RENEWED EU SUSTAINABLE FINANCE STRATEGY: IS IT SUFFICIENT?

1. Main stakes and challenges specific to the EU Renewed Sustainable Finance Strategy (RSFS)

1.1 Achieving integrity, quality, and transparency of the data

A public representative stated that the upgraded work touches almost all of the key elements: the integrity, quality and transparency of the data, the reporting mechanisms created, and the global element. The EU needs to be the motor that drives a global reporting scheme and a global data scheme, with comparability. This covers all environmental factors such as biodiversity, land use, emissions, and circularity, but also reflects on the social side. It is important that the science base and what the industry does is up to the challenge, so it does not end up with side-tracks and sunk investments.

1.2 Mainstreaming green in the financial regulatory framework as well as in financial institutions' strategy and management is an ambitious target

A public representative noted that green elements need to come into banking. It should be compulsory for credit ratings to rate the environment and environmental, social and governance (ESG) factors.

The Chair highlighted that not all legislation could be rewritten, but what could be done is to bear in mind the sustainability angle in any upcoming reviews of, for example, Solvency II, of the Alternative Investment Fund Managers (AIFM) Directive or in the EU implementation of the most recent Basel package.

An industry representative stated that the initial action plan is continuing to help push sustainable finance into the mainstream, particularly with the prudential climate risk-type regulation. The business strategy is demand-led, as clients continue to be interested in investing sustainably and aligning with some of the larger and longer-term policy outcomes.

1.3 Transforming the economies to sustainability requires a better combination of public and private sector sustainability initiatives, and of frameworks leveraging the financial sector and policies defining unavoidable sets of 'carrots and sticks'

A public representative observed that industry works in different silos and is heavily concentrating on the private sector. There needs to be harmonisation of both public and private finance on reporting, metering, rating and channelling public money. There is work on how to integrate, with political pressure, those two sectors. Following that, there may be some ideas about what to do voluntarily and what needs to be regulated in companies' transition plans, such as ecological competence support.

An industry representative added that very large numbers are often thrown out around sustainable finance. As of Q2 the figure is about $2.5 trillion for sustainable investments in terms of funds, and around $2.6 trillion globally in terms of sustainable debt across bonds and loan instruments. They are single digit percentages on the total investible assets globally. The numbers that are often cited are $5 trillion to $7 trillion of investment that is needed annually to help achieve the Paris Agreement and the broader Sustainable Development Goals (SDGs). There is clearly still a long way to go, but it is about sustainable economies and societies, not just sustainable finance. The finance sector can be a critical leverage point, but ultimately it is the real economy that is going to be transitioning to renewable energy.

An industry representative noted that in the summer the Swiss people voted down the government's climate plans that had been developed over a number of years. When paying for climate-change mitigation there are a number of different views. It is important not to underestimate the challenge.

1.4 Combining incentives and obligations as well as targets and transition paths, avoiding disruptions, tailoring risk mitigation tools relevant to new types of risks, achieving workable and proportionate rules, and mobilising and addressing the needs of the wide variety of economic players are some of the challenges posed to the Renewed Sustainable Finance Strategy

A public sector representative stated that the renewed strategy is a good piece of work and an important refinement of the first one. The questions are how it can be implemented, what are the first steps that are needed to support the ambitions of the EU, how the taxonomy will be developed going forward, and how the financial sector will participate. Banks and insurance companies may need to put aside capital to account for sustainability risks.

The Chair agreed on the need for balance and the fact that there are diverging views between member states. Not everyone starts from the same place. Inclusiveness is very important in the renewed strategy.

An industry representative noted that a legislative framework should not be created if it is excessively complex for many financial-market participants. There is a risk that sustainable finance efforts could be damaged if the rules are quite difficult to comply with. Sustainability rules need to allow financial institutions to support activities by companies such as energy companies. Disproportionate investment is necessary for all transition-related sectors.

