IV. ENHANCING SUSTAINABILITY AND LONG-TERM INVESTMENT

Issues at stake

The current Covid-19 crisis shows that certain risks that may appear negligible can provoke huge socio-economic damages. Although the Green Deal can contribute to long term growth, it cannot be considered the top priority for relaunching the EU economy. However, it defines an indispensable set of (ESG) targets that must be pursued to reduce climate and biodiversity-related risks that are becoming increasingly material.

Such a vital and ambitious repositioning of the economy will require a significant and sustained deployment of capital. This makes the definition of an ESG language, common to financiers and entrepreneurs, necessary. One essential contribution in this perspective is the taxonomy of activities currently being defined by the Commission. However, monitoring whether each category of economic player is both transitioning and leveraging these fundamental changes in a timely manner, is also essential in order to gain strategic advantages in addition to a general mitigation of these threats.

Consequently, integrating the whole ESG considerations into the strategy planning processes and governance of financial and non-financial companies is indispensable, in addition to the necessary consideration of climate related financial risks, which is required to ensure the resilience of the economy. However, an appropriate framework that EU Small- and Mid-Caps and more generally SMEs can use to define and report on their ESG strategy is still lacking. It would be preferable that such efforts are undertaken at the EU and global levels to ensure that they are sufficiently cost efficient and proportionate

Content

Green Deal: implications for the financial sector

Harald Waiglein

Director General for Economic Policy,
Financial Markets and Customs, Federal Ministry of Finance, Austria

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. ●

World Economic Forum, 2020, The Global Risks Report 2020, https://www.weforum.org/reports/the-global-risks-report-2020 .
University of Cambridge Institute for Sustainability Leadership, 2019, Walking the talk: Understanding consumer demand for sustainable investing, October 2019, https://www.cisl.cam.ac.uk/resources/sustainable-finance-publications/walking-the-talk-understanding-consumer-demand-for-sustainable-investing.

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. ●

ESG trends in business and finance

Tomoko Amaya

Vice Commissioner for International Affairs, Financial Services Agency, Japan (J-FSA)

The business community and financial community working together

The attention on sustainable finance has been significantly increasing globally, including in Japan. I see this topic appearing more often on the agendas of international and national conferences in the financial sector. The ESG investment has been rapidly growing. For example, some reports state that in Japan, the issuance of ESG bonds doubled between 2017 and 2018.The JFSA is proactively working to support the SDGs initiative given that SDGs' vision is consistent with the JFSA's mission, i.e., to contribute to the national welfare by promoting the sustainable growth of the economy and stable asset building.

At the same time, it is also important that the private sector (e.g., companies, investors and financial institutions) takes action to achieve SDGs on their own initiatives in such a manner as to enhance corporate value and investment returns in the medium to long term.

From this perspective, we see great value in the FSB Task Force on Climate related Financial Disclosures (TCFD) initiative. With more than 200 companies and organizations supporting it, Japan now has the highest number of TCFD supporters in the world. Among the TCFD supporters, the number of business corporations is larger than that of financial institutions. Moreover, carbon intensive industries such as energy, electricity, steel, chemical and cement have also expressed their support and willingness for engagement with the TCFD recommendations.

As a background to this increase, the TCFD Consortium was established as a private sector initiative in May 2019. The Consortium brings together companies and investors to discuss challenges and share leading practices to move ahead with corporate disclosure aligned with the TCFD recommendations. As a product of such discussions, the Consortium released Green Investment Guidance last year to demonstrate viewpoints and good practices for investors making use of information disclosed in line with the TCFD recommendations. This Green Investment Guidance would also help companies better understand investors' expectations, and thereby improve their own disclosures. In furtherance of the work, the Consortium is planning to revise the Guidance for Climate related Financial Disclosure (TCFD Guidance), which was initially published in December 2018. Both the Green Investment Guidance and the revised TCFD Guidance will facilitate collaboration with the business and finance sectors.

The inclusive, dialogue-based framework of the Consortium is the key to success of increased support of the TCFD in Japan. Through its activities, participants are able to deepen their thoughts on the effect of climate change on their business environments. We expect both business corporations and financial institutions to review their strategies, business models and risk management, which may contribute to turning the risk into an opportunity for innovation in the low- and zero-carbon economy. ●

Liange Liu

Chairman of the Board of Directors, Bank of China

Sustainable finance: China's practices, challenges and future actions

In recent years, sustainable finance with green finance at its core witnessed robust development in China. It has become common practice among major Chinese financial institutions to support sustainable development as a key aspect of embracing corporate social responsibility. As of the end of 2019, China had a green credit balance of approximately USD 1.5 trillion, and witnessed a total of more than USD 150 billions of green bond issuance.

Mutual funds that have incorporated ESG related strategies reached a volume of USD 7 billion, while other innovative green financial products, such as Green Insurance, Green Trust and Carbon Finance, are thriving. ▶

Despite the rapid growth, sustainable finance development in China is still facing challenges.

The total volume is still insufficient to meet needs. According to the China Green Financial Development Research Report 2019, the total demand for green finance in 2018 stood at about USD 300 billion, while the supply was less than USD 200 billion, making a shortfall of over USD100 billion. The financial industry needs to attach more importance to and effectively stimulate internal driving forces to fill the gap.

The structure of sustainable finance imbalanced. In China, the funding for urban rail transit and renewable energy is ample, but that for environmental restoration relatively falls short. Although green bonds are growing rapidly, green credit still accounts for over 90% of the green finance. Financial institutions need to foster product innovation and provide better-targeted services.

External incentives and policy support are insufficient. As public product, the pricing of sustainable finance is difficult. Compared with regular financial projects, sustainable financial projects often involve longer duration, higher-standard disclosure requirements, and more cost of management and risk control. China has introduced a comprehensive policy framework to support green finance development, while the specific measures are still in the process.

> *More efforts should be made to further promote the sustainable finance in China.*

Financial institutions should actively tackle the challenges and provide strong support for environmental and social sustainability.

Boosting internal driving forces. To enhance the development on sustainable finance, financial institutions should develop a unified strategy of sustainable development and incorporate it into the management framework, strengthen the strategy implementation and post-assessment, and reasonably increase the weight of sustainable finance indicators in the KPI assessment system.

Enhancing the service capabilities. Adhering to market principles, financial institutions should implement differentiated pricing on the sustainable development risk of customers, strengthen development of green bond/credit and product innovation of green insurance, green trusts, green industrial funds, etc., and build powerful brands, to support the development of an eco-value compensation mechanism, hence the appropriate pricing on externalities of green projects.

Improving the quality of development. By establishing an international platform to share best practices in sustainable finance, financial institutions can share relevant policies, data information and business experiences on sustainable finance, and co-establish a supportive and coordinative mechanism to improve the global participation and development quality. ●

Sylvie Goulard

Second Deputy Governor, Banque de France

Greening the financial sector remains an urgent need to face the persistent challenge of climate change

Amidst the current Covid-19 crisis, we all need to keep fighting another crisis, climate change, and keep thinking about the best measures to undertake to finance the transition to a low carbon economy. In that perspective, one priority stays to ensure that "green" projects can be appropriately funded. Financial institutions must be able to assess the risks and returns of such projects on the accurate (longer) time horizon. Considering climate change seriously also means, for the financial sector, taking into account the financial risks relating to transition- notably the risks of stranded assets- and physical risks in their own balance sheets. In a nutshell, climate-related risks must become a widespread axis of risk analysis by financial institutions.

> *The political will to produce standards should not weaken in the context of the current Covid-19 crisis.*

Over the past years, the financial sector has been moving in a greener direction, no doubt. Part of this trend has indeed resulted from both market pressure and clients' appetite for greener products. However, regulation has also played a key role, both at national and European levels, by setting disclosure standards for instance. In France, since 2016[1], financial institutions must disclose their exposure to climate-related risks and assess the related financial risks.

The French supervisory Authority for Banks and Insurance (ACPR) recent studies[2] find that there was a significant progress in the governance of climate change risks and in the analysis of transition risks. The need to closely monitor climate-related financial risks is also observed globally: the Central Banks and Supervisors' Network ▶

for Greening the Financial System (NGFS) is planning to release a Status Report on this topic in the coming weeks.

This is something we follow upon carefully as we, Central Banks and Supervisors, definitely believe that we can support this evolution and foster its harmonization, along with standard setters. The Banque de France is particularly active within the NGFS, launched at the One Planet Summit in 2017.

This network is a coalition of Central Bankers and Supervisors willing to share best practices and leverage each other's knowledge. At the national level, the ACPR established last year a Commission on Climate and Sustainable Finance aiming at keeping track of the commitments taken by banks and insurers relating to climate risks. Our next step will be to simulate the resilience of these institutions: a pilot exercise, based on climate scenario analysis, will be conducted by the Banque de France and the ACPR in 2020.

Nevertheless, the NGFS is not a standard setting body, and we rely on standard setters and policy makers to allow for homogenous data, without which no consistent monitoring and pricing of climate- related risks can exist. The political will to produce standards should not weaken in the context of the current Covid-19 crisis. We should keep in mind that the fight against climate change is vital. Some experts even suggest that both crisis are related at some point. Hence, the biodiversity loss and its impacts on the financial sector may be one topic to further explore in the future.

