European Financial Services
Round Table

Mr. Wopke Hoekstra
Commissioner for Climate Action
European Commission
Berlaymont
B-1049 Brussels
Belgium

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Subject: COP29 – Sustainable Finance

Dear Mr. Hoekstra,

We are writing to you as the global policymakers who are key to tackling climate change. From the outset, the European Financial Services Round Table (EFR) and its Members –Chairmen and CEOs of EU-headquartered international banks and insurers - have been strong supporters of the ambitious Paris Agreement from COP21. As financial institutions, we particularly welcome recognition of the contribution our sector can make and recognising the role that insurance and the financial industry in general play in tackling the loss and damage associated with climate change impacts.

In view of the upcoming COP29, we are sharing our views on how policy should be developed so that the financial sector can play its envisaged role.

Over the last decade, sustainable finance has become a core focus for regulators and now affects every activity of a company. However, policy development has taken place at varying speeds in different jurisdictions, leading to a patchwork of requirements that have preceded the development of global standards (many of which are still under development or are to be developed).

The EFR believes that regulatory fragmentation should be avoided and that requirements which meet a baseline standard, whilst unlikely to be fully aligned, should be interoperable to avoid placing excessive and duplicative compliance burdens on firms.

This is also in line with the conclusions of the future of European competitiveness report by Mario Draghi calling for simplifying rules. Excessive regulatory and administrative burden can hinder the competitiveness of EU companies compared to other blocs. The EU's sustainability reporting and due diligence framework is a source of regulatory burden, magnified by a lack of guidance to facilitate the application of complex rules and to clarify the interaction between various pieces of legislation.

Regulation should support investment in the transition

The regulatory framework needs to be coherent and constructed in such a way that it allows financial services to contribute to funding the transition to a net zero economy, rather than imposing a significant compliance burden to the extent that it constrains investment and creates confusion amongst investors. Regulators should acknowledge that climate and ESG remain developing areas of expertise, and should consider using a mix of rules, principles and guidance to allow best practice to develop within the market, rather than adopting an overly prescriptive approach which does not allow for progress and innovation over time.

Global standards are still emerging, but global convergence is key

Corporate sustainability reporting is an essential part of the sustainable finance regulatory framework, as it provides information to support investor decision-making and allows financial services firms to better understand the physical and transition risks to which they are exposed. Against the backdrop of an urgent climate threat, geopolitical volatility, energy price inflation and energy security concerns, there is now, more than ever, a once-in-a-generation opportunity to adopt a globally consistent baseline of sustainability disclosures.

Policymakers should consider the ways in which the sustainable finance regulatory framework could be made simpler, clearer and more consistent in order to avoid disincentivising companies from moving towards decarbonised business models and prevent the risk of greenwashing.

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In the same vein, it is worth noting that the reliability of the data also depends on the credibility of ESG data providers as they will continue to play a role. Regulation and supervision of this sector would be critical to ensure data quality. Supervisors should consider the ways in which their approaches to the oversight of climate-related financial risks and associated stress testing have evolved over time.

The EFR would support an approach that promotes regulatory cooperation to share best practice and reduce fragmentation for firms operating in multiple jurisdictions.

Investment in transition activity is as important as "bright green"

To date, the regulatory framework has focused on identifying those sectors whose activities are already deemed to be sustainable. This narrow focus, only now being supplemented by emerging guidance on transition finance, risks channelling finance only to those activities and products that are already on a sustainable path while diverting capital away from the transition itself and potentially raising the capital cost of financing the transition.

Policymakers should also bear in mind that the transition to net zero is a global challenge – particularly in developing economies – and there is merit in financing activities which provide incremental benefits whilst not yet meeting European sustainability standards. A focus on establishing a transition finance framework, with principle-based guidelines and benchmark sectoral transition pathways and company-specific transition plans, based on existing initiatives such as GFANZ, is important. The call by GFANZ for more clearly articulated country transition (and adaptation) plans should be endorsed. Moreover, a consistent framework for transition planning requirements should be ensured internationally.

We support the position that the Institute of International Finance (IIF) has recently taken in its Paper "*Resetting the debate on the role of private finance in the net zero transition*". We agree with the key message that the financial industry is an enabler of the transition and not its sole driver. Private sector financial intermediation can only support economic transformation if the business case for transition investment is strong, demand for transition finance is evident, and market signals are clear. Instead of a narrow focus on how to scale the flow of capital from the regulated private financial sector, the emphasis should be on scaling up transition activity and demand for transition finance across the real economy, alongside the development of new low-carbon technologies, sectors, and supply chains—and on improving the risk-return profiles of these investment opportunities. The three key priorities that IIF propose for the way forward, are key in this respect:

1. Strengthening real economy policy frameworks and developing national-level transition strategies
2. Prioritizing risk-based financial sector policy to complement, not replace, broader net zero policy frameworks
3. Enhancing the international financial architecture in support of transition finance in emerging markets and developing economies (EMDEs).

The prudential framework for climate-related factors should remain risk-based

Climate change should continue to be seen as a driver of traditional financial risks, including credit, operational and market risks. Given the objective of supporting the transition, the EFR is concerned that politicising capital requirements could jeopardise the transition of the global economy. The other challenging aspect is the inclusion of transition plans of EU credit institutions in the scope of the prudential supervision, taking account of EU Climate law. Any extension of prudential supervision to include financial institutions' transition plans should also be consistent with the risk-based nature of the prudential framework and take into consideration the fact that transition plans are first and foremost a strategic business planning tool and not a risk management tool.

As data becomes more readily available, financial institutions may be better able to integrate climate-related factors in their existing risk categories and models. Over time, it may therefore be possible to consider how different prudential tools can best respond to climate change-related financial risks, without applying blunt and risk-insensitive supporting or penalising factors for green or brown exposures or macroprudential buffers.

Yours sincerely,

Michel M. Liès
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Chairman of the Board
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