European Financial Services Round Table

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# EFR KEY MESSAGES ON SUSTAINABLE FINANCE

In light of the Paris Agreement on climate change[1], the EFR (European Financial Services Round Table) welcomes the European Commission's Action Plan on Financing Sustainable Growth and has actively participated in the delivery of legislative proposals contained within it. The transition to a low carbon economy will be a long and complex process. A sustainable path must be established that is ambitious but does not set unachievable or unrealistic goals for institutions. Financial actors are important but it must involve the broader economy as well.

## Role of the financial sector

To accompany the ambitious political and economic agenda set by the COP21 and the European Union, the financial sector has an important role to play. There are various ways in which banks and insurers can support the transition towards a sustainable socioeconomic model:

- Mobilising capital through investments, loans, issuances, hedging instruments and advisory functions.
- Providing sustainable finance solutions, so that customers can invest in the transition to a low carbon economy, while promoting and supporting financial education to embed sustainable financial behaviours in society.
- Integrating social and environmental considerations in decision making and risk management such that risks and opportunities are properly assessed.
- Ensuring a progressive alignment of portfolios to accomplish the Paris Agreement objectives in sectors of greatest impact.

The regulatory framework defined by the European Union authorities should help the financial sector fulfil this role. For this, the EFR would like to raise the following points of attention:

1. **A gradual approach should be taken to ensure that the regulatory framework promotes stability and supports a fundamental shift towards a green economy – this requires a more flexible taxonomy.** The rhythm of changes should be adapted to the respective capacities of market players and to the different geographies (as per the Paris Agreement). Consequently, for instance in the definition of the taxonomy, the EFR welcomes recent developments that are going beyond a narrowly defined green/brown approach. Indeed, to be effective, the taxonomy should be dynamic, internationally aligned and based on transition pathways, rather than a static and fixed interpretation of sustainable activity.
2. **In order to realign investment towards sustainable assets, investees should have a greater role in providing sufficient and reliable data on their projects.** Indeed, data quality on the activity breakdown is of utmost importance to assess ESG risks and structure ESG oriented products. Improvements to the availability and quality of ESG data are required, including mandatory disclosure of certain data. In the current context, companies are not used to publicly reporting their activities in the way proposed by the Technical Expert Group in its taxonomy report.
3. **To solve the issue of scarcity of eligible projects, determined action by the public sector is required in both regulatory and investment fields.** Private sustainable investment is currently constrained by the lack of potential investible projects. Decisive and effective action is needed to increase the availability and variety of green projects and assets for financial markets participants to invest in. Public institutions (multilateral development banks as well as national institutions) have a key role in enlarging the scope of investible assets, e.g. by investing in junior equity or bond tranches and by selling the assets to private investors once the construction phase has been completed. In addition, regulations should be adapted to allow and foster investments in sustainable projects/assets by all financial actors.

[1] The Agreement within the United Nations Framework Convention on Climate (UNFCCC), dealing with greenhouse-gas-emissions mitigation, adaptation and finance, signed in 2016 and as negotiated in COP21.

In order to make progresses in these areas, the EFR has defined a list of recommendations including the following:

## Action on climate change and the SDGs

- **Climate change** presents both physical and transition risks. These risks are extremely diverse – from pressure caused by shifting populations to changes in energy security. A transformation of economic activity is therefore required, involving significant investment but also greater incorporation of climate related factors into regulatory and business frameworks.
- A just transition: It is crucial that the transition is steered in a fair manner, measuring the impact on society and ensuring that we advance in our sustainable goals while guarantying social inclusion (e.g. re-training people who may lose their job due to the transition).
- Investment should be supported by **climate impact measurement and steering** to increase the availability of data relating to the sustainability performance of businesses.
- While current initiatives strongly focus on climate change given its immediacy, the UN Sustainable Development Goals are much broader and cover in particular social and governance goals that are currently receiving less attention and resources. Greater awareness and further efforts will be needed to incorporate these aspects into mainstream investment decision-making.

## Priority regulatory action

- **Legal requirements should leave ample room for transitional investments.** In the short to medium term at least, the majority of the funding will have to go to projects / industries that still need to make the transition rather than to established ESG leaders. Incentivising investment in transitional activities should be prioritised and the overall policy framework will need to support such transitional activities. As a result, the Taxonomy should consider that funding does not only go to already green activities. Especially brown activities that are transitioning to green may ultimately get the majority of funding as financing this transition will have the greatest impact.
- Due to the complexity and difficult usability of the currently envisaged EU taxonomy, its application **should be on a voluntary basis.**
- For a taxonomy, we propose an approach that is based on **transition pathways and milestones targeting net-zero CO2 emissions by 2050.** The individual commitments of companies to a certain sustainability trajectory should be made public, thereby becoming market-relevant information subject to formal governance requirements. This could be complemented by further external and science-based verification processes.
- On **data reporting**, we believe that the strong, principle-based reporting framework developed by the TCFD would significantly improve the level of harmonisation as well as the quantity and quality of relevant climate-related data available. Investees should bear the main responsibility for producing adequate, reliable data.
- To meet its climate investments targets the EU will need to develop a clear picture of the type of sustainable infrastructure projects that are required across the EU and the type of finance that is most appropriate to them. The EU should conduct a **robust mapping exercise that builds a picture of the diverse investments that are needed and how they can be financed.** This should form the basis of the EU's sustainable investment programme.
- To solve the current lack of projects that would qualify as green under the taxonomy, the EC should work with member states and other governments to build **a pipeline of green energy and infrastructure projects,** leveraging multilateral development banks as well as national institutions.

## Broadening the uptake of sustainability

- Synergies can be promoted between **technology** and sustainable finance. This can include both developing innovative products and interfaces to engage customers, as well as using technology to increase the availability of data and process it more effectively.

Finally, we should not forget to work towards a global framework, in order to avoid the risk of having EU financial institutions facing additional costs in terms of compliance and required capital compared to those of other financial institutions based and operating in non-EU jurisdictions. The preservation of a level playing field at international level is of paramount importance.

These recommendations aim at giving a practical and pragmatic way for the EU to go forward in the development of the regulatory framework that will allow the EU to become a leader in transitioning to a green economy.

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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