Green Deal: implications for the financial sector

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Sustainable Finance – a broader approach seems necessary

Considering the major challenge to combat climate change it is comprehensible and very positive that numerous initiatives regarding Sustainable Finance are taken, at global as well as at European level. As a matter of fact, this is also exactly why it is essential to coordinate all those initiatives in the best possible way to further strengthen cooperation and to avoid any overlap or duplication tying considerable resources.

While Europe is about to take a leading role in the international community when it comes to setting and achieving climate change goals, proportionality with respect to the European share of the global greenhouse gas emissions should not be forgotten.

I certainly share the view that the European Union should show leadership in the global fight against climate change, but this must not lead to pioneering activities inviting others to lean back without any ambition. In this respect the coordination of joint efforts of the International Platform on Sustainable Finance, the Coalition of Finance Ministers for Climate Action or the Network for Greening the Financial System to name the most important ones, should be the prior interest of the European Union and European institutions.

However, to give those initiatives the necessary purview it remains to be wished that these important international cooperation activities are joined by more and more countries in the near future. What is also deemed decisive for the success of the joint objectives is that measures are not over-bureaucratic and too cumbersome and allow for the necessary flexibility and proportionality supporting the market to adapt.

Another example for European leadership is the recently adopted business model of the European Investment Bank, pushing the climate and sustainability agenda within the International Finance Institution peers. International Financial Institutions, such as the World Bank Group, together with regional Financial Institutions in Africa, Asia and Latin America are key when it comes to leveraging climate financing on a global scale. They ensure that "green washing" is held at bay and common quality standards are adhered to. These institutions committed over 43 billion USD in climate finance alone in 2018 for developing and emerging economies.

It is essential to coordinate all initiatives in the best possible way to further strengthen cooperation.

A further key task when it comes to Sustainable Finance is the proper integration of climate and sustainability risks posed by climate change in the overall risk management of financial institutions. Concerns still exist that this relatively new task, at least to this extend, could be misinterpreted by financial market participants prioritising climate and sustainability risks and underestimating or neglecting general banking or financial risks still continuing to exist at an unchanged level.

It is fundamental to address and mitigate the entire risk of a financial instrument, otherwise unanticipated losses would impose negative economic impacts and threaten financial stability.

With a view to the market, the recent past has shown that the interest in sustainable finance in general is high and the demand for green or sustainable financial products is strongly increasing. Against this background, the availability of sufficient sustainable projects and investment possibilities is fundamental for the proper and swift functioning of the market. Therefore, policy priorities should not only focus on avoiding "green washing", but also on fostering private sustainable projects and initiatives. In this context it is also an undisputed fact that a swift and smooth transition to mainstreaming sustainable finance is required. However, to avoid incalculable risks and consequences as well as stranded costs it seems to be important to not immediately and abruptly drive certain branches out of the market, but rather to support their timely transition.

Mario Nava

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

Commission's rising ambition on sustainable finance

The current pandemic crisis of COVID shows that risks that were ignored may materialise and provoke huge damages to the socio-economic fabric of the world. The Action Plan on sustainable finance aims at preparing an orderly response to the sustainability risks that have kept accumulating in the last decades.

The start of the adventure on sustainable finance can be traced back to 2017 when the Commission set up a High Level Expert group and asked the members and experts of that group to make strategic recommendations for a financial system that supports sustainable investments. Those recommendations informed the European Commission's initial 2018 Action Plan on financing sustainable growth, which laid down the foundations for channeling private capital towards sustainable investments.

Among the 10 priority actions it's worth recalling the Commission's proposal of a "green" taxonomy (i.e. classification system of environmentally friendly economy activities) for which a political agreement was found in December 2019 establishing the overall framework and principles. This piece of law, also through the adoption of subsequent delegated acts, provides clarity to and a common language for the financial market hence on one side fighting green-washing and on the other side facilitating sustainable investments.

