SESSION SUMMARY - BERLIN SEPTEMBER 2020

Have the prospects of global and EU ESG policies changed with the COVID crisis?

1. Facing the challenges of COVID 19 and sustainability

1.1 The need to react

A public representative stated that Europe has to react to save its economy after the COVID crisis and it will probably also need to react in the future, because of the 'long tail' of impact from the crisis.

1.2 The reaction will either further increase the risks or improve both the economic and sustainability situations

A public representative described how €1 trillion is being pumped into Europe's economy for the COVID 19 recovery. If this money is used to support 'walking dead' industries in the fossil economy, Europe will end up with financial debt, environmental debt and out dated and uncompetitive industries. However, if Europe adheres strictly to its principle of 'do no significant harm' by committing to investment in green deal aligned economies, there will be a huge impact on Europe's economies and their ability to develop through the creation of new industries and increased innovation and digitalisation.

An industry speaker agreed. There is alignment between current thinking about COVID 19 and sustainable finance. There is a $10 trillion opportunity for the private sector to invest in sustainable finance. There will be a huge opportunity until 2030 for companies to invest, create jobs and create growth.

1.3 The economic response to the COVID 19 downturn and the green transition are complementary

A public representative observed that there is political division about economic policy following the crisis. In a finely balanced situation, a slight nudge can make a difference. The public representative emphasised that the COVID 19 response and the green transition are entirely complementary.

A policymaker described how the Commission views the crisis as an opportunity to accelerate the green transition. There are tremendous opportunities for investing in more sustainable economic activities, given the yearly investment gap of €470 billion on climate and environmental goals.

A regulator reiterated the importance of enabling a recovery that also supports the sustainability agenda, highlighting the fact that investors are also clearly viewing the recovery in this way.

1.4 The financial sphere is necessary to leverage the €750 billion Next Generation EU package

A public representative expressed their belief that, given the importance of the financial markets to the real economy, the financial community needs more than a small nudge to make it move in the right direction.

An industry speaker suggested that there will be no medium or long term trade offs between the recovery from the COVID crisis and the green transition. The industry speaker's firm has seen a record inflow into ESG aligned ETFs. One of this firm's products saw record inflow in March, which was the beginning or peak of the COVID crisis in many countries. Furthermore, a recent survey of high-net-worth individuals indicated that a majority of investors are focused on investing in sustainable finance.

A policy maker stated that the private sector must play an important role in Europe's transition to a more sustainable economy, but the public sector can play an important role as a catalyst. The €750 billion Next Generation EU package will not be sufficient. With its sustainable finance action plan, the Commission has tried to incentivise and facilitate the participation of the private sector. The appetite is there, and investors' expectations are moving in this direction. It is now for European policy makers to create a regulatory framework in which sustainable finance will be facilitated and incentivised.

1.5 Key success factors

1.5.1 A generalised use of the EU Sustainable Finance Taxonomy

A public representative stated that the taxonomy must be used for both private finance and public funding. If there are different metering systems, it will be impossible to define 'green' and 'harmful'.

An industry representative stressed the importance of designing the EU recovery fund with both the taxonomy and the sustainable finance principles in mind. Otherwise, there will not be a level playing field between the private and public sectors when investing in corporates. This would result in weakened resilience in the economies that Europe is attempting to strengthen. Achieving a robust economy will only be possible if all investor stakeholders apply the same sustainable finance principles.

Noting that the EIB was active in the working groups which defined the EU taxonomy, an IFI representative supported the remarks made by the industry representative on the importance of public sector institutions also applying these standards.

A public representative emphasised that politicians must be lobbied on the fact that taxonomy alignment is in the interest of public finances, which has not been made sufficiently clear.

1.5.2 The importance of a broader sustainability agenda

An industry speaker reminded participants of the importance of the broader sustainability agenda and the UN's Sustainable Development Goals within any green recovery, while also focusing on growth, jobs and issues such as gender and diversity. One of the most powerful aspects of the discussions on ESG issues is the idea of incorporating these issues into the taxonomy and its future strategy.

1.5.3 It is essential to consider the different situations in different countries

An industry speaker highlighted the importance of considering the different positions of different countries. As the world determines how to transition to a low carbon economy, it is important to acknowledge that there are different situations in, for example, Belgium and Bangladesh.