1. Act of 17 August 2015 on energy transition for green growth
2 Analyses et Synthèses n°101 et 102, avril 2019

Ricardo Laiseca

Head of Global Sustainability Office, Banco Bilbao Vizcaya Argentaria (BBVA)

Sustainable finance: bringing the age of opportunity to everyone

"Good comes out of evil", a Japanese proverb states.

We are living an unprecedented paradigm driven by an unknown evil, the Coronavirus. It is going to have a negative impact on the financial system, the real economy and, also, the aggregated social welfare function.

Good swiftly came out: the whole society, public bodies and private agents quickly reacted to do whatever it takes to jointly battle the COVID-19. We will overcome this tempest. The decisions we are taking now could transform our lives.

Our coordinated response against evil is going to evidence that society, altogether, can overcome huge challenges. Cooperation and working together are the only way. It is time to think about the reconstruction, and to apply what we have learnt from this experience to deal with some other challenges, such as climate change.

> *Breaking the "tragedy of the horizon" and working as one engaged team towards a "new horizon" is the only way forward.*

Public bodies and private agents must keep working as one engaged team that thinks big towards a common goal: to provide value added financial solutions that help society to beat the consequences of negative shocks, like the two previous ones.

In that vein, sustainable finance is also needed to come out as a good and being part of the solution. The Coronavirus is testing companies' environmental, social and governance (ESG) commitment and strategies in a hard uncertain environment. ESG investing and funding has proven some resiliency and a good track so far: there is some empirical evidence that points a better ESG performance than the market in aggregated terms during the last year.

Sustainability is going to gain traction because social dynamics are leading the response, and companies are going to be penalized by investors if they do not take care of their employees and the rest of their stakeholders.

I firmly believe that providing value added environmental and social solutions according to the society and our clients' needs is a win-win that can generate a virtuous cycle:

On the supply side, banks can jointly positively impact the economy and the financial system and contribute to the achievement of the Paris Agreement. We must proactively interact with our clients to provide some high-quality advice and deliver new business opportunities.

On the demand side, the aggregated social welfare function will be enhanced because their needs will be better and more efficiently met. Indeed, society is the key driver of this transformation which is happening faster and deeply than expected.

The enrichment of both, supply and demand, will allow for an improvement of the production possibilities

frontier, and will be a catalyzer for sustainability to continue accelerating.

To achieve that upgraded frontier, sustainable finance markets need to continue their development which is still small and still lacks depth and breath. Banks can contribute by expanding our product offering, strengthening our advisory capabilities and updating our internal processes levering on digital tools and technology.

Last but not least, public authorities, financial regulators & supervisors and international bodies play a vital role, obviously. Their bold and effective response when the COVID-19 impacted the whole system last March, empirically proves that they are also a good needed by the society and by the financial agents.

"Breaking the tragedy of the horizon" and working together for a "new horizon" is the only way forward. There is some work to be done and no time for procrastination: we have the chance of bringing the age of opportunity to everyone when most needed. ●

Ann Prendergast

Managing Director
and Head, State Street Global
Advisors Ireland

Hope on the horizon: addressing the ESG challenge

A growing number of financial institutions, investors and policymakers have shifted focus toward sustainability investing, or incorporating environmental, social and governance (ESG) matters into the investment process.

Although the topic of ESG may seem like a novel phenomenon, the financial services industry has weighed in on certain financially-material ESG factors for some time. What is different now is a heightened sense of urgency given the physical devastation of climate change has become measurably real.

There are two key drivers in this focus shift. The first is increased client demand for sustainable investment and their general changing mindset requiring more stable returns over the longer-term that poses no harm the wider environment.

Even amid the current market turmoil due to the Coronavirus pandemic, investors appear keen to maintain ESG values, for instance by monitoring companies' treatment of employees. The second – perhaps, in part, driving client demand – is regulation which has prioritised policies broadly relating to ESG in recent times, albeit globally divergent approaches have emerged. Clearly, the paradigm has changed and progress has been made.

Nevertheless, persistent key challenges must be addressed. The first step, especially from an investor perspective, is to achieve a common language – or taxonomy – on what constitutes a sustainable investment. The European Union has made headway in classifying economic activities that contribute to its environmental objectives.

> *Clearly, the paradigm has changed and progress has been made.*

To articulate a common understanding of sustainability in practice, however, binary definitions that could limit choice of sustainability products and services should be avoided. Moreover, for financial market participants to apply any taxonomy, there needs to be significant improvements in the quality of sustainability data. Specifically, greater clarity and simplicity is needed for corporate ESG disclosures.

This means harmonisation of reporting standards as well as convergence of data sets and scoring methodologies, at the international level, to allow for better comparability of the sustainability of investments.

Financial institutions, investors and policymakers continue to develop toolkits needed to incorporate sustainability into the investment process. Efforts by the Sustainability Accounting Standards Board (SASB) and the Taskforce on Climate-Related Financial Disclosure (TCFD) have already been important contributions to help industry coalesce around common metrics and reporting standards, akin to what the major credit rating agencies use today to measure credit risk. Importantly, these international frameworks ensure the concept of materiality is upheld when considering ESG integration.

Ultimately, we need to be mindful that the policy goal is not to elevate sustainability risks above other critical components of the investment process, rather it is to ensure ESG is on an equal footing so as to enable private capital flows to be reoriented towards a more sustainable future. ●

Dr. Kay Swinburne

Vice Chair, Financial Services,
KPMG UK

Diversity: time to act upon the evidence

The financial services sector will become more effective if it meets societal demands, such as diversity.

ESG (environmental, social and governance) is the investment phenomenon of our time. The independent research firm ETFGI suggest assets in exchange-traded funds that consider ESG criteria increased from $6bn to more than $250bn between 2015 and 2019.

Much of the ESG debate tends to focus on climate change – the E. This is understandable, but the S and G factors should be of equal prominence. One aspect of S is diversity, on which the sector's record falls short.

Europe's financial services businesses remain remarkably "pale and male". Women, people of black, Asian and minority ethnicity (BAME), and staff with disabilities are all notable by their low numbers. LGBT staff, the industry itself acknowledges, need much greater support[1].

Unfortunately, the COVID-19 crisis may magnify some of these imbalances. In these times of economic stress with no childcare or schooling, it makes sense for the partner earning less to do the childcare. In a greater proportion of households this is likely to be the woman.

Some progress is being made, particularly on gender. The consultant Oliver Wyman says the proportion of senior women in finance now stands at around 20%, doubling over the past 16 years[2]. But women account for only 17% of "approved individuals" according to the UK Financial Conduct Authority[3]. And the European Banking Authority says 42% of credit institutions and investment firms do not yet have a diversity policy[4].

Why should we take this seriously? Well, leaving aside the moral imperative to embrace equality of opportunity, the research overwhelmingly shows a clear link between diversity and corporate performance. Morgan Stanley's "Holistic Equal Representation" research, for example, rates businesses on the diversity of their senior leadership[5]. The stocks of European companies with higher ratings have outperformed by an average of 1.6% a year over the past eight years, it says.

McKinsey research found companies in the top-quartile for gender diversity on executive teams were 21% more likely to outperform on profitability and 27% more likely to have superior value creation[6].

> *Europe's financial services businesses remain remarkably "pale and male".*

Lack of diversity creates "group think" and stifles imagination and creativity. Businesses that look completely different to the range of customers they serve cannot expect to understand their needs.

Recognising these issues, however, is more straightforward than tackling them. The jury remains out, for example, on mandatory quotas. France and Germany have both set legally binding targets for women on the board, at 40% and 30% respectively. In the UK, a softer Government approach has seen the number of women on FTSE 100 boards grow from 12.5% to 33% since 2011[7]. The Women in Finance charter is an example of how a voluntary approach can work well[8].

Quotas will not fix all ills. There is some evidence that the focus on women in the UK has coincided with a fall in BAME representation at the senior levels of companies[9]. No-one is suggesting mandatory quotas for disabled people or the LGBT constituency.

Increased reporting may be part of the answer. Countries including France, Germany, Iceland and the UK already require many businesses to publish data on their gender pay gaps.

This appears to be having some positive results. Given that pay differentials based on gender, sexual orientation, ethnicity, disability and other factors are illegal across much of Europe, there may be scope to do more. The European Commission is now consulting on mandatory gender pay gap reporting.

At the micro level, good practice at some financial services businesses shows what it is possible to achieve. Initiatives linking pay to good diversity-related performance in recruitment and retention show promise. So do efforts to promote flexible working, particularly where both men and women participate; shared maternity and paternity schemes are a good example. Other firms have trialled 'returnee' intern programmes for women who have taken extended breaks from the workforce.