Now fast-forwarding to 2020, the political context has changed compared to when the Commission put forward the initial Plan. The EU Green Deal is the political priority of this new Commission and the vision is clear: we need to act now and decisively to transition the EU economy to carbon net zero by 2050. To this end, the Green Deal proposes the design of deeply transformative Europe-wide policies that will aim to revolutionise the continent's clean energy supply, industry, production and consumption, large-scale infrastructure, transport, food and agriculture, construction, taxation and social benefits. This increased ambition of the goals and targets under the EU Green Deal requires a much more fundamental transformation of how the financial and corporate sectors operate.

> *The EU Green Deal is a priority: we need to act to transition the economy to carbon net zero by 2050.*

The financial sector is making progress, but its efforts should be assessed against this new policy framework and the pressing necessity to avoid climate and biodiversity crisis tipping points. It is now time to intensify efforts to reach the higher level of ambition set out in the European Green Deal. After an Action Plan that started to address the most urgent issues, the current context requires a more comprehensive and fundamentally more progressive strategy. The renewed strategy on financing sustainable and inclusive growth is foreseen over Fall 2020 and is expected to predominantly focus on three areas:

1. Strengthening the foundations for sustainable investment by creating an enabling framework, with appropriate tools and structures. Too many financial and non-financial companies still disproportionately focus on short-term financial performance compared to their long-term development and sustainability-related challenges and opportunities.
2. Increased opportunities to have a positive impact on sustainability for citizens, financial institutions and companies. This second pillar aims at maximising the impact of the frameworks and tools in our arsenal in order to "finance green".

3. Climate and environmental risks will need to be fully managed and integrated into financial institutions and the financial system as a whole in order to move from brown to green, while ensuring social risks are duly taken into account when relevant.
4. As it's the case for all major initiatives, the Commission will consult over spring 2020 on some preliminary ideas and strongly invites citizens, the business world, the national administrations, NGOs and society at large to engage in this process. Only through a collective effort and broad feedback and support can the Commission put forward an ambitious strategy that will provide the right framework for-and recognize the important role of-the financial sector in accelerating the sustainability transition and mitigating potential sustainability related risks.

This will be all the more true in the months and years to come given that adherence to sustainability criteria like the Sustainable Development Goals will be key to channel the right type of support to economies around the globe currently struggling due to the pandemic COVID-19 crisis.

Gilles Boyer

MEP, Economic and Monetary Affairs Committee, European Parliament

EU taxonomy: crucial first step to fulfil citizens' sustainability expectations

The world is changing rapidly and what just a short time ago may have seemed unrealistic, unfeasible and a pipedream is quickly becoming a reality in the field of the greening of the financial sector, amongst others. The sustainable finance (taxonomy) file recently agreed between the European Parliament and the Council is a concrete example. In reaching an agreement on the taxonomy file, the EU institutions have created a clear framework for the financial sector regarding sustainable finance and investments for the future.

The European Union is leading the world in this field having created this unique taxonomy. This is an incredibly dynamic and rapidly growing sector and lawmakers are aware of the stakes involved. Citizens are calling out for clear and transparent rules for this sector, to provide clarity and uniform standards to enable them to invest with confidence in certified sustainable projects.

The financial sector is also, in my experience as a lawmaker in this field, in general highly supportive of clear legislation in this field. By providing a legislative framework this allows them to propose sustainable products to the market and create their internal modelling to ensure they are able to provide the required reporting information and respond to the increasing market demand in this sector.

There are of course legitimate concerns about how the adoption of ESG targets more generally and the taxonomy framework more specifically will be implemented, both in terms of which investments will be taxonomy compliant and the timeframe available to ensure that the required reporting data is available and able to be submitted in the appropriate format and at an appropriate cost.

In discussions with the financial sector there is a clear consciousness that this sustainable finance evolution is not a flash in the pan but a sector which will increase in importance rapidly over the coming years. Those actors who understood this early have already made significant progress in incorporating changes into their products, modelling, reporting and decision-making process and are supportive of the legislative evolutions.

