EU Strategy on Sustainable Finance

Martin Spolc, European Commission

November 2019

The EU has increased its ambition on climate change

2014-2019

Jean Claude Juncker, 2014

A Resilient Energy Union with a Forward-Looking Climate Change Policy

Target

- **40%** cuts in greenhouse gas emissions by 2030
- **32%** renewables in energy consumption
- **32,5%** energy savings

Progress

Climate and energy legislation, if implemented: 45% greenhouse gas emission by 2030

2019-2024

Ursula von der Leyen, 2019

A European Green Deal

Target

- **50%** cuts in greenhouse gas emissions by **2030**
- **Climate-neutral** continent by **2050**

Target envisaged

Public money

The yearly investment gap to meet these targets is estimated to be **between € 175 to 290 billion.**

Private money

Financing the Green Transition

Ambition

Reaching climate neutrality by 2050 while ensuring that the transition is just and fair

	Large-scale Investment
EU Budget	Commission's target = at least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework
Blended Finance	InvestEU & European Fund for Sustainable Development (EFSD)
Private Finance	**Commission Action Plan on financing Sustainable Growth**

Commission Action Plan on financing sustainable growth

Reorient capital flow towards more sustainable investments

1. Establish a **Taxonomy** of environmentally sustainability activities
2. Create **standards and labels** for green financial products
3. Fostering **investment in sustainable projects**
4. Incorporate **sustainability** in providing investment **advice**
5. Develop sustainability **benchmarks**

Mainstreaming sustainability in risk management

6. Better integrate sustainability in ratings and market research
7. Clarify institutional **investors**' and asset managers' **duties**
8. Incorporate sustainability in **prudential requirements**

Foster transparency & long-termism

9. Strengthen corporate **sustainability disclosure**
10. ↑sustainable **corporate governance** and ↓ short-termism

Action plan on financing sustainable growth -overview

Commission's actions stretch across the whole investment chain

1	**Taxonomy**	Develop an EU classification system for environmentally sustainable economic activities
2	**Standards and labels**	Develop EU standards (such as EU Green Bond Standard) and labels for sustainable financial products (via Ecolabel) to protect integrity and trust of sustainable finance market
3	**Fostering investment in sustainable projects**	Exploring measures to improve the efficiency and impact of instruments aiming at investment support. Mapping on investment gaps and financing.
4	**Incorporating sustainability in financial advice**	Amend MiFID II and IDD delegated acts to ensure that sustainability preferences are taken into account in the suitability assessment.
5	**Developing sustainability benchmarks**	Develop climate benchmarks and ESG disclosures for benchmarks
6	**Sustainability in research and ratings**	Explore how credit rating agencies could more explicitly integrate sustainability in to their assessments. Study on sustainability ratings and research and exploring possible measures to encourage their uptake.
7	**Disclosures by financial market participants**	Enhance transparency to end-investors on how financial market participants consider sustainability
8	**Sustainability in prudential requirements**	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)
9	**Strengthening sustainability disclosures and improving accounting**	Enhance climate and sustainability-related information provided by corporations
10	**Fostering sustainable corporate governance**	Collect evidence of undue short-term pressures from capital markets on corporations and consider steps for promoting corporate governance that is more conducive to sustainable investments.

European Commission

The Legislative Proposals

The most urgent actions were taken forward as Legislative Proposals in May 2018.

1 **Establish EU Sustainable Taxonomy**	**Taxonomy Proposal:** Proposal setting out criteria to determine the environmental sustainability of an economic activity (**'taxonomy'**).
5 **Develop Sustainability Benchmarks**	**Draft rules on benchmarks:** Political agreement was reached on creating two new categories of climate benchmarks and benchmarks' ESG disclosures.
7 **Clarify institutional investors and asset managers duties**	**Draft Disclosure regulation:** political agreement was reached to (i) introduce consistency on **how institutional investors and asset managers should integrate sustainability** in investment decision-making processes; (ii) increase transparency towards end-investors.

The Taxonomy Proposal

What is the Taxonomy?

A list of economic activities that are considered environmentally sustainable for investment purposes.

What is set out in the Proposal?

The framework to develop the taxonomy. For an economic activity to be on the list, it has to comply with four conditions:

(a) **Substantially contribute** to at least one of the six environmental objectives as defined in the proposed Regulation*

+

(b) **Do no significant harm** to any of the other six environmental objecties as defined in the proposed Regulation*

+

(c) Comply with **minimum safeguards**

+

(d) Comply with quantitative or qualitative **Technical Screening Criteria**

*The six environmental objectives as defined in the proposed Regulation are: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems.