Such initiatives beg an obvious question – will more financial services businesses do more to practice what they preach? ●

1. https://www.theia.org/sites/default/files/press-releases/document/20180701-bringingourwholeselvestowork.pdf
2. https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2019/November/Women-In-Financial-Services-2020.pdf
3. https://www.fca.org.uk/publication/research/research-note-gender-diversity-in-uk-financial-services.pdf
4. https://eba.europa.eu/eba-calls-measures-ensure-more-balanced-composition-management-bodies-institutions
5. https://www.morganstanley.com/ideas/womens-impact-on-the-economy
6. https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Organization/Our%20Insights/Delivering%20through%20diversity/Delivering-through-diversity_full-report.ashx
7. https://www.gov.uk/government/news/third-of-ftse-100-board-members-now-women-but-business-secretary-says-more-needs-to-be-done
8. https://www.gov.uk/government/publications/women-in-finance-charter
9. https://www.green-park.co.uk/insights/green-park-leadership-10-000-2019/s94929/

Suzan Revell

Deputy Chair and General Counsel, EMEA, BNY Mellon

Why Purpose Matters

This EuroFi conference was going to focus on key challenges for European financial services and beyond – chief amongst them was to ensure sustainability plays a central role in financial services and to leverage digitalisation and technology to help future proof the European financial services sector, in particular in its delivery to consumers and clients. Whilst the Covid-19 crisis may have diverted our attention temporarily, these concepts remain central to the future of financial services.

In looking to tackle them, we cannot lose sight that financial services – despite the advent of algos and AI, Machine Learning and DLT – remains a people business. The human element is critical in determining how our industry can meet these future challenges. Ensuring that our firms remain sustainable, that they stay ahead of the curve within an environment of ever accelerating pace of technological change, requires dedicated individuals, working collaboratively and being attune to the corporate Zeitgeist. In turn, as leaders we need to ensure our industry continues to attract talent in the face of competition, particular from the tech sector, and enable them to reach their full potential.

It is here that the recent Corona crisis comes into sharp focus. It has and is challenging us to find new ways to interact with each other, to work at physical distance to each other including the closest co-workers, to understand the personal circumstances of colleagues and family members – the human element has taken centre stage. And it is the individuals, up and down the organisation, that we rely on to continue to serve clients and deliver services across the various parts of our organisations.

A lot of research has been conducted in how companies can succeed in such challenging circumstances. Through our work on corporate purpose, including by participation in AFME and UK FCA working groups, we have explored how critical individual employees' perception of their personal connection with the organisational purpose can be in setting a framework for all the other corporate objectives that we collectively work towards. A corporate purpose that is focused on serving all of its stakeholders - in addition to shareholders also customers, employees and the community - can help to transform a short term focus on profitability into a longer term focus on sustainability. It is key in setting corporate culture and in turn shapes governance processes and decisions - both in business-as-usual circumstances, but particularly in challenging situations where formal governance structures may need to adjust to meet the needs of the organisation, such as the current Covid-19 crisis.

> *A corporate purpose that is focused on serving all of its stakeholders can help to transform a short-term focus on profitability into a longer term focus on sustainability.*

It is therefore critical that companies can embrace a corporate purpose which individuals can align to and rally around. This can take different forms – whether a mission statement, a set of company goals, shared perspective on tackling global challenges. And that corporate purpose can be relevant in multiple different facets – purpose can be a benefitting factor for motivation of the wider workforce but also for wider company alignment. But crucially, being able to internalise a purpose, to harness a purpose which drives performance and profitability, allows companies to compete with a distinct competitive advantage. As the E&Y Beacon Institute has found "companies who clearly articulate their purpose enjoy higher growth rates and higher levels of success in transformation and innovation initiatives".

Whilst purpose is primarily an internal driver, a purpose that permeates into corporate strategy and product development can also be a key success factor with clients. As an example, a company that sets itself a clear purpose to be sustainable may be better able to launch products with a sustainability angle – against the backdrop of growing investor interest in sustainable investment products this can be a crucial success factor.

But there is also a risk in communicating a corporate purpose if such mission statements are not followed up by actions. If they are perceived by the own workforce or externally as mere campaign slogans. In that sense, acting against a stated purpose can bear significant risk for the corporate. A disconnect between the purpose that is being communicated widely and the action undertaken by the firm, can lead to a breakdown in authenticity which, in turn, can lead to a breakdown in trust and ultimately longer-term reputational damage.

These risks aside, I believe the industry and the wider ecosystem, including policy makers, need to embrace corporate purpose as a key factor for our industry in the years to come. To meet the many challenges that lie ahead, only an engaged, talented and inspired workforce can deliver success – and leading by example, embracing a purpose is not only a means to that end but a critical ingredient. ●

Implementing the EU sustainable taxonomy

Emma Navarro

Vice-President,
European Investment Bank (EIB)

Implementing the EU taxonomy

To tackle the climate and environmental crises, the financial system and sustainability will need to be closely connected. Only integrating ESG considerations into investment decision-making, sustainable investments could be unlocked at the scale required to support the transition to a climate neutral society. For this to happen, we must start with a common understanding on what is a sustainable investment.

Having a common language in place is key to give clarity to investors on what is a green investment and avoid "greenwashing" in the market.

This is precisely the goal of the EU Taxonomy on sustainable activities. The taxonomy establishes the conditions and framework to create a unified classification system on what can be considered an environmentally sustainable economic activity. The aim is to develop a list of such activities for the purpose of investment, building around six environmental objectives and based on technical screening criteria. Eligible activities will need to make a significant contribution to one or more of these goals, avoiding significant harm to the others. The list of activities will be developed over time starting with two first environmental objectives, climate change mitigation and adaptation.

The taxonomy will be open to change, to align the classification to market trends and regulatory changes. Transparency and standardization will also be fostered. The regulation on the taxonomy introduces new disclosure obligations for financial market participants that offers financial products. More than 6000 large companies and groups across the EU will be required to comply with its disclosure requirements.

On the other hand, the taxonomy provides green definitions that will be used in the upcoming EU Green Bond Standard and InvestEU regulation. Beyond that, it will also play a major role in promoting consistent and transparent definitions of green loans, green mortgages and other green financial products.

As the EU climate bank, the European Investment Bank has been technically supporting the development of the Taxonomy, through the Technical Expert Group (TEG) set up in 2018. After the final report of the TEG published last March, the EIB will continue to help with expansion of the taxonomy to the other environmental objectives and to provide technical support to Commission towards the publication of the legislation by the end of 2021.

The EU taxonomy will be the most comprehensive guideline of sustainable activities ever developed and is likely to set a global benchmark. One of the key outlets for this taxonomy is the International Platform on Sustainable Finance, of which the EIB is also a supporting partner.

Launched in October 2019 by a group of countries that emit almost half of the world's greenhouse gas, the platform will seek international coordination and information exchange on different sustainable finance initiatives that will help identify barriers and opportunities. It will give an opportunity to promote the EU taxonomy framework.

> *The taxonomy represents a major step for Europe to meet its energy and climate goals.*

A key challenge in the implementation of the taxonomy is data. The development of sound methodologies, metrics, and data collection and reporting systems will be critical for the success of the taxonomy. The TEG has been exploring how to address these challenges, giving guidance on the use of data to different types of users of the classification.

The taxonomy represents a major step for Europe to meet its energy and climate goals. When investors have better information about their climate impact, they can make better decisions. This increases the private sector's investments in low-carbon projects and in climate change adaptation.

That is how we will finance the transition to a green, climate-resilient future. ●

Natalie Westerbarkey

Head of EU Public Policy, Fidelity International

Implementing the EU sustainable taxonomy: a race against time

The EU taxonomy report published on 9 March 2020 is a major milestone providing guidance to investors, companies and issuers on the definition of environmentally green, enabling and transitioning economic activities.

It also introduces specific social and governance criteria, as activities can only be deemed sustainable if they comply with 'minimum safeguards' such as the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles for Business and Human Rights, and the International Labour Organisation's (ILO) declaration on Fundamental Rights and Principles at Work.

Of course, countries can apply more stringent or additional environmental, social and governance (ESG) requirements through local climate, labour or other laws.

There is a systemic nexus between climate change, global disease, social and governance aspects. The pandemic crisis amplifies that ESG criteria are interdependent, exponential and of global systemic relevance. According to the UN, large scale climate migration is expected to increase the frequency and severity of disease outbreaks.

It impacts global medical supply, food security, supply chains, employee rights, economies and financial markets. The WHO suggests that changes in infectious disease transmission patterns are a major consequence of climate change.

The EU taxonomy therefore represents an indispensable policy tool which collectively guides corporates, investors and sovereigns in defining those activities that are environmentally, socially and from a governance perspective sustainable. It has the potential to promote a true shift towards responsible capitalism, if corporates disclose ESG data or roadmap, so to attract more investments. Fidelity has launched a proprietary ESG rating tool to capture that data and engage with corporates and investor clients.

Investor client choices remains the main driver. From a financial perspective ESG assets seemingly show greater resilience during down turns, creating an incentive for investors who look for downside protection. Raising further awareness through investor education will be critical right now.

A timely implementation of the EU sustainable taxonomy is crucial to prevent irreversible environmental damage and future outbreaks to protect the people and planet. Many countries and the European Parliament acting on behalf of almost half a billion EU citizens have only recently declared a climate emergency.

Implementing the EU taxonomy creates opportunities as sustainable finance goes beyond just green investments related to energy and transport. The wider European Green Deal remains vital. It stretches from agriculture, foods, manufacturing, real estate to large infrastructure projects including the health care sector and medicine innovation projects co-financed by the European Investment Bank.