> *What may have seemed a pipedream is becoming a reality in the field of the greening of the financial sector.*

The journey is only just beginning. The EU has currently agreed on a sustainable finance framework but the concrete details of which investments will qualify remain to be finalised. This will happen in a staggered approach over the next two years. As legislators we have foreseen a difference of 12 months between the adoption of the specific standards concerning what can be considered a sustainable investment and the entry into force of this legislation, and thus the reporting requirements, in order to try to ensure that the market has sufficient time to adapt, as these are significant and important evolutions.

It was a strategic choice for the EU taxonomy framework to focus on environmental activities. This is already an important step forward, which will have significant implications for the financial sector. This is just the beginning. Before making the taxonomy proposal the Commission established the High Level Expert Group on sustainable finance to work on the issue (HLEG). The HLEG undertook a thorough and important job of deep analysis and reflection. This serious and essential work provided crucial input to the legislative process, which is advancing rapidly.

To complement the environmental strand, social and governance issues are also of crucial importance but the HLEG focused their initial work on the environmental aspects, which already took years of analysis and reflection. The European Parliament and the Council decided to start with an environmental taxonomy and called for further analysis to enlarge this taxonomy to also include social and governance issues in time.

The story does not end here. It is essential to see the taxonomy legislation within the broader EU legislative framework, for example the ambitious European Green Deal, and within that notably the Sustainable Europe investment plan.

Emma Navarro

Vice-President, European Investment Bank (EIB)

Getting sustainable finance right

The coronavirus has disrupted our daily lives and global efforts are rightly focused on combating the pandemic and its economic impact. The EIB is also committed to supporting the EU and partner countries in these times of hardship. Yet, while we are all doing our utmost in response to the pandemic, we should not forget about the medium and long-term perspective and the other global defining challenge. Climate change poses major threats to our societies and economies, with irreversible consequences if we do not act now. Once we get out of the current emergency, we will need to spur recovery by supporting investments consistent with our climate action efforts.

The transition to a more sustainable, carbon-neutral society is critically needed to face the pressing climate and environmental challenges and ensure our future prosperity. This transition implies a profound transformation of our economies and lifestyles that will require massive investments. The European Commission has estimated that achieving Europe's 2030 energy and climate targets will require EUR 260bn of additional investment every year. And this estimate does not factor the revision of these targets announced as part of the European Green Deal or broader environmental objectives. It is clear that the private sector will have to play a key role to close this investment gap. For that, we need a financial system that takes into account climate considerations and guides investors and savers towards sustainable investments. The EU has moved quickly in this direction.

Building on the recommendations of a High-Level Expert Group, the Commission launched an ambitious Action Plan on Sustainable Finance to anchor sustainability in the EU's financial regulatory framework and help redirect private capital flows towards more sustainable investments. One of its key measures is the EU sustainability taxonomy that seeks to establish a common language for green investments, giving investors the much needed clarity.

> *Today, green finance has become one of the most important topics for the financial sector.*

Since the launch of the EU's Action Plan, the topic of sustainable finance has gained strong momentum. When the Paris Agreement entered into force in 2016, sustainable finance was only a small part of the financial market. Today, green finance has become one of the most important topics for the financial sector. This is notably the case in Europe, where the sustainable finance agenda is moving ahead at significant pace. Last December, the co-legislators reached a political agreement on the taxonomy regulation. Other important legislative initiatives have also been adopted to create new low-carbon benchmarks and strengthen disclosure obligations for sustainable investments. The European Green Deal will continue on this path with new initiatives to scale up sustainable finance even further. For the EIB, the commitment to sustainable finance is clear. As a public, policy-driven bank, sustainable investments lie at the heart of our mission. Yet, in view of the scale of the climate and environment challenges, we have significantly stepped up our climate ambition to support a just transition to a more sustainable future.

Progress is also visible at a global scale. Around 250 banks from all over the world have signed the UN's Principles for Responsible Banking, committing to embrace sustainability and support the Paris Agreement Sustainable Development Goals. Climate disclosures are also widely spreading with more than one thousand private organizations today supporting the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Climate risks are also attracting increasing attention. More than 50 central banks and supervisors are now cooperating under the Network for Greening the Financial System (NGFS) to develop a better understanding and management of climate change financial risks. The challenges of climate change and environmental sustainability are important to the whole world and require collective action.

In today's global financial markets, international consistency and global standards are critical. In this sense, the EU's initiative to launch the International Platform on Sustainable Finance, of which the EIB is a partner, is a major step forward in promoting coherent approaches and accelerating sustainable finance globally. It seems clear that sustainable finance is here to stay.

Laurent Zylberberg

President, European Association of Long-Term Investors (ELTI)

Investing today for the long-term

In the context of the future recovery, National Promotional Banks and Institutions (NPBIs) are firmly committed to promoting sustainable development by increasingly integrating these concepts into their operations. Ensuring a robust economic recovery compatible with sustainable development is at the very heart of NPBIs' mission, namely to provide the right balance between today's constraints and tomorrow's challenges, with activities being aimed at improving economic, environmental and social living conditions — on a local, national, European and global level and from a long-term perspective. ELTI members committed more than 50 bn EUR of financing for sustainable projects in 2018.

Such a fundamental task involves the development of sustainable, self-supporting economic structures. Therefore, NPBIs strive to deliver financial solutions which enable our industries and economies to cope with today's and tomorrow's huge challenges. Close to the European citizens, NPBIs remain beacons for trust and confidence. In this perspective, the long-standing co-operation of NPBIs with the EIB Group, the Council of Europe Development Bank or the EBRD allows for a more effective impact of European initiatives as well as of the financing provided by NPBIs. Working together is not an option, it's a must. NPBIs are part of the missing link between citizens and our European common future.

> *European NPBIs will be at the heart of the future economic recovery. Before the crisis, ELTI members committed more than 50 bn EUR of financing for sustainable projects in 2018.*

Following the commitment to achieve climate neutrality by 2050, carbon-neutral projects need to be implemented and financed today. With this in mind, NPBIs are committed in achieving the success of this endeavour. The role of Long-Term Investors has become more important today than ever since infrastructure investment projects have an average lifetime of around 30 years whilst projects which require long planning phases – and financed today, might run longer than 2050.

NPBIs commitment towards Sustainable Finance has several dimensions:

- Environment, Energy, Climate, Social, Health and more: Beyond the fields of environmental improvements (energy efficiency, transport, infrastructure), NPBIs partners benefit from financing innovation as well as social projects (student loans, municipal financing, affordable housing, health projects).
- Green, Environmental and Social Bonds: Bonds with an amount of more than 3.5 bn EUR were issued from ELTI members in 2018.
- Market experience at local, regional and national level: The European Green Deal relies on ESIF as a source of funding in order to cover "every corner of the EU". NPBIs will be essential players in making this happen, by contributing to financial leverage, combining national funds with EU promotional instruments and by providing their market experience at local, regional and national level.
- Cooperation between members and with International Financial Institutions: Cooperation is a key strategy in addressing the challenges of our sustainable future. ELTI members are already engaged in projects such as the "Joint Initiative on Circular Economy", the "Clean Ocean Initiative" or the "Marguerite Fund", all of which have a strong cross-border dimension.
- Know-how transfer between members: The financing of Sustainable projects requires specific know-how to adapt financing programmes to the state-of-the-art technology in order to reach projects on the ground.
- Providing support to public authorities: ELTI welcomes the initiative of the European Commission to reach a common understanding about Sustainable Finance, ultimately streamlining the flows of private investors' capital towards sustainable projects.

ELTI members are actively engaged in discussions on the Sustainable Finance Action Plan of the European Commission by participating in the High-Level Expert Group and in the Technical Expert Group and they will be deeply involved into the revision of the Action Plan in fall 2020.

