Sustainable finance legislative proposals

Sylvie Goulard

Second Deputy Governor, Banque de France

Improving climate-related risk disclosures is a necessary step towards a green economy

The Network of central banks and supervisors for Greening the Financial System (NGFS), launched one year ago during the One Planet Summit, is a coalition of the willing, which aims to share experiences and best practices on a voluntary basis. It also aims to promote recommendations in order to contribute to the development of environment and climate risk management in the financial sector and to mobilize mainstream finance to support the transition toward a sustainable economy. The network grew from 8 to over 30 members and observers (as of end-February 2019) and is today present on the five continents.

In its first progress report, released in October 2018, the NGFS unanimously concluded that "climate-related risks are a source of financial risks. It is therefore within the mandates of Central Banks and Supervisors to ensure the financial system is resilient to these risks." To operationalize this breakthrough statement, the NGFS will publish its first comprehensive report on April, 17th 2019 during an international conference in Paris, including recommendations towards all stakeholders of the financial system.

One key topic that must be addressed is clearly the improvement of climate-related risks disclosures. Indeed, this is a necessary step to properly shape investors' expectations and facilitate accurate pricing and assessment of climate-related risks embedded in the assets held by financial institutions. Climate-related risks disclosures would facilitate the transition of financial markets, thanks to market discipline in the spirit of the Basel Committee and its Pillar 3 framework.

France has been at the forefront of this issue. Since 2015, asset managers, banks and insurance companies in France are required by law to publish information about how they take climate change into account. This approach, that follows a "comply or explain" principle, has the advantage of making disclosure compulsory for financial institutions while allowing for sufficient flexibility in the way they report information. Equally importantly, it has helped set up a new financial ecosystem dedicated to sustainable investment, underscoring that ambitious climate policies could benefit to the global economy.

At the international level, a substantial amount of work has already been completed. The recommendations of the FSB's Task Force on Climate-related Financial Disclosures (TCFD) provide a worldwide benchmark for the voluntary disclosure of information about climate-related risks on a comprehensive and consistent basis. At the European level, the ongoing action plan on sustainable finance of the European Commission is also very ambitious and will notably provide increased guidance on non-financial disclosures. Usefully leveraging on the TCFD recommendations, the update of the non-binding guidelines related to

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>>> the Non-Financial Reporting Directive will help companies disclose climate-related information in a more comprehensive and comparable manner.

As to the Banque de France itself, it will disclose this year the climate-related risk exposures and impacts of its own funds and pension funds' portfolios in accordance with the French legislation by using a TCFD-like approach. This upcoming publication is consistent with the Responsible Investment Charter that we published a year ago.

However, to be efficient, disclosure frameworks must go hand in hand with taxonomies which are: i) robust and detailed enough to prevent green washing; ii) dynamic and reviewed regularly to account for technological changes and international developments; iii) publicly available and easily comparable.

This is why the work on taxonomy made of the Technical Expert Group set up by the European Commission is likely to be a decisive step forward, as it will provide one of the most ambitious policy blueprints ever published on sustainable finance. ●

Lauri Rosendahl

President, Nasdaq Nordics

Supporting sustainable economic growth across the economy

The world is currently at a tipping point, where we need solutions to climate change, inequalities and a number of other global challenges. Exchanges, issuers, investors and other financial market participants can play a critical role in the transition towards more sustainable capital markets, and Nasdaq Nordic's ambition is to take a leading position in this shift.

Exchanges play a key role in creating jobs and growth across our economies. Given our central role in the financial ecosystem, we have the ability to support the flow of capital in a more sustainable direction, by fostering a dialogue between issuers and investors and ensuring that sustainability is considered across our product and service offerings.

At Nasdaq, we are encouraging sustainable markets in a number of ways. In March 2017, we issued a voluntary support program on environmental, social and governance (ESG) data disclosure to support our listed companies across the Nordic and Baltic markets. Based on positive feedback from this program, we were excited to expand this initiative by launching an updated version of this guide in March 2019 – aiming to serve all Nasdaq listed companies globally.

Apart from our work with issuers, we have a number of other initiatives and products in place, from an ESG Data Portal connecting issuers and investors, ESG screened indexes and index futures to one of the world's most successful sustainable debt markets; a market that more than doubled in size last year.

While I sincerely believe that these examples confirm that the financial market is moving in the right direction, it is evident that a lot of work remains to be done.

Our experience is that true development on sustainability is driven by demand, rather than by regulatory intervention. More and more businesses do see benefits in adapting to more sustainable business models, and more are also communicating their efforts in ESG reports, responding to an investor base which is becoming increasingly ESG oriented. While all ESG and sustainability related discussions are welcomed, Nasdaq generally favors self-regulation.