A global approach is indispensable to achieve a meaningful impact. The EU launched an important International Platform on Sustainable Finance (IPSF) which already includes some of the largest countries. In parallel, the G20/OECD are working with asset managers on a sustainable infrastructure report to be presented to G20 Finance Ministers mid 2020.

A global rapid response on sustainable finance is required to limit the catastrophic impact and the optimal solution is reached through international solidarity. ●

Ingrid Holmes

Director, Head of Policy & Advocacy, Federated Hermes – International

EU sustainable taxonomy: a good start but only part of the jigsaw puzzle

The EU's sustainable taxonomy has attracted criticism for reflecting only a narrow set of economic activities being undertaken by an even narrower slice of financial markets. However, such criticism is misplaced. The taxonomy is a work in progress and reflects only one piece of the broader financial market reforms put in place as part of the EU's Sustainable Finance Action Plan.

The taxonomy is needed because many financial market participants do not understand what sustainability, or 'net zero,' means in the context of specific climate-related economic transition. Such a lack of understanding is equally true amongst many corporates and policy makers too. Academics have referred ▶

to the taxonomy as a 'boundary object': common information that can span a range of intersecting communities. In this case investors, corporates and policymakers. It is facilitating a common understanding of the characteristics our future 'deep green' economy needs if we are to make a success of the Paris Agreement on Climate Change.

Developed in consultation with a broad-based group of experts, the taxonomy is an impressive piece of work. It not only defines in detail our 'deep green' future, it also helps users of the taxonomy to think through how they need to balance the different facets of a truly sustainable economy.

The EU taxonomy should be embraced by all governments/regulators as a basis for a global conversation and serve as the basis for an emergent set of integrated sustainability expectations. Continued development of the EU taxonomy should be supported, free from political pressure. The EU taxonomy represents expert views on what European economies need to achieve to be considered, truly sustainable. It needs to be outcome based – rather than reflecting the different transition pathways each member state might take.

> *The taxonomy is a work in progress and reflects only one piece of the broader financial market reforms*

The next step in the taxonomy evolution will be its adoption and implementation by the investment community, where it will serve as a new reporting tool for clients to better understand how aligned, or not, different products and firms are to the taxonomy. The decision by the European Commission to link the taxonomy to the Non-Financial Reporting Directive reporting requirements was critical to ensure necessary data flows, as one of the challenges the investment community would have faced is that companies currently are not required to report on their economic activities at the level of detail envisaged by the taxonomy.

There is anecdotal evidence real economy firms affected by the climate transition are already using the taxonomy to consider forward capital expenditure planning – and this can only be a good thing. The window of opportunity to manage climate change is less than a decade, and it is critical that both companies looking to access capital markets, and investors looking to encourage sustainable investments, consider whether their forward operations and strategies map to the taxonomy. ●

Takanori Sazaki

Regional Executive for EMEA, Mitsubishi UFJ Financial Group (MUFG)

The road to responsible decarbonised banking

The end goal of the energy transition to a net zero world is clear: creating a sustainable world for future generations by preventing an increase in global warming by 2° Celsius. We all have a role to play as we try to achieve this goal in the coming years; no single company, industry sector, government or community can do this alone. Each stakeholder has a different responsibility when it comes to the energy transition and we should acknowledge that there are limitations to what each organisation - including banks - can contribute.

Banks' role in the energy transition

Banks have and will continue to play a crucial role in financing the economy. They also help providing solutions for social issues and can help build a sustainable society where clients can achieve sustainable growth. For banks operating globally, sustainable strategies will have to reflect the interests of all stakeholders; national policy makers, central banks, the industry, regulators as well as the public. Each economy has their own starting point, their own energy mix and their own unique incentives and ability to transition to a net zero world. Most banks support a wide range of companies and industries, including those in areas which are reliant on oil, gas and even coal for the most basic needs of heat, food and shelter. This will not change overnight. The key for these sectors is to become more energy efficient and banks can encourage these efforts by adjusting their individual ESG policies and procedures. However, they must do so in a responsible manner to ensure the energy transition runs a smooth course without unnecessary disruption to the financial system and the real economy.

> *Any taxonomy with the aim to define sustainability of all economic activities should have the aim of becoming a global solution to avoid fragmentation along jurisdictional lines.*

Regulatory framework and the transition

Climate change is a global issue and several important global initiatives have been developed to further monitor, facilitate and regulate the contribution from the financial services industry. The EU taxonomy is an important first attempt to draw a clear line between which economic activity is sustainable and which is not, and it creates incentives for investors to move towards ▶

more sustainable solutions. The transitional path is slowly becoming more clear due to improved reporting, enhanced risk management and more coherent public policy frameworks. And while climate change is a global phenomenon, the energy transition also has a dynamic nature given the various geographical, social economic and technological dimensions that need to be taken into consideration. Any taxonomy with the aim to define sustainability of all economic activities should have the aim of becoming a global solution to avoid fragmentation along jurisdictional lines and at the same time able to evolve dynamically, taking into consideration technical innovation in energy efficiency, energy consumption patterns and market dynamics in new energy sectors.

Working together to support the transition

Achieving net zero targets, even with the resources, talent and technology available today, is going to be a tremendous challenge. Societies at large need to work together to explore opportunities for new energy solutions. All GSIB banks are focused on understanding and managing the risks arising from climate change, including active engagement with clients. It is important that governments are transparent about what is achievable for each sector in the economy and this path forms the basis of a responsible road to decarbonised banking, allowing for a balanced road to Paris.

Gerhard Endemann

Head Sustainability, Head Environment, Wirtschaftsvereinigung Stahl (German Steel Association)

Challenges to introduce sustainable finance and taxonomy into the steel sector

EU Steel companies produce according to legal requirements, and often go beyond. Existing processes have been optimized why an increase in efficiency and reduction in environmental and climate-relevant effects is hardly possible within existing processes and plants.

Correspondingly, all companies search for new and modified processes in order to gradually enable the path to a CO_2-free and sustainable future.

The steel sector fundamentally supports the approach of sustainable financing and the goal of the change to a sustainable and CO_2-free society. But, an appropriate and solid design of sustainable finance rules is inevitable. A holistic approach is essential that takes full account of the specifics of a basic industry, its significance for the value-added networks and its enabling properties for sustainable activities.

The transformation within sectors will not happen overnight. New technologies must be developed and implemented. In the meantime, existing plants that have not yet reached the end of their life will continue to be operated. In order to rule out negative (environmental) effects during continued operation, these existing plants must be kept in optimal condition and be adapted to the best available technologies and processes must be further developed.

> *Transformation requires parallel financing of new technologies and further development of existing technologies.*

As a result, there is a need for financing both – 1. the further development of existing systems and processes and 2. the desired transformation itself. The financing must be ensured in parallel. These are transitional activities in accordance with Article 6, Paragraph 1a of the "Regulation of the European Parliament and of the Council on the introduction of a framework to facilitate sustainable investments".

While the taxonomy for future low-carbon technologies is defined by the "Taxonomy for Sustainable Financing" in both EU legislation and ISO standardization procedures, the conditions for the transition activities and a transformation taxonomy are still widely unclear.

Several points must be considered in a transformation taxonomy. Transformation must be accompanied by simultaneously securing the financing of both new technologies and the further development of existing technologies.

This presumes that (i) currently a low-carbon alternative is technically and economically not available, and (ii) financing in existing assets neither hinders the development of new low-carbon alternatives, nor (iii) retains carbon-intensive assets beyond the transformation period.

Therefore, companies will demonstrably create and follow a CO_2 reduction plan while aiming for continuous improvement across all existing and future processes. The industrial emissions directive is applied, and facilities are adapted to best available technology.

In principle, the same basic conditions with regard to climate protection/adaptation, emissions, water protection, nature conservation and CE shall be used for the transitional activities as for climate-neutral activities, but – except of being among the best 25% of the sector in Europe – no stronger thresholds should be set.

Due to above mentioned big challenges, setbacks in continuous improvement for technical reasons as well as setbacks because of legal or political changes must not be borne by the affected sectors.

Gerry Cross

Director of Financial Regulation, Policy and Risk, Central Bank of Ireland

The Taxonomy – the cornerstone of the Action Plan on Financing Sustainable Growth

When considering the impact of the Taxonomy and how its role could be expanded, we should firstly acknowledge, from a financial regulation point of view, the highly ambitious work set out in the European Commission's *Action Plan on Financing Sustainable Growth* and the influence it hopes to have on the financial services industry, investors and of course, regulators. It is obvious that this is an area of financial regulation that is developing rapidly. It is important for regulators and financial market participants to be well sighted on the changes. Not only on the relevant details - though these are of course very important - but also on the underlying direction of travel. What we are seeing is a material evolution in financial regulation. One which is consistent with a change in how a well-functioning economy is perceived and understood, with sustainability one of its determining features. The development of a Taxonomy of sustainable economic activities it is an essential step in supporting the flow of capital into sustainable activities in need of financing and plays a critical role in progressing towards that well-functioning sustainable economy.