What is the EU Taxonomy?

EU Taxonomy is a list of economic activities with performance criteria for their contribution to six environmental objectives.

IS	IS NOT
A list of economic activities and relevant criteria	A rating of good or bad companies
Flexible to adapt to different investment styles and strategies	A mandatory list to invest in
Based on latest scientific and industry experience	Making a judgement on the financial performance of an investment – only the environmental performance
Dynamic, responding to changes in technology, science, new activities and data	Inflexible or static

Environmental objectives

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

Key features of the Taxonomy

- **Reflecting technological and policy developments:** The Taxonomy will be updated regularly by the Platform on Sustainable Finance which will replace the TEG after its mandate.
- **Building on market practices and existing initiatives**
- **What’s not green is not necessarily brown.** Activities that are not on the list, are not necessarily polluting activities. The focus is simply on activities that contribute substantially to environmental objectives.
- **Facilitating transition of polluting sectors**
- **Technology neutral**

The “spotlight on taxonomy” provides a useful summary of the taxonomy and its features.

Who will use the Taxonomy and how?

The proposed regulation has two mandatory users:

1. **Financial market participants**
2. **EU Member States**

Under the Non-Binding Guidelines for Non-Financial Reporting, **Companies** are also encouraged to disclose in line with the Taxonomy.

The Taxonomy can be used on a voluntary basis by **credit institutions** and other **issuers**, such as local authorities.

Voluntary use by investors

- Expressing investment preferences
- Selecting holdings
- Designing green financial products
- Measuring the environmental performance of a security or product
- Engaging with investees

The Technical Expert Group on Sustainable Finance

The “TEG” was established in June 2018 to assist the Commission in the **implementation of the Action Plan.** In particular in the development of:

1. Technical screening criteria for environmentally sustainable economic activities under the **EU taxonomy**;

2. An EU **Green Bond Standard**;

3. Minimum standards for methodologies of **climate benchmarks** and ESG disclosures of benchmarks; and

4. Metrics allowing improving **Corporate disclosure on climate-related information**.

Climate change mitigation taxonomy covers 67 economic activities in 7 sectors

(1) High-emitting macro sectors

(2) Enabling sectors

- Agriculture and forestry
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Water, sewerage, waste and remediation
- Transport
- Information and Communication Technologies (ICT)
- Buildings

Substantial contribution to climate change mitigation

Characteristics	Type of activity	Criteria	Example
"Greening of"	**Already low carbon** (very low, zero or net negative emissions). Compatible with net zero carbon economy by 2050.	Likely to be stable and long term	Electricity generation from solar PV
	Contribute to a transition to a zero net emissions economy in 2050 or shortly thereafter, but are not currently close to a net zero carbon emission level.	Likely to be revised regularly and tightened over time	Manufacturing of steel
"Greening by"	Activities that **enable emissions reductions** in either of the two previous categories.	Some likely to be stable and long term, some likely to be revised regularly	Manufacturing of wind turbines

Activities that undermine mitigation objectives are **not** included.

EU Green Bond Standard

Main principles	(1) **Voluntary standard** applicable for both listed and non-**listed** bonds (2) Builds on best **market practices** (transparency and use-of-proceeds approach) (3) Applicable to **EU or international** green projects and issuers
Recommendations establishing the standard	**#01:** Create a **voluntary** EU Green Bond Standard. **#02**: The EU-GBS should comprise **four core components**: (1) alignment of Green Projects with the EU Taxonomy, (2) Green Bond Framework, (3) reporting on allocation and impact and (4) verification by accredited verifiers. **#03**: Encourage the set-up of a **voluntary interim registration process for Verifiers** of EU Green Bonds for an estimated transition period of up to three years until a permanent ESMA-led accreditation scheme comes into force.

Key elements of the EU Green Bond Standard

Green projects	• Alignment with the environmental objectives and technical screening criteria as defined in the **EU taxonomy** • Physical or financial assets, tangible or intangible: any capital expenditure and selected operating expenditure such as maintenance costs related to green assets that either increase the lifetime or the value of the assets, as well as research and development costs, and relevant public investments and public subsidies for sovereign and sub-sovereigns • Green assets qualify without a lookback period, and eligible green operating expenditure shall qualify with a maximum of three years lookback • The use of proceeds is specified either in the prospectus or in the final terms of the bond
Green bond framework	• Document explaining issuer's alignment with the EU taxonomy and environmental objectives, green bond strategy, project selection, methodologies and processes for allocation and impact reporting of the Green bond or Green Bond program • The issuer must produce it when confirming the alignment with the EU Green Bonds standard
Reporