success in the market place. Further, we should seek a global regulatory approach that creates a level-playing field across all financial services providers and products, and the EU can play a key role in international coordination. While a global approach may seem ambitious, we should strive to avoid a repeat of the schism within the accounting world between US GAAP and International accounting standards that complicates free capital flows. ●

Eric Campos

Head of Corporate Social Responsibility, Credit Agricole S.A

The strategy of climate disclosure

In the wake of the European elections in spring 2019, EU citizens have witnessed a flowering of statements marking an important step in the development of a much-needed common and transparent language for mainstreaming sustainability in the financial sector. The European Commission adopted new guidelines on companies' climate-related information reporting consistent with the TCFD's recommendations, and 3 new key reports has been published by the EU Technical Expert Group on sustainable finance (on Taxonomy, Green Bond Standard, Climate benchmarks).

Much has been done over the last years at the national, European and international level to improve the quality of the disclosure of non-financial information (France's article 173, the European NRFD, the TCFD's work). However, much still remains to be done in order to combat two of the main threats posed to the goal of decarbonizing our economies effectively: the lack of consistency (confusion) and transparency (greenwashing) of climate-related information. If a meta-framework is needed to improve the robustness and comparability of companies' non-financial performance, the financial actors themselves – as enablers of the real

economy – should also play a significant role in order to meet their stakeholders' rising expectations for transparency and accountability. >>>

>>> As a leading provider of funding to the French economy with an international reach, Credit Agricole is being committed in terms of its societal responsibility. Over the last decade, the Group has been a pioneer in climate finance: disclosing the carbon footprint of its portfolios since 2011, being a world's leader in Green Bonds since 2012... Mindful of the climate emergency, Crédit Agricole adopted in June 2019 a new Climate Strategy whose ambition is to make green finance a growth driver for the Group, in line with the Paris Agreement. To live up to this complex ambition, the Group has defined the main conditions for the success of this strategy. The first one is a commitment to greater transparency, entrenched at the highest governance levels. Steered by an innovative governance based on scientific expertise and operational assessment, the climate strategy's implementation will be audited and certified by an independent third-party body, and its reporting requirement will be published in full accordance with the TCFD's recommendations by 2020.

"A transparent language is needed to mainstream sustainability in the financial sector."

\- ERIC CAMPOS

The second lies in the Group's ability to assess its corporate clients' level of alignment with a below 2°C scenario and to reallocate its own portfolios in accordance with it, by increasing its energy transition and decreasing its fossil fuel financing (with a planned total phase-out from thermal coal, and the annual publication of our coal exposure as of 2019).

In the absence of available and robust non-financial data, this assessment is in itself a challenge. To meet it, the Group decided to build-up two central tools: a "transition scoring" that will measure the clients' capacity to adapt their business models to the energy transition; and an information system that will be able to capture financial and non-financial data through a relevant reading grid. Creating these instruments, and thus securing the Group's own transparency, face two difficulties:

- an "internal" one: the criteria the Group will choose for building this relevant reading grid in an adequate information system. Here, the EU Taxonomy is likely to be of valuable help.
- an "external" one: the quality and accessibility of its corporate clients' non-financial data. Here, the Group will be dependent on the data its clients share.

Therefore, more than ever, Credit Agricole supports the efforts of the European Commission to make corporate climate-related financial disclosure mandatory, public and verifiable. ●

Sylvie Goulard

Second Deputy Governor,
Banque de France

What can central banks do to manage the challenges of climate change?

The Stern report in 2006, entitled the "costs of inaction", laid bare the urgency of better anticipating – and tackling – the challenges of climate change. Even though it is difficult to assess precisely the "costs of inaction", there is today a broad consensus that they will be much higher than the "costs of action". It is also clear that these costs will have a huge impact on the global economy. As an example, according to the OECD, if no action is taken to reduce carbon emissions (and temperatures continue to rise on a 4°C pathway), global GDP could be hurt by up to 10% by the end of the century.

It is within Central banks' remit to assess how climate-related risks can affect financial stability. To do so, the Banque de France, together with seven other central banks, launched in 2017 the Central Banks and Supervisors Network for Greening the Financial System (NGFS). The NGFS understands itself as a "coalition of the willing". The rapid path at which the NGFS is growing can thus be seen as an indicator of the importance topics related to climate change are gaining among central banks globally: as of July 2019, the NGFS membership consists in 42 members and 8 observers. This April, the NGFS published its first comprehensive report. The report presents four recommendations for central banks and supervisors and two recommendations for policymakers at large, to enhance their role in greening the financial system. In the coming months, the NGFS will publish a series of technical documents on climate and environmental risk management for supervisory authorities and financial institutions, voluntary guidelines on scenario-based risk analysis and best practices for incorporating sustainability criteria into central banks' portfolio management.

The Banque de France provides the NGFS Secretariat[1]. Furthermore, as any financial institution, the Banque de France has its very own responsibility in overcoming the "tragedy of the horizon" (Carney, 2015) and has decided to lead by example by integrating climate-related criteria into its own portfolio management strategy.

Managing the challenges of climate change also means measuring the level of "preparedness" of the financial sector. In April 2019, the Autorité du Contrôle Prudentiel et de Résolution (ACPR) – the French supervisor for banks and insurance corporations, published two reports[2] on how French banks and insurers take into account and manage climate-related risks. The studies find that there is a significant progress in the governance of climate change risks and in the analysis of transition risks. However, banks and insurers can still make some progress in analyzing physical and liability risks. ●

1. NGFS: A call for action – Climate change as a source of financial risk (https://www.banque-france.fr/sites/default/files/media/2019/04/17/ngfs_first_comprehensive_report_-_17042019_0.pdf), April 2019.
2. ACPR: French insurers facing climate change risk (https://acpr.banque-france.fr/sites/default/files/medias/documents/as_102_climate_change_insurers_en.pdf), April 2019.; ACPR: French banking groups facing climate change-related risks (https://acpr.banque-france.fr/sites/default/files/medias/documents/as_101_climate_risk_banks_en.pdf), April 2019.