Secondly, it should be acknowledged that the role the Taxonomy will play in other areas of financial regulation, most notably disclosure, will be crucial in protecting investors. Under the Regulation on sustainability-related disclosures in the financial services sector (the Disclosures Regulation) where a financial product promotes environmental or social characteristics or has sustainable investment as its objective, the financial market participant will be required to disclose information as to how those characteristics are met. The Taxonomy now extends this obligation by requiring financial products which invest in an economic activity that contributes to an environmental objective to use the criteria set out in the Taxonomy to include detailed information on that environmental objective, and describe how the investments underlying the financial product invest in activities captured by the Taxonomy.

> *A taxonomy of sustainable economic activities it is an essential step in supporting the flow of capital into sustainable activities.*

For this to work, data about company or issuer performance against the Taxonomy activity criteria will be required. So, it is timely that the European Commission is currently consulting on enhanced ESG corporate disclosure under the Non Financial Reporting Directive to target an estimated 6,000 large listed companies with a view to enhancing their delivery of high quality environmental-related reporting.

While we are still in the early stages, we can broadly see the development of a sustainable finance eco-system with the Taxonomy as the common feature. Lastly, we know the European Commission has mandated work in relation to Ecolabels for financial products and Green Bonds. The Taxonomy will, of course, play a crucial role in the development of these labels, and, it would seem fair to suggest, will continue to underpin future sustainable finance regulation. ●

Eurofi would like to thank very warmly
the Croatian EU Council Presidency
for their support to the preparation of this publication

ESG challenges for small and mid-caps

Mario Nava

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

European Commission work on non-financial reporting

The European Green Deal has put Europe on the path to become the first climate-neutral continent in the world by 2050. The Commission recently took a big step in that direction by unveiling its proposal for the first ever European Climate Law.

By the end of 2020, the European Commission will also put forward a new Sustainable Finance Strategy, as well as proposals to revise the Non-Financial Reporting Directive.

Currently there is a sustainability reporting gap. The needs of investors for corporate sustainability information are increasing faster than any improvements in company reporting. There is plenty of evidence that the non-financial information reported by companies is not sufficiently comparable, reliable or complete.

Non-financial reporting from investee companies will need to improve to enable the financial sector to meet its own legal obligations to report certain sustainability-related information under new European laws – in particular the taxonomy Regulation and the regulation on sustainability disclosures by investors.

At the same time, the current situation is also unsatisfactory for reporting companies. They face uncertainty and complexity when faced with an array of overlapping and inconsistent private non-financial reporting standards and frameworks. And they are under pressure are under pressure to respond to additional demands for non-financial information from sustainability rating agencies, data providers and civil society, irrespective of the information that they publish as a result of existing European reporting rules.

In parallel to the development of a legislative proposal to revise the Non-Financial Reporting Directive itself, Vice-President Dombrovskis, has announced the launch of a process to develop European non-financial reporting standards. Not every detail can – or should – be fixed in law. There is also a need for clear reporting standards for companies to apply.

The EU cannot develop such standards on its own. While we are well placed to take the lead, the EU will need work closely with existing private standard-setters such as the Global Reporting Initiative and the Sustainability Accounting Standards Board. We will incorporate the best and most widely accepted elements of existing standards, even though none of them on their fully meet European needs. This cannot be a question of reinventing the wheel.

Our work on non-financial reporting will have to strike a balance between the information needs of users, primarily the investment community, and the ability of investee companies to collect and report such information. We will need to play close attention to the potential costs of stronger non-financial reporting requirements, and compare them to the costs of not taking action.

We have contracted consultants to gather better data on the costs of non-financial reporting. We will also gather feedback from a major online consultation that is open until Mid-May, and from a separate survey targeted to SMEs.

Our aim is to enable the financial sector and companies to realise their full potential as catalysts for the transition to a sustainable economic system in Europe. ●

Yann Pouëzat

Director for Corporate Financing and Financial Markets, French Treasury, Ministry of Economy and Finance, France

Policies challenges for addressing standardized ESG adoption

Since the Paris Agreement in 2015, various institutional and normative initiatives have emerged to foster more transparency and long-termism in the economy. The fight against climate change requires to involve the financial system into the path of energy transition.

The ambition to redirect financial flows towards a more sustainable economy has been partly made more tangible. However, the absence of convergence around a common definition of 'sustainability' prevents companies from appropriately disclosing the degree of environmental sustainability of their economic activities. In this regard, the future adoption of the European Taxonomy in 2020 - classifying the economic activities regarding their sustainable impact - has a strategic role to play in helping investors define their investment policies accordingly. Thus, this common language and the associated regulatory efforts are essential ▶

to tackle the existing challenges regarding the corporate issuer's disclosure of environmental, social and governance (ESG) information and consequently sustainable investing.

The European Union, through its Action Plan for sustainable finance has incorporated some new reporting requirements on the sustainable impact of investments in the existing regulations applying to financial markets. However, the multiplicity of non-comparable ESG information reflects the different approaches to corporate issuer disclosure and scoring system frameworks. European public policy initiatives shall help to streamline the number of different corporate disclosure frameworks which – as strong as they may appear – blur the readability of the ESG information among different corporate issuers and incur significant costs. By delivering some proportionate policy measures to corporate issuers, the EU shall focus, as first step, on promoting a better global alignment of the different ESG indicators. Nonetheless, the normative character of the EU future policies will have to avoid the risk of excessive granularity and the restriction over investors or rating agencies' innovation upon indicator measurements.

This common sustainable reporting framework makes it necessary to adapt this requirement to the capacity of each corporate issuer. As clear disclosure from small and mid-caps becomes scarce, the reliance by investors or insurers on every kind of data can give rise to a somewhat misleading image of smaller companies' ESG criteria adoption. The establishment of a pragmatic common reporting framework consistent with corporate issuers' resources is a key success factor for the development of sustainable investment.

> *The multiplicity of ESG information reflects the different approaches to corporate issuer disclosure and scoring system frameworks.*

The common objective to achieve a higher quality and comparable ESG data cannot be disconnected from the ambition to adjust our real economy. Europe must be able to respond to the concrete expectations of its citizens with regard to the energy transition. To this end, the social dimension, as one of the pillar of the ESG criterias, should be acknowledged through the simplicity of the ambitious framework required. This makes it necessary to take into account operational complexities for the incorporation of ESG information in order to consider the sustainability impact as a key element of the corporate strategy. ●

Carmine Di Noia

Commissioner, Italian Securities and Exchange Commission (CONSOB)

No obligations but market-based drivers to successful ESG adoption by SMEs

The publication of non-financing reports among listed SMEs is still limited. Lack of communication obviously doesn't necessary imply absence of adoption, but it would appear quite bizarre a company embracing ESG philosophy in its internal processes then "forgetting" to ride the wave of current ESG hype.

Integrating ESG factors into managerial thinking, however, is a revolution under way, not a simple fad. Temptation to "prompt" revolutionary change in business by means of rulemaking is always around the corner. No surprise that the Consultation Document on the Review of NFRD, thus, proposes, as one possible response to the lag in non-financial reporting, the enlargement of the disclosure duties also to small/unlisted undertakings.

I do not think this is the best way to convince SMEs of the potential embedded into a shift of their strategic planning towards a long-term, sustainable horizon. Regulatory actions, with its unavoidably but burdensome solutions, should leave the floor to sound and progressive market-based evolutions. EU Institutions have already put in place the regulatory framework to favor spreading of ESG-compliant strategies (also) among SMEs: this is Capital Markets Union.

> *Demand for ESG values from long-term investors is the best way for SMEs towards sustainability.*

The initial 2015 Action Plan strongly addressed SMEs funding needs by

proposing measures aiming at broadening market-based financing. The goal to enlarge the so-called "funding elevator" was pivotal in the Action Plan, with particular regard to the equity side (venture capital and private equity) and, more in general, the supply of "patient capital" suitable for convincing (small) companies to abandon short-term approach for a more sustainable ▶

management. 2017 Mid–term Review went further on outlining that a "deep re-engineering of the financial system is necessary for investments to become more sustainable and for the system to promote truly sustainable development from an economic, social and environmental perspective". Recent Report of The Next CMU High-Level Group stressed the sustainable character of CMU to the point that proposed a re-branding the entire project "Savings and Sustainable Investment Union".

Tools to spread ESG among SMEs are already present in the CMU logic and measures. A full deployment of the regulatory actions, reinforced by a strong injection of fiscal incentives, should boost long-term investment by both institutional and retail investor. This should in turn bring to light the need for a longer-term orientation of the goal of small firms: a sustainable strategy, an improved governance and a management focused on social and environmental targets. A successful development of market–based sustainable finance, in conclusion, is the market response to the problem: favoring demand for ESG values and data from sustainable long-term investors is the best way to persuade innovative SMEs to take meaningful steps towards sustainability. ●

Christophe Bourdillon

Chief Executive Officer,
CDC Croissance

ESG integration by small- and mid-cap companies: a difficult yet essential transition

The major movement to promote the imperatives of an ESG approach in the contemporary economy now seems to be irrevocably under way. The European Union aims to play an important role in this transition, by pursuing a proactive soft power strategy for green growth, as recently adopted by the Commission. Sustainable finance is the key lever for action in this area.

For several years, the EU has been engaged in work to gradually establish a framework, including a taxonomy and guidelines, aimed at encouraging investors to systematically embed the analysis of multiple ESG factors in their asset allocation decision processes. National authorities throughout Europe have reaffirmed this approach, which has already been taken on board in the large-cap sector, where many companies have put in place substantial measures to ensure better dialogue with the financial ecosystem (stock exchanges, investors, issuers, NGOs, rating agencies, regulators, etc.).