2. Corporates with robust governance and sustainability frameworks are better positioned to generate long term shareholder value

An IFI representative noted that companies with robust ESG frameworks have outperformed their benchmarks in recent years and queried whether this is a result of improved performance in such companies or whether it merely reflects current investor preferences.

2.1 Improving shareholder value through better management of emerging risk

Another industry representative explained how their firm considers the question of ESG factors in terms of shareholder value. The companies with robust governance and sustainability frameworks are better positioned to manage risk in their business, which enables them to generate long term shareholder value.

An industry representative agreed, citing the fact that corporates with strong scores on E, S and G metrics have suffered fewer financial losses in the COVID crisis and hence have outperformed. The industry representative's firm is now seeking a link between performance on its proprietary ESG metric and financial performance. It is also becoming increasingly apparent that the individual E, S and G factors are interlinked.

2.2 A focus on "value and risk" avoids an emotive discussion of "values"

An industry representative observed that the conversations their business has with its clients are less about values and more about value. When the discussion of ESG performance centres on values it can become emotive, and there can be disagreements about the composition of these values, but everybody can focus on the importance of generating shareholder value.

2.3 The COVID 19 crisis has further increased the importance of ESG for shareholder value

An industry representative described how ESG factors have gained importance during the COVID crisis as a result of increased thinking about labour force practices, access to supply chains or simply something such as dealing with a crisis situation. The industry representative explained how ESG factors contribute to investment analysis and research. Traditionally, research into a company centres on the analysis of financial statements and considerations of industry trends, growth strategies and competitive advantages; increasingly, however, ESG factors are also important. Understanding the factors relevant to different industries is becoming increasingly important for investment research.

Another industry representative stressed how much the COVID crisis has accelerated the focus on ESG. There is a need for corporates, economies and governments to embed ESG criteria in their investment process and there is increased investor awareness of the correlation between ESG factors and financial performance.

2.4 Anticipating and communicating ESG impact requires a distillation of the relevant data into a limited number of key performance indicators

An industry representative emphasised the importance of the role played by data, the amount of data, and how it can be crystallised into a usable form for clients, investors and investee companies. The industry representative's company has developed a proprietary tool to do ESG analysis, the purpose of which is to collate the most relevant information on individual companies. This information is then utilised in discussions with companies and clients. Another industry representative highlighted their own firm's proprietary ESG rating tool, which is used to assess investee companies on ESG KPIs.

3. EU initiatives supporting green finance

An IFI representative turned the discussion towards the EU, querying the EU's principal achievements in supporting green finance work streams and asking how Europe can ensure adequate levels of investment in climate action and environmental sustainability.

A policy maker noted that the European Commission's 2018 sustainable finance action plan rests on two key pillars: the EU Sustainable Finance Taxonomy and the disclosure regulation.

3.1 Pillar 1: the EU Sustainable Finance Taxonomy

Noting that the taxonomy regulation was adopted in June 2020, a policy maker stated that the Commission is now preparing the implementing rules to make the taxonomy fully operational. The Commission is working internationally, because the taxonomy must not remain solely an EU instrument.

A regulator agreed on the need for standards to be internationally aligned. Wherever possible, Europe should try to work with the international community to come to a common agreement. The standards should also be consistent across the financial sector and the entire investment chain.

The policy maker noted that this international work started in autumn. The Commission engaged with a limited number of companies as part of a platform on this issue. The policy maker agreed on the importance of applying the taxonomy broadly, including in the private sector.

An industry representative praised the policy development undertaken by the European Commission and other bodies, noting how extremely helpful this is for both the supply and demand sides of the economy. The taxonomy is a step in the right direction, because the demand side can further develop the definition of ESG factors. On the supply side, the taxonomy will guide asset managers when they offer fund products and effectively streamline the criteria which the public sector wants industry to focus on.

3.2 Pillar 2: the disclosure regulation

A policy maker outlined how, through the disclosure regulation, the Commission is seeking to promote investments in a more sustainable economy. The disclosure regulation covers all the environmental, social and governance aspects of sustainability. Additionally, work is continuing on a review of the Non Financial Reporting Directive. As a result of the crisis, the openness of member states to pursue an ambitious project here has increased.

An industry speaker reiterated the importance of data. There has been much focus on data disclosures within the financial sector. It is important to move this into the real economy now to enable financial actors to take decisions based on that data.