All ELTI members have provided emergency measures to tackle the economic crisis, we proved our agility and capability to answer quickly to major challenges. Let's do it together for the long-term!

Tobias Bücheler

Head of Regulatory Affairs, Allianz SE

Sustainable finance regulation needs to facilitate a broad economic transition

Climate change poses a major challenge to the world and to society as a whole and requires comprehensive structural change. If the objectives of the Paris Climate Agreement and the UN Goals for Sustainable Development are to be achieved, not only the way how we generate energy must change fundamentally, but also the way we use energy, how we feed ourselves, how we travel, and much more. The transition to a low-carbon economy will be a long and complex process. A sustainable path must be established that is ambitious enough but does not set unachievable or unrealistic goals for institutions while also being politically and socially viable.

The financial sector has an important role to support the aspiring political and economic sustainability agenda set by the European Union. Banks and insurers can facilitate the transformation towards a more resource-efficient economy in various ways: By mobilizing capital through investments and loans, providing sustainable insurance solutions, integrating social and environmental considerations in business and risk management and - last but not least - by ensuring a progressive decarbonization of portfolios including engagement processes with investee companies. Already today, the financial industry mobilizes private investment for sustainable purposes such as climate and environmental protection, provides financing for infrastructure projects – and over the past years, more and more financial companies started integrating sustainability factors into key business areas.

However, the financial industry should not be regarded and treated as the sole change agent to achieve global sustainability targets, especially when it depends on third-party efforts. In order to channel investments towards sustainable assets and assess sustainability risks correctly, the financial sector needs reliable information by investee companies. Improvements to the availability, quality and comparability of sustainability data are therefore of utmost importance in order to be able to provide sustainable financial products. Ultimately, sustainability will become a key factor in assessing companies' risk return profiles, both in the financial sector and in the real economy.

In order to promote sustainability and sustainable finance more widely, there is a need for a certain level of regulation. In this context, greater transparency (e.g. global corporate disclosure requirements based on the recommendations of the task-force on climate-related financial disclosures) is an imperative, but even more important is to establish regulation that facilitates and incentivizes structural change on a broad basis. Financing only a narrow "green" niche will not be sufficient to transform the economy. Moreover, to mainstream sustainability, relevant regulation needs to be straight-forward to apply.

The current state of knowledge in climate science calls for decarbonization as quickly as possible. At the same time, an orderly and just transformation process comprising adequate regulation must be ensured. We can only achieve this balancing act if politics, real economy and financial services industry work together.

Sandra Švaljek

Deputy Governor, Croatian National Bank

Crisis urges financial systems to adapt to foreseeable global shocks

The establishment of the High-level Expert Group on Sustainable Finance (HLEG) late in 2016 and the publication of its final report at the beginning of 2018 put in motion a series of actions at the EU level. They were aimed at creating a framework for economic growth based on sustainable public and private projects and underpinned by financial products that take into account the environment-related risks. The European Commission incorporated HLEG's recommendations into its Action Plan on Sustainable Finance and, following to that plan, set up a Technical Expert Group on Sustainable Finance.

The European Union's political orientation to taking decisive steps towards sustainable finance supported by expert advice has so far resulted in an elaborated and complex sustainable finance regulatory framework. The framework covers various issues, among which the issue of the unified classification system for sustainable economic activities ("taxonomy"), the EU green bond standard, methodologies for low-carbon indices (Benchmark Regulation), the regulation on disclosures relating to sustainable investment and sustainability risks etc. Finally, at the end of 2019 European Commission published the European Green Deal, a comprehensive EU growth strategy with the aim to achieve climate neutrality by 2050.

The developments setting a stage for sustainable finance are without any doubt based on the increasingly pronounced environmental and societal concerns (WEF, 2020), urging the need that the world of finance itself aligns with those concerns and incorporates the ESG principles into its daily business. However, those developments are equally driven by the awareness that there is a strong preference for sustainable financing among the interested public – retail investors, pension fund policy holders and savers in general (University of Cambridge Institute for Sustainability Leadership, 2019).