The situation is entirely different for small- and mid-cap (SMID) companies, which tend to be more varied in terms of capitalisation (from several hundred thousand to about five billion euros) and available resources. Investors are becoming more aware every day of just how much this sector, with a few brilliant exceptions, is failing to embrace such an approach. The reasons for this astonishing unpreparedness range from a lack of knowledge to an existential fear brought about by developments confusedly perceived more as threats than as opportunities. Companies in the sector are discouraged by the methodological complexity (with a multitude of factors to be analysed and reported) and the cost of the transition to a business model that includes ESG considerations.

But the stakes could not be higher, since it is SMID companies, and more generally SMEs, that are the backbone of the European economy. There is thus a risk that, in the absence of proportionate action, these companies could be eliminated in coming years from asset allocation strategies, raising crucial financing issues for them and endangering their very survival. The same is true for intermediaries specialised in the SMID sector, already deeply affected by the transformation of the investment research industry due to the arrival of MiFID II.

> *The firm is studying the feasibility of an ESG fund based on a "best efforts" investment philosophy ...*

As a leading investor in French SMID companies, the equity fund management firm CDC Croissance, a subsidiary of the state-owned Caisse des Dépôts group, has decided to opt for a persuasive approach. The firm is studying the feasibility of an ESG fund based on a "best efforts" investment philosophy, rather than the more commonly applied best-in-class approach.

The aim will be to select listed companies not among the top ESG performers, but instead having prepared for ESG integration only to a minimal or moderate extent and that will agree to engage in a gradual and measurable adaptation process.

The fund, with a target size of €100 million, is expected to begin operations in mid-2020 using a specific methodology. It is anticipated that its launch will coincide with that of an ESG SMID index, designed by Euronext NV and the Ethifinance rating agency.

This new fund should thus become part of an intense mobilisation effort driven by European and national authorities to implement a distinct and gradual adaptation process for SMEs, in order to support their transition towards more sustainable business models. ●

Rami Feghali

Partner, PwC

There is still a long way to go

Sustainable Finance is considered as a central tool to drive the real economy towards sustainability targets such as carbon neutrality by 2050. There is still however a long way to go. The share of ESG financial assets is currently less than two percents of total financial assets. Time is also running out, if we want to meet the carbon neutrality target by 2050 then the required infrastructure investments which are long term by nature must be fully sustainable by 2025. Significant investments and progress are therefore needed within the next five years. A key underlying building block of sustainable finance is however missing. The transition of the 98% remaining financial assets can not be achieved without the availability of appropriate ESG data. There is a wide recognition among financial institutions that ESG data are incomplete, not comparable and of poor quality. This is true for all categories of ESG data, environment, social and governance, and it also true for all categories of companies although the issue is more acute for climate related data and for SMEs.

The gap between financial institutions regulatory requirements on climate risk and the ability of these institutions to comply with them based on the information they have at their disposal will be hard to close. The transmission mechanism can then be broken and instead of steering transition, finance might ultimately exclude those companies that need most support on a fair transition journey: environmental sensitive companies and smaller companies.

No one would think of a financial ecosystem operating without financial statements. We need a non financial reporting framework of the same quality as the financial reporting framework. This would be beneficial for the development of sustainable finance, but it will also be key to structure the transition journey of the real economy. Non financial information is actually more diverse, granular and complex than financial information. It requires a reporting on a set of relevant exposure indicators, ideally by sector, location and company, and even ultimately measuring the impact of such indicators through the whole value chain. It took hundreds of years to build the financial statements that we currently use, by capitalizing on best practices and adopting progressive standardization. We only have five years ahead of us.

> *Sustainable Finance can not be successful without the appropriate non financial reporting framework.*

The revision of Non Financial Reporting Directive is a unique opportunity in that respect, provided it includes a binding standardization of a minimum set of ESG indicators and an appropriate accountability framework. Given its leadership on sustainability and its political legitimacy, the European Union is best placed to build on the multiple existing reporting frameworks and find a solution. This solution can later be refined and form the basis of a global reporting framework. It is not a matter of sovereignty, perfection or excessive regulation. It is a matter of urgency and efficiency. ●

Pervenche Berès

MEP from 1994 to 2019,
European Parliament

Why Small and Mid-caps should welcome non-financial reporting

EU non-financial reporting is this part of information that financial reporting in itself cannot deliver even though they are key to value security and stability of financial markets. The answers to the Covid-19 should not water down this need. In its February 2020 consultation document on the review of the non-financial reporting directive (NFRD), the Commission questions (cf. 40) expending the "scope to include all EU companies with securities listed in regulated markets, regardless of their size". Earlier, the Commission had acknowledged that to widen the scope of the directive "could reduce the burden for companies of having to respond to individual requests for information from sustainability rating agencies and data providers".

But before answering the scope, one should consider aspects affecting any companies. The development of non-financial reporting should not be seen as a way for green washing or to develop ▶

a new hierarchy regarding financial reporting. The quality of the latter is a pre-condition for the former. The current legal tool is a directive with options for Members States. There are now strong arguments to move to a regulation. For example, one area where this option regime has proved to create damage and confusion is when it comes to the control regime.

The proper format should be a compulsory control by third-party independent bodies. The foreseeable review of NFRD is also an opportunity to clarify what is the standard for this reporting, to start with the format including obligation related to prospectus or key information document. But this could also be an opportunity to build a common culture around the Task force on climate related financial disclosures (TCFD) recommendations taking into account the entry into force of the taxonomy. One of the questions that will need to be answer is how to increase comparability and consistency between companies reporting without jeopardizing innovation or capacity of a reporting format to capture the specificity of a business.

> *It would be in the best interest of Small and Mid-Caps to enter the scoop of non-financial reporting because more and more investors will ask for it.*

Currently NFRD only applies to Public-interest entities with more than 500 employees, large banks and insurances listed or not. It allows Member state to define a wider scope, option that has been used by some Members states. In terms of competition and internal market, it would be more appropriate to close this option with a regulation. Regarding Small and Mid-Caps, one could argue that it would be in their best interest to enter the scoop of non-financial reporting because more and more investors will ask for it, it will become part of a business model and it will help the due diligence process when, following the OECD guidance, "entreprises should carry out to identify, prevent, mitigate and account for how they address these actual and potential adverse impacts in their own operations, their supply chain and other business relationships".

The question could then arise, should this be accompanied by three categories standards: compulsory, recommended and encouraged to adjust the proportionality argument? One could also consider in which sector the Mid cap is active to define its obligations. But in the end, it should be recall that nature of risk doesn't always relate to the size of the business, this is true for financial risk, no doubt it is also true for non-financial ones. ●

Anamarija Staničić

Head of Division, Policy and International Cooperation Division, Croatian Financial Services Supervisory Agency (HANFA)

SMEs and ESGs – what is in it for me?

Small and medium enterprises (SMEs) are the backbone of the EU economy. In 2015, just 0.2 % of all enterprises had 250 or more persons employed and were classified as large enterprises. If the EU wants to move towards a sustainable future, SMEs have to be a large part of the agenda. Another consideration is – if a thriving SME sector is an engine for growth, what impact will the adoption of Environmental, social and governance (ESG) criteria have on the business performance of SMEs, and consequently on the growth of the EU economy?

The existing subset of already ESG conscious SMEs aside, when taking up ESG criteria, a natural question will be – what is in it for me? Long term, there may be benefits for SMEs to adapt their business model to the new framework, but taking the long view may be difficult for a small business trying to keep its head above water, especially in the context of the on-going crisis.

Here, the key will be setting up the right incentives. The first step was the sustainable finance package – the taxonomy, the disclosure framework for financial market participants (FMPs) and the changes to the benchmark regulation. The second will be the changes to the Non-Financial Reporting Directive (NFRD), where the Commission is consulting on broadening the scope of the NFRD to SMEs. Short-term, this implies an increase in the reporting burden for SMEs, which should be accompanied by an equivalent regulatory burden decrease elsewhere.

> *The success of the sustainability agenda depends on the EU being able to explain to SMEs how they will profit from the take-up of ESG criteria.*

SMEs will also need a robust support network to help them adapt, both on a national and on an EU level. This is an opportunity for financial intermediaries to branch out and offer support to SMEs, both in implementing ESG strategic planning and external reporting, and getting SMEs the funds they need to do this while growing their business.

The larger issue is that SMEs need to see what the advantages for them are, and they need to see them now. We need to figure out how to make the ESG transition profitable for SMEs. Consumer demand for sustainable products and services will be a main driver for ▶

change in business models, and the market does not naturally reward sensible behaviour, nor do consumers naturally flock to more socially responsible firms. The supply and demand chain does not have in-built ethical considerations and is an engine devoted to making a profit. If we want to change that, we will have to build-in counterweights to the bottom line motive, through appropriate policy choices, including tax incentives and disincentives in national frameworks, as well as impacting the behaviour of FMPs when they market products to their clients, or decide on what business ventures to fund. An example of how to build in incentives for FMPs can be linking prudential requirements to ESG criteria, including an assessment of their business and what they fund against an ESG compliant standard. We also need to acknowledge that there is a reason why SMEs are more reluctant to access the capital market in the EU than in the US.