An industry representative highlighted that in May 2021 the Japanese government published basic guidelines on climate change transition finance. These are still very conceptual, and it is practically impossible to cover all business activities. A degree of discretion is needed to allow companies to assess whether financing is justifiable from a sustainability perspective.

2. Regulatory aspects

2.1 Key concerns and implementation challenges

A regulator supported the sense of urgency that has been expressed. It is important for the Commission to build a comprehensive legislative framework that covers the entire value chain. Sustainability is now an integral part of ESMA's mandate. The prevention of greenwashing is at the heart of ESMA's concerns and is a key priority. Appropriate disclosures can also help to avoid misallocation of capital. The European regulation already adopted should help, with the Sustainable Finance Disclosure Regulation (SFDR) and other proposals on the table, but there are still concerns. Some definitions are not clear. There are concerns as some members that what ESMA has done is not enough.

A regulator added that there are implementation challenges. It is important not to miss the opportunity of having consistency across all legislations in terms of definitions, scope and implementation deadlines. The other aspect is proportionality. If the system is too complex or excessively burdensome it may be difficult for corporates to comply, whereas they need to be onboarded and in the system. Skills and capacity-building is yet another challenge that cuts across the entire industry. The key challenges are preventing greenwashing, maintaining trust, and making sure the implementation works well.

An industry representative welcomes and applauds the EU for its new strategy. It is comprehensive and builds on the work that has been happening over the last several years in pursuit of the Green Deal. The overall emphasis has been on disclosures which raise awareness of what is truly a sustainable investment. This helps to battle against greenwashing, which was and still remains a big challenge. Over the next decade there need to be significant changes in capital flow, which will go beyond the world of sustainable investing. To achieve this, honesty is needed. Most capital is being deployed by companies, not by investors. In order to change those capital flows, companies themselves need to change strategy. Investors only have two routes: they can divest and no longer invest in the company, or they can escalate their stewardship. Divestment, even at large scale, will not achieve the changes that are needed in the real economy. Investors need to commit to changing companies' strategies through their stewardship approach.

2.2 Greenwashing and taxonomies

The Chair noted that greenwashing is directly linked to regulatory issues. The more discretion and flexibility and the less precise rules a sector has, the bigger the potential for the problems of greenwashing.

A public sector representative stated that the taxonomy, disclosure, and labels will work to implement the EU Sustainable Finance Strategy. The taxonomy is still not developed, so there are sectors that are still missing. Europe already has a well elaborated disclosure scheme and is dealing with EU green bond standards at the moment. It is about preventing greenwashing and ensuring investor protection in this context. The right balance needs to be achieved with the objective of maximising the large capital flows to sustainable finance that are needed for the strategy to be met.

A public sector representative recognised that remarkable progress has been made since the first action plans in 2018. Europe is a strong global leader in sustainable finance, both on the market and on the policy side. However, where the challenge now lies is that progress is still too slow considering the magnitude of the challenge, the urgency, and the fact that time is running out. It is important to ensure a high level of ambition and, at the same time, to ensure consistency and practicality of the measures, taking into account that Europe has also already produced an impressive body of legislation. Europe cannot think in the binary terms of 'dark' and 'green', since it might leave too many behind. Small and medium-sized enterprises (SMEs) deserve special attention and support.

A public sector representative added that transition is important, as recognised in the strategy. It is important to make sure this is fit for purpose as a transition tool without overwhelming market participants. Major policy decisions have to be taken to Level 1, but a taxonomy is needed that is credible, otherwise it will not be useful for investors. Therefore, it cannot contain nuclear energy. There is increasingly a need to have even more certainty about the concrete contents of sustainable investment.

An industry representative noted that although the taxonomy is good at identifying the green half of the equation, transition metrics are the most important. For each sector there are different ways of looking at scope 3 emissions, and there has been a lot of excellent work in the private sector between investors as part of Climate Action 100+ (CA 100+) on building on the benchmark. The stewardship side is the principal lens by which companies are changed, rather than leaving them to a world of foreign, misaligned capital. A stewardship code is needed that articulates the principles.