However, I do believe our industry needs a more clear definition of what is sustainable and what is not sustainable. Nasdaq therefore supports the idea of having a common taxonomy which can help us define what can be considered an environmentally sustainable economic activity. There are several useful guidelines and frameworks in place, and the challenge is to not destroy what already works.

Policy measures which can support and further bolster development, without interfering with innovation and companies' ability to raise growth capital, are welcome. As an example, Nasdaq is looking forward to further developing our index portfolio based on the incoming rules on low-carbon benchmarks.

I am convinced that we all will benefit from more sustainable markets, not least from a commercial point of view. Nasdaq is fully committed to continuing to explore opportunities in the ESG space and look forward to work together with all our stakeholders to achieve better, more transparent and sustainable markets. ●

Rhian-Mari Thomas

Global Head of Green Banking, Barclays Bank

Barclays supports the EU sustainable finance taxonomy to provide clarity and inspire ambition

Barclays supports the EU's proposed Sustainable Finance Taxonomy and with it the notion of providing greater clarity for the financial marketplace on the scope, scale and ambition of Green financial products and services.

Is the envisaged taxonomy effectively providing greater clarity to the markets?

The envisaged taxonomy will provide greater clarity to the markets, if, as expected, it provides clear definitions for the markets to adopt, which cover a broad range of economic activities and investments, across the global marketplace. A range of definitions, rather than a binary set of definitions, will more accurately reflect the investment marketplace, and most help both Corporates to identify financing opportunities associated with sustainable activities, and Investors to better judge the risks and opportunities associated with their investments.

Current proposals focus primarily on what is 'Sustainable', whereas Barclays also encourages exploration of the broader ecosystem, including, for example, the role for oil, gas and nuclear power within the transition toward a lower-carbon economy.

Utilisation of existing frameworks is also key. Different financial markets already work to a number of frameworks which have guided the development of new, 'Green' products and services. These include ICMA's Green Bond principles, the Energy Efficient Mortgages Initiative, and the Principles for Sustainable Insurance Initiative. The Climate Bond Initiative and the European Investment Bank have also committed extensive work in this area. Barclays recommends utilisation of the most popular and widely embedded frameworks in a 'bottom-up' approach, rather than 'top-down' approach which threatens the validity of many existing 'Green' products and services.

Is it flexible enough to take into account the evolution of technology and to avoid possible bureaucratic burden?

Barclays believes the taxonomy should be sufficiently flexible to take into account the evolution of technology (and broader marketplace adjustments), through regular reviews and maintenance. This may be best achieved via the proposed 'Platform on Sustainable Finance' set out in Article 15 of the taxonomy regulation, or a similar body. A review every two months should be sufficient to ensure the taxonomy continues to reflect market developments.

Is the taxonomy providing sufficient incentives to head toward sustainability adaptation?

We believe the primary incentive for market participants to engage with the taxonomy is the clarity it will provide around the sustainability implications of economic activities. However, the broader question around legislative or regulatory levers to support take-up of sustainability activities is pertinent. For example, Barclays supports the exploration of what preferential, prudential treatment may be given to Green Assets. Such interventions would enable us to engage more fully in the Green marketplace, while also passing on the economic benefits to our clients for further Green purposes. ●

Dr. Manuel Rybach

Global Head of Public Affairs and Policy, Credit Suisse

Mitigating greenwashing risk by introducing defined carbon benchmarks

The European Commission's Action Plan on Financing Sustainable Growth is a welcome initiative showing the EU's strong commitment to implement the Paris agreement. The financial sector can play a role in contributing to sustainable growth by allocating capital towards sustainable investments and by helping to promote the transition of the global economy towards low carbon activities. However, to deliver on the EU's ambition and commitment to transition to a low-carbon, more resource-efficient and sustainable economy, it is important that the EU does not adopt an overly-prescriptive and static regulatory approach in financial services, but rather ensures sufficient flexibility to support innovation in a field where the market needs to develop further. Finally, it is key that the EU framework is designed in a way that can be "exported" at international level to encourage other jurisdictions to follow suit.

The low carbon benchmark (or "climate transition benchmark", as called by the European Parliament) is based on the decarbonisation of a standard benchmark. The underlying stocks would qualify for selection on account of their reduced carbon emissions when compared with stocks constituting a standard benchmark. As such, the low carbon benchmark allows for relative differentiation of stocks and assets, which can incentivize companies to move the needle towards environmentally-friendly technologies, and process improvements leading to lower carbon emissions.

The positive-carbon impact benchmark (or the "Paris-aligned benchmark", in the proposed terminology of the European Parliament), would select stocks which save more carbon than they produce, and which contribute to attaining the 2-degree objective of the Paris Agreement. As such, the positive-carbon impact benchmark sets a higher ambition and allows for an absolute measurement of the climate performance of the underlying stocks against a defined objective. To qualify >>>

>>> for selection, companies will need to be on the emissions reductions trajectory that has been defined for its sector based on widely accepted scenario models.