A new concept is needed for SMEs – a market that would be adapted to their needs and free of the many regulatory burdens that are appropriate for larger, more mature firms, while also incentivising the take-up of ESG criteria with the profitability goal in mind. The benefits of the sustainability agenda need to convince SMEs, or the future of the project remains uncertain.

Mitigating climate risk in the financial sector

Nathalie Aufauvre

Director General Financial Stability and Operations, Banque de France

Climate change: a global issue at the top of the European regulatory agenda

Central bankers and supervisors should consider financial risks related to climate change in order to ensure the resilience of the financial sector as well as the accurate pricing of these risks. This has been the stance of the Network for Greening the Financial System, co-founded in 2017 by the Banque de France, who hosts its secretariat, and which gathers now more than 60 members around the globe. This "club of the willing" called standard setters for action and led the way by providing some strong analytical foundations and practice oriented deliverables. In 2020, it will release a guide for banking and insurance supervisors on how to integrate climate-related and environmental risks in their work, as well as a set of reference scenarios capturing the macro-financial impact of transition and physical risks related to different transition pathways. The NGFS will also publish a report on the current practices of financial institutions in monitoring these risks, highlighting the challenges arising from the lack of homogeneous taxonomy.

The European Union understood well the need for a green taxonomy, with the related regulation being officially released soon. This taxonomy, if complemented in the future by a "brown" one to classify assets with a negative environmental impact, will be a building block for supervisors to tackle ESG[1] risks. On the banking side, the EBA released in December 2019 an action plan for sustainable finance which entails in particular reports by 2021 and 2022 on the inclusion of ESG risks into the annual supervisory review process (SREP) and then into the pillar 3 disclosure framework. The EBA will also assess the relevance of applying a different prudential treatment on assets from a sustainability perspective by 2025. The EIOPA is addressing ESG risks for the insurance sector as well. To foster internal risk assessment by insurers, the EIOPA will finalize scenarios of climate related risks by the end of 2020. Both ESAs will conduct sensitivity analysis related to the impact of climate change on the insurers and banks' balance sheets. In the EBA exercise, participating institutions will identify the share of their exposures consistent with the European taxonomy.

At national level, the ACPR launched in 2020 a pilot exercise (with no impact on capital requirements) for banks and insurers, aiming at measuring the impact of various transition scenarios on the French financial sector. On the other hand, in 2019, the ACPR established a Consultative Commission on Climate and Sustainable Finance to monitor commitment taken by financial institutions, in particular to reduce the financing of carbon intensive activities.

The next challenge to face is to integrate climate risk into the international standards. In this perspective, the new High Level Task Force on Climate Related Financial Risks established by the BCBS is a very positive first step to ensure a more homogeneous understanding of climate related risks by institutions and supervisors. Standard setters should preserve this momentum despite the current crisis, as the risks created by climate change are still ahead of us. ●

1. Environment (including climate-related), Social and Governance risks.

Diony Lebot

Deputy Chief Executive Officer, Société Générale

A fair regulation for sustainable finance: balancing constraints with incentives

Integrating ESG considerations into the banks' strategy and governance becomes increasingly important in view of the climate emergency but also as shown by the Covid-19 crisis. In this context, two major issues arise: the first relates to the risks carried by banks, while the other is on the role banks play towards the economy, their employees and all related stakeholders.

New banking regulations will help clarify and harmonize at EU level the existing ESG approaches implemented by banks. These should cover both risks and financial stability issues and provide the right incentives to allow for a real shift towards sustainable investments. ▶

Firstly, while there is no doubt that climate risks could be a source of financial risks, ensuring a harmonized approach as well as tackling methodological issues are a prerequisite before any specific prudential treatment of exposures is agreed. In this respect, the Network for Greening the Financial System is doing essential work to provide a harmonized supervisory toolbox to define risk management mechanisms. The climate scenario analysis that will be conducted as of 2020 by supervisors should also help in developing a consistent approach. However, key challenges of methodological nature still need to be addressed with respect to data availability and consistency, mismatches of time-horizon between sustainable investments and loan maturities, and the complex integration of banks and clients' long-term strategies, as well as regional discrepancies while operating global businesses.

Secondly, many European banks already have made strong commitments to speed up the redirection of capital flows, by agreeing to the Principles for Responsible Banking or by progressively realigning their portfolio with the Paris targets. Going further, the EU taxonomy should help the identification of activities which are aligned with those commitments. A clear concern however is that the framework's narrow restriction to activities that could be carbon neutral in the very short term could undermine banks' capacity to finance transitioning sectors or companies that are well engaged on a decarbonization path.

Thirdly, data availability is a pressing issue: only EU large corporates are subject to non-financial reporting requirements. To avoid undermining banks' capacity to finance SME as well the development of emerging economies, the framework will need to consider how this data gap should be reflected into banks' own reporting requirements.

Finally, while the spotlight is currently on the climate emergency, sustainable development must also address social impacts. The pace of the transition will not be the same in all geographical areas: this calls for a differentiated treatment as clearly stressed by the Paris agreement at its inception. Indeed, banks play a decisive role to ensure that the energy transition is as fair and as inclusive as possible. Social considerations should be carefully evaluated for each new regulation including environmental ones. In that respect, governments will have to increase their commitment and accompany the necessary transition, and collaboration of private and public sector is of essence.

Daniel Hanna

Global Head, Sustainable Finance,
Standard Chartered Plc

Understanding, mitigating and tackling climate risk and climate change

Regulators are rightly concerned by the potential risk to financial stability posed by climate change. We are very supportive of their efforts. We are also mindful that while everyone in finance has a collective duty to protect the financial sector from climate risk, we must not lose sight of the critical role finance needs to play in preventing climate change itself. This is especially true in Asia, Africa and the Middle East, where we do most of our business. These markets face the greatest risk from climate change and the greatest opportunity to leapfrog to low carbon infrastructure and technology.

We believe that focusing purely on protecting the financial system, excluding considerations of how we finance the transition to low carbon, could even lead to an unintended consequence of making climate change more likely by raising the cost of private sector finance and locking countries into higher carbon pathways. We believe that transitioning to a low carbon future shouldn't come at the expense of lifting living standards, especially in countries where millions who remain in poverty have contributed the least to climate change and are the most vulnerable to it.

Capital and innovation are currently not moving fast enough or to the right places to support the needed transition to a low carbon world. Our recent Opportunity2030 study highlights a $10 trillion opportunity to support sustainable growth in emerging markets. In line with our findings, we've set ourselves ambitious targets to finance and facilitate $75bn of clean technology, renewables and sustainable infrastructure by the end of 2024. We have also framed our lending around the SDGs as evidenced in our Green & Sustainable Product Framework.

The lack of reliable data is a key impediment to tackling climate change. Data, like the information presented in Opportunity2030, is important to understand the potential risk around climate change, the opportunity to invest in the transition, and to track our progress in tackling both. This is one of the many reasons that we have long supported TCFD reporting. However, the uptake in many markets remains slow and carbon data for most of the real economy, especially in unlisted sectors and emerging markets is still absent.

Consistent and trusted frameworks help markets develop. Green bonds have grown more than six times in volume since the announcement of the Green Bond Principles for example. However, given how fast our understanding of ESG is evolving, we should be careful not to overly focus on nomenclature at the expense of impact. A transition bond helping an emerging markets energy company pivot away from coal may well be more impactful than a European green bond backed by retrofits of commercial real estate. A consistent framework for measuring transition and impact is critical.

Ultimately, a global challenge requires coordinated solutions. Developments like the NGFS and IPFS are positive signs that regulators are thoughtful about bringing together global standards. We would welcome the same partnership across private and public sectors to ensure that we can develop the right data and standards to encourage transition to happen during the 2020s, the decade of delivery.

Elizabeth Gillam

Head of European Government Relations and Public Policy, Invesco

Redefining risk and reward for the climate transition

Addressing climate change will require significant and sustained deployment of capital to finance the transition to a sustainable and climate neutral economy. In Europe, the fund, insurance and pensions sectors represent €17tn, €10tn and €4tn respectively of patient capital to be deployed to achieve this goal. In seeking to leverage these pools of capital to support the climate transition, we need to give equal weight to both the risks and opportunities relating to climate change.

A core function of markets is pricing risks. But assessing the financial impacts of climate risks represents a unique challenge – how to price in a risk where the timing and impact are uncertain. The usual disclaimer that "past performance is no guide to future performance" has taken on a whole new significance in the debate around climate change. Firms and supervisors are increasingly turning to scenario analysis to address these challenges by allowing firms to model the financial impact of different climate transition pathways. However, undertaking scenario analysis is a complex exercise, and is only as good as the assumptions underlying the scenarios against which a portfolio is assessed. The Network for Greening the Financial System is showing leadership in this area and we look forward to the publication of their work on scenario analysis in due course. This is uncharted territory for firms and supervisors alike, and an area where public-private collaboration and capacity building would be of mutual benefit as we seek to chart a path through the uncertainty.