A public sector representative stated that everyone knows the RSFS is insufficient to tackle the major environmental challenges, as the strategy must be clear and readable. Inclusivity is needed, as if there is a strategy then there will be companies and financial actors which will try to escape from it. Most people do not believe that the finance sector is serious when it speaks about sustainable finance. Finance is now regarded as a major actor for transforming the economy. Banks are not only regarded as followers, but as actors for the transformation. Greenwashing was a good signal three or five years ago when it meant that the finance sector regarded green as an important challenge. It is now a burden, as the public does not believe the effort is being done. The industry needs to have incentives for long-term investing and for investing in sustainable finance, and disincentives when organisations are caught.

A public representative added that SMEs are a big bulk of the economy. An easily accessible data space should be developed, as people can then derive what the total impact is.

A public sector representative asked whether assets that have the taxonomy of green, will have the same return as those that are not labelled. If they have a lower return, then the question will be on how to attract new products. The answer is by taking the upside of the non-labelled assets. Banks must think not only about labels and taxonomy but about the impact and the result of it.

The Chair observed that Europe is on the right track, although it is very clear that the challenges are formidable on many levels. There is also a need for global coherence, consistency, and inclusiveness, as well as an inclusive transition.

2.3 CSRD, international coherence, compatibility, and transition

A public representative noted transitional activities are a big risk, such as the transition from coal to gas, building infrastructure for hydrogen that is based on fossil fuels, or the wrong type of bioenergy. That should be regarded as greenwashing as well, which is why there need to be globally unified indicators and a strict bottom line in terms of Do No Significant Harm. It is important to get rid of the $40 trillion of assets that are in unsustainable sources. It is beneficial that there are initiatives like net-zero stewardship that can push big companies that invest to have a transition plan up to 2030 or 2035.

An industry representative stated that their company is very interested in international alignment and standards. There needs to be a strong link between the next round of the European effort with international efforts. The industry representative's company is very much in favour of double materiality and impact-type reporting, but to do it well there is absolutely a precondition to get information from corporates, investee companies, counterparties, and clients. Alignment on the reporting standards is very important. The industry representative's company is very supportive of the International Financial Reporting Standards (IFRS) work on the Sustainability Standards Board and encourages a high degree of alignment between what Europe moves forward on the Corporate Sustainability Reporting Directive (CSRD) and the European Financial Reporting Advisory Group (EFRAG).

An industry representative stated that their company is trying to seek transition as a concept in the truest sense. Financial institutions are left to their initiative to work out the relevant transition path with their customers. One thing that is important to discuss is the importance of consistency among the ESG transparency and disclosure requirements. The hope is that regulators or policymakers will align the concepts under the different disclosures with standards. The recent work of the European Banking Authority (EBA) in aligning Capital Requirements Regulation (CRR) Pillar 3 and EU taxonomy disclosures is noteworthy.

A regulator observed that ESG data has been the missing piece in the overall strategy until now. Information is needed from the corporates in the first place, so that investors and financial institutions can analyse it, understand their exposure, and manage their risks. The CSRD will help address some of the shortcomings of the Non-Financial Reporting Directive. While there is a need for international consistency, in the EU, there is strong support for double materiality.

A regulator added that ESG rating is very important to their institution, because market participants are looking for that information notably to meet regulatory expectations and to respond to investor demand. But assessments are very diverse. We see very low correlations. Although it is totally understandable that there can be different qualitative judgements, there is a need for a robust framework to ensure information provided is reliable, up to date, transparent and based on consistent methodologies.

A public sector representative stated that the CSRD is the missing link between the other pieces of work. The participation of the wider population and retail investors is important, as and therefore greenwashing should be avoided.