A variety of benchmarks claim to pursue environmental, social and governance ("ESG") objectives or low carbon investment strategies. In the absence of clear definitions or minimum standards for such strategies, there is a risk of marketing speech and misrepresentation. The required disclosure of the methodologies applied by the two benchmarks for selecting and weighting underlying assets, of the types and sources of data used for calculating carbon footprints and carbon savings, as well as how the benchmark differs from its underlying parent index, will serve to reduce the risk of such greenwashing. Among the two, the low carbon benchmark, based on relative differentiation, is more prone to greenwashing compared with the positive-carbon impact benchmark, which relies on absolute differentiation. However, the methodologies for measuring a company's contribution to the 2 degrees objective are still work in progress (like other banks, Credit Suisse is working on methods to measure the alignment of its credit portfolio with the Paris Agreement). Moreover, a risk of unintended greenwashing remains, since both approaches by necessity are dependent on the availability and reliability of corporate disclosures of carbon emissions.

The two benchmarks can meet their intended objective to "reorient capital flows towards sustainable investment" if they are designed as minimum standards beyond which market participants are free to innovate, if they are not too narrow and prescriptive, and if they allow for a sufficiently long period of transition. The benchmarks should be reflective of the real economy and cover all industry sectors without exclusions; especially the most carbon-intensive sectors have the biggest potential to decarbonize – and they need investment capital to transform their production methods and business models. ●

Mario Nava

Director, Horizontal Policies, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

Sustainable finance in the EU: achievements, challenges and outlook

The EU is committed to the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development. It has been estimated that the EU needs to annually invest around €180 billion just to achieve the 2030 EU climate and energy targets. The scale of this investment challenge is well beyond the capacity of the public sector alone.

The financial sector has a key role to play in transforming our economy into a more sustainable one. That is why in March 2018, the Commission adopted an Action Plan on Financing Sustainable Growth consisting of ten ambitious legislative and non-legislative measures to help mobilise the private sector to finance sustainable investments and sustainable growth.

Just one year later, and at the end of this legislative term, we have made major progress in the implementation of the Action Plan. In May 2018, the Commission tabled three legislative proposals.

The first legislative proposal concerns the establishment of a unified classification system (taxonomy) that will define what is 'green' in order to identify activities and projects where investment can make the biggest impact. This EU taxonomy focuses on environmentally sustainable activities starting in the area of climate change mitigation, followed by climate change adaptation and other environmental fields. The taxonomy will help us develop standards and labels for green financial products. It will also underpin disclosure and reporting of financial institutions and companies on climate and environmental impacts.

The second legislative proposal concerns the disclosure requirements related to sustainability risks and opportunities by asset managers, institutional investors, and financial advisors. Our proposal will require them to disclose how they integrate sustainability considerations into their processes. To better inform retail investors, we will also require investment and insurance advisors to ask clients about their sustainability preferences, and offer suitable investment products.

The third legislative proposal on low-carbon benchmarks will create a new generation of benchmarks. The two new categories are voluntary labels designed to orient the choice of investors who wish to adopt a climate-conscious investment strategy.

Thanks to the quick work by the European Parliament and the Council, a political agreement has been reached on the legislative proposals on sustainability disclosures and low-carbon benchmarks, while we continue to work full speed on the taxonomy proposal.

A key to success of revising the financial system depends on companies being more transparent about their impact on the climate and on the business risks and opportunities that climate change creates. The Action Plan announced that the Commission will amend its non-binding guidelines as regards climate reporting to take into account the results of the FSB industry-led Task Force on climate-related disclosures. Following a consultation in March 2019, the Commission is scheduled to adopt its amended non-binding guidelines by this summer.

In parallel, the Commission established a Technical Expert Group (TEG) to assist it with the technical work underpinning some of these legislative proposals. The TEG has prepared reports and asked for feedback from external stakeholders on taxonomy, an EU green bond standard, low-carbon benchmarks and climate-related disclosures, that will feed into EU policy.

Regardless of these achievements, challenges remain ahead. To put the taxonomy in place we need an agreement by the co-legislators. At the same time, constructing the technical aspects of the taxonomy is complex, and needs to proceed step-by-step. For the short-term the TEG is doing an outstanding job. However, for the long-term a more robust governance structure is needed, bringing together all relevant stakeholders. Therefore, the Commission has proposed to establish a platform to further develop and adjust the taxonomy. But once this taxonomy is established, we should be able to make green finance the new normal.

Moving to a greener and sustainable economy is a long journey. I believe that our concrete actions are an important step to achieving our mid-term goals of the 2030 agenda, and long-term vision of a fully climate-neutral economy by 2050. We hope that the EU can lead by example, and inspire others to modernise and decarbonize their economies. ●