It should therefore not come as a surprise that there is a growing population of financial institutions that are individually, or jointly within initiatives such as the Task Force on Climate-Related Financial Disclosures, putting their efforts to provide green financial products as well as to disclose to the investors the financial risks related to the climate change and other environmental risks. For the last few years, the issue of sustainable finance has also attracted the attention of both central banks and supervisors.

At the end of 2017, eight central banks and supervisors established the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), which, only two years later, consisted of 54 members and 12 observers representing countries from five continents, and contributing to the global output with 57 percent. The NGFS is a consensus-based forum aimed at sharing best practices, contributing to the development of the climate and environment related risk management in the financial sector and mobilising mainstream finance to support the transition toward a sustainable economy.

Vigorous developments in the area of sustainable finance were going to continue in 2020 and the years to come. However, the global economic crisis caused by the outbreak of the COVID-19 pandemic might disrupt this, otherwise certain trend. Due to the pandemic crisis, the focus of both businesses and policy makers is turning to preserving economic activity and maintaining financial stability, so that environmental considerations might disappear from the priority list. There are two ways forward. The current economic crisis can be an opportunity to strengthen the efforts on climate change. However, it can also cause the loss of the momentum on the pathway towards the low-carbon transition. It is up to the central banks and regulators to use this crisis to make the financial system more resilient to future global shocks, with shocks related to climate change and biodiversity loss being the foreseeable planetary emergencies.

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Margarida Corrêa de Aguiar

President, Portuguese Insurance and Pensions Funds Supervisory Authority (ASF)

Sustainable finance challenges – the role of the insurance sector

The issue of sustainability in general – and of climate change in particular – has risen to the top of the political agenda in recent years.

It is widely acknowledged that transitioning to a more sustainable economic model and achieving the objectives of carbon neutrality will require full commitment from all economic agents. The financial sector will, in particular, have a pivotal role in a successful transition considering the financing needs required largely surpass the capability of public spending. Within the Union, the announcement of the European Commission's Action Plan for Financing Sustainable Growth, in March 2018, was a determinant stepping stone for mainstreaming 'sustainable finance'.

As the discussions deepened on how to materialize the actions foreseen in the Action Plan, the introduction of 'green supporting' and/or 'brown penalizing' factors in prudential regimes of the financial sector has rapidly gained momentum as a catalyst to reorient capital flows towards sustainable investments, activities and projects. The insurance and pension funds sectors, in particular, due to their notorious role as a major institutional investors with a long-term profile, are considered as natural candidates for this task, and, for the former, the upcoming review of the Solvency II Directive – which establishes the Union's harmonized insurance prudential regime – provides an appealing opportunity to do so.

ASF – the Portuguese Insurance and Pensions Funds Supervisory Authority – has always advocated that the prudential regime, and particularly the capital requirement' calibration, should be corroborated by empiric evidence as a precondition to maintain the regime risk-based and ensure adequate levels of consumer protection, while safeguarding financial stability. Such evidence should, however, not be available in the short-term due to the scarcity of available and reliable data with the relevant level of granularity to perform adequate calibrations. In this regard, other initiatives under the Commission's Action Plan will be crucial to close that gap, such as the development of a unified EU classification system (taxonomy) and of sustainability benchmarks, as well as the enhancement of non-financial disclosure requirements.

Moreover, it should be highlighted that an eventual introduction of green supporting' and/or 'brown penalizing' factors in prudential regimes, should not be seen as a sufficient condition for mobilizing substantial funds to sustainable activities, as a multitude of other criteria are factored in when making investment decisions.

In that sense, other actions could prove a more efficient vehicle towards that end. For example, mandating supranational bodies to set up 'green banks', back-up the issuance of 'green bonds', and to attribute 'green labels' to financial products could act in a more effective and also more swift manner to build relevant capacity considering the long period of time it will be necessary to mobilize and consolidate 'green' activities and projects, while preventing abrupt disruption to businesses or assets.