Encouraging early action on climate change is critical to avoid the "tragedy of the horizons" described by Mark Carney. To achieve this, we need to crowd-in investors and companies that are heading in the right direction and ensure that such actions are rewarded in the markets. We are increasingly seeing markets pricing in a so-called "green-ium" for companies that are actively taking steps to transition to a net zero world. The Taxonomy could accelerate this trend by providing investors and companies with a common, science-based framework to assess which activities are compatible with the Paris Agreement. However, the strong price signal that European investors can send by coalescing around the Taxonomy risks being diluted in a global marketplace. Other jurisdictions are also developing their own tools, as well as the many industry-led initiatives such as the Transition Pathway Initiative and Science-Based Targets. The International Platform on Sustainable Finance could play a key role to play in the next phase of the Sustainable Finance Strategy to begin building international convergence in this space.

> *...public-private collaboration and capacity building would be of mutual benefit as we seek to chart a path through the uncertainty.*

To accurately assess both risk and reward, reliable data is critical. The Task-Force for Climate-related Financial Disclosures has quickly become the key reference framework for climate-related disclosures for over 1,000 global organisations representing $12 trillion of market capitalization. However, as laid out in its latest progress report, companies are still not disclosing enough decision-useful information. Addressing the data gaps will be of vital importance both for investors and supervisors to better assess both the risks and opportunities inherent in the transition to a net zero economy. ●

Eugenie Molyneux

Chief Risk Officer Commercial Insurance, Zurich Insurance

ESG considerations, business and regulatory challenges and opportunities

Environmental, social and corporate governance (ESG) considerations increasingly influence insurance companies in their role both as investors and as underwriters. Defining the ESG topics to focus on is a challenging ask and an extensive process. As views of internal and external stakeholders (investors, customers, employees, regulators) diverge, Zurich drives a data driven materiality analysis and a three-staged approach to identify, assess and develop sustainability risk positions on difficult ethical issues.

Sustainability risk positions are implemented and operationalized in the business and translated into underwriting practices, recommended business actions and along the product development process. Because we do not to underwrite or investing in thermal coal, oil sands/shales and banned weapons businesses, balancing our own ESG considerations against ▶

those taken more broadly by the market is challenging. Indeed, if the market and/or country, are not yet also focused on the transition to a low carbon economy, it can create the environment for poor relationships with those stakeholders and a difficult business environment. Therefore, Zurich Insurance believes it is key that companies across all sectors of the economy start to analyse and understand the impact climate change could have on their business.

This is an ongoing process and the development of the EU taxonomy will help all sectors comprehend sustainability risks. Zurich Insurance Group supports the international and European initiatives focused on promoting sustainable policies and a progressive transition to a low-carbon economy. However, limiting climate change to 2°C or below will lower physical climate risk, the technological and policy changes required create their own set of risks. Some potential drawbacks can arise from legal uncertainty and complex regulatory requirements resulting in insurers being subject to unnecessary liability risks and clients and investees having difficulties in applying them.

> *Achieving a transition to a low-carbon economy will require fundamental changes to our society and economy.*

Consistency needs to be ensured between the increasing number of reporting and investment regulation (the revised EU Non-Financial Reporting Directive, the Sustainable Finance Action plan and the EU Green Deal). Flexibility in implementation and an adequate level of details in ESG disclosures are required to avoid creating an additional level of barriers. Information overload, duplication, prescriptive and overly detailed ESG disclosures should be avoided. Sound risk assessment should underpin every investment decision.

Green or sustainable investments are not necessarily less risky than more traditional investments. Hence, Zurich does not support a 'green supporting factor' or a penalising 'brown factor'. We would prefer to price externalities at their source, not through insurers capital requirements. When inadequate they may also have the unintended consequence of slowing down the transition. New green industries due to the degree of uncertainty around new risks might require additional capital loading. The cost of insurance and/or appetite of insurers would then impact negatively the transition. It is vital for insurers to manage their total exposures to protect both the company and its customers. Data currently not easily accessible are crucial to invest and to underwrite. Policymakers could play a crucial role in designing mechanisms improving data availability, quality and comparability. ●

Stefanie Ott

Head Group Qualitative Risk Management, Swiss Re

Accelerating sustainable progress in the financial sector and beyond

Sustainability has become a strategic, long-term value driver in the financial sector. By managing and monitoring risks and opportunities associated with environmental, societal and governance (ESG) issues, Swiss Re helps to accelerate the transformation towards a more sustainable economy. Among the wide array of sustainability topics, climate change remains one of the key topics for the industry.

Tackling this topic effectively is challenging and needs a true multi-stakeholder effort. We therefore set an emphasis on our own risk research and partnerships, on product solutions to adapt to the effects of climate change (through e.g. NatCat protection) and low-carbon transition opportunities (through e.g. wind and solar power plants).The topic remains relevant for our re/insurance business, our investment side as well as for our operations. To take a concrete example the wildfires in Australia, Canada and USA increased in frequency and have been linked to climate change. While not a systematic loss in respect to scale, the fires proved that climate change can have effects not considered before. Over the past years, we have witnessed the initial incorporation of sustainability into prudential and conduct regulation across the financial sector at international and regional levels across the globe. From a global perspective, we are part of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) which has developed a set of recommendations to ensure consistent climate-related financial risk disclosures by companies to the market and continues to push for widespread international voluntary adoption of this standard across all financial services sectors.

> *Sustainability is a strategic, long-term value driver in the financial sector. Swiss Re supports the transformation towards a sustainable economy.*

The International Association of Insurance Supervisors (IAIS) together with the Sustainable Insurance Forum (SIF) has been supporting the TCFD's work and is raising awareness of the challenges presented by climate change for insurers and supervisors, mapping out how these issues could be tackled. More recently, Central Banks and Supervisors established the Network for Greening the Financial System (NGFS) which aims to mobilise capital for green and low-carbon investments and identify what ▶

measures are needed to manage financial risks related to climate change.

In most cases, such emerging regulation includes disclosure requirements for insurers' exposure to climate change risks. These efforts intend to achieve more transparency about how sustainability issues affect an organization's businesses, investments, strategy and financial planning.

The regulatory response to the climate change threat is often driven by the political situation in the respective jurisdiction. Political forces increasingly exert pressure on regulators to move capital to a low-carbon economy. Voluntary disclosures of climate-related financial information will likely become mandatory in a couple of years. However commendable this may be, fragmented or overly onerous requirements should be avoided. Consequently, what our industry needs is a harmonized and gradual implementation and therefore an intense discussion of decision-useful disclosures.

We believe that climate-related financial disclosures should be aligned across different regulatory jurisdictions in order to enhance the transparency and comparability between firms operating across different geographies, to ensure a level playing field and to reduce the operational burden on global firms. We will support mandatory disclosures after they will have become decision-useful and best-practice learnings / experience from the industry have become more established. ●

Fausto Parente

Executive Director, European Insurance and Occupational Pensions Authority (EIOPA)

Climate change: the role of insurers in mitigating risk

Sustainability, and in particular climate change, has been a very important part of the political agenda for some time and the success of the sustainability agenda depends to a great extent on the capacity of financial market participants, including insurers, to incorporate the expected long-term consequences of climate change and environmental, social and governance issues into today's risk measurement and decision-making processes.

EIOPA has been working on a number of policy proposals, tools and methods for identifying and managing sustainability risks, including climate change. Without doubt climate change brings considerable challenges to the valuation of assets and liabilities, underwriting and investment decisions and risk measurement. This is because climate change increases the uncertainty about the occurrence and the impact of physical or transition risks, which can happen at any time and suddenly, with far-reaching consequences. Hence, undertakings should not be complacent about these risks.

EIOPA has therefore also included natural catastrophe scenarios in its stress testing of the insurance sector in Europe and our most recent stress test, completed in 2018, participating groups demonstrated a high resilience to the series of natural catastrophes tested, showing the importance of the risk transfer mechanisms, namely reinsurance, in place.

Another element of EIOPA's work has been to integrate environmental, social and governance factors into existing regulations. Regarding Solvency II, in our Opinion, published in September last year, EIOPA addresses the integration of climate-related risks in Solvency II Pillar I requirements.

Overall, Solvency II - as a risk-based, forward-looking and market-consistent framework - is well equipped to accommodate sustainability risks and factors and the Opinion outlines how insurers can contribute to identifying, measuring and managing risks arising from climate change, through their investment and underwriting activities. It is for this reason therefore that insurers and reinsurers should implement measures linked with climate change-related risks, especially in view of a substantial impact to their business strategy and in this context EIOPA has stressed the importance of scenario analysis in the undertakings' risk management.

Insurers can also mitigate the risks of climate change by considering the impact of their own underwriting practices on the environment. In this way, insurers can increase market and citizens' resilience to climate change.

> *Insurers can play a stewardship role. As large investors, insurance groups are well-placed to incentivise and engage with business to act responsibly.*

Above all, insurers can play a stewardship role. As large investors, insurance groups are well-placed to incentivise and engage with business to act responsibly and ensure long-term value creation, playing therefore an important role in the gradual transition to a more sustainable and resilient economy. This stewardship role is more important than ever in contributing to climate change adaptation and mitigation.

Meeting the challenges of climate change requires concerted action from all players and EIOPA will continue to a role to secure a resilient and sustainable industry that is for the benefit of consumers. ●