3.3 The global dimension is essential

An industry speaker praised the leadership shown by the European authorities in developing the taxonomy. This shared set of standards will drive future growth in sustainable finance. The COVID crisis, climate change and capital markets are all global, so it is important for the world to drive forward this agenda.

The industry speaker underlined the fact that capital markets are global, just like the challenges around COVID and climate change. This means it is important to adopt a single set of standards across the industry. Ultimately, the goal of the work on sustainable finance is to create green and more sustainable growth across the globe. Europe is not an island: climate change will happen as a result of global emissions, and 90% of the world's emissions happen outside the European Union.

3.4 The sequencing of actions is very important

An industry representative highlighted the importance of the sequencing of action on climate risk. Europe must ensure its ambitious programme is delivered. There are worrying elements in the level two proposals on disclosure, particularly around an overly granular or one size fits all approach for entity level reporting on adverse impacts.

3.5 Improving green bond markets can introduce flexibility without 'greenwashing'

3.5.1 Green bond issuance is down

Another industry speaker highlighted the importance of green bonds. The issuance of green bonds fell significantly during 2020, while issuers and investors are increasingly interested in other types of ESG bonds such as social and sustainability linked bonds, the issuance of which appears to be growing. The industry speaker's firm ascribes these trends to the fact that these bonds offer issuers greater flexibility on the use of proceeds, which means they can issue larger sizes. However, it is important to avoid 'greenwashing'.

3.5.2 It is necessary to find a better balance between flexibility and sustainability

The industry speaker reiterated that the challenge is to find flexibility without undermining the objectives of the regime. For example, some bonds allow a degree of flexibility in how issuers may use the funds raised. To minimise risks of green washing, these bonds have overall sustainability targets issuers need to meet. In the instance issuers do not meet the targets, they must compensate the investors. This creates a financial incentive to meet broader sustainability targets without imposing restrictions on proceeds. To solve this problem, the industry speaker suggested that, as mentioned in work by the Commission, bond verifiers could confirm that the activity being financed will broadly contribute to environmental sustainability.

An IFI representative noted that the German government recently issued green bonds with great success, which is a major step in the development of the green bond market.

4. Improving the comprehension of climate, environment and public health risks, requires improved disclosures at the entity level and product level, underpinned by a consistent framework

A regulator opined that investors should be enabled to judge things for themselves. To do this, there must be an underlying basis of disclosure supporting the financial sector. In this regard, the ESAs have been empowered to provide technical standards to define the presentation and content of taxonomy related disclosures by market participants. The ESAs are also developing technical standards for the disclosure regulation. At its core, disclosure can happen at the entity level or the product level and it can involve pre contractual disclosure and public disclosure around a relevant product. There is a consultation out at the moment on both the taxonomy regulation and the disclosure regulation. The aim is to deliver the relevant technical standards in the coming months, taking into account the feedback from this consultation.

The regulator considered the Non Financial Reporting Directive another crucial pillar. Europe must ensure there is better ESG disclosure, and that any ESG disclosure is consistent. This comes back to the issue of data and the availability of information. The regulator highlighted the fact that several of the panellists from the industry spoke about their firms' proprietary ESG metrics. It is vital to develop a common method of considering these factors and to connect non financial and financial reporting.

An industry speaker praised the development of a comprehensive ESG framework. The financial industry is seeking a clear and consistent disclosure regime in all sectors and across the entire investment chain, which will foster greater transparency.

A public representative reiterated the importance of data. Europe must create an 'ESG IFRS', potentially using the IFRS framework. At the European level, there should be a single entry-point for data and integrated reporting.

5. Consumers should be empowered rather than having restrictions imposed on their investment decisions

An industry representative stated that clients are indeed interested in ESG. Clients are a key stakeholder in the development of ESG. The industry's customers should be at the heart of any action on ESG. Consumers must have confidence in what is happening. Disclosure will contribute significantly to this. Consumers should be empowered instead of having restrictions imposed on their investment decisions. Aligned to this idea, the industry representative suggested that a principle based approach would enable the further expansion of ESG. Collaboration on this topic is not finished, however, and it will not be finished for some time.

A public representative agreed that there should be leeway for investors to choose how they combine, for example, a biodiversity target with a different social target. Currently, there is no acceptable answer for this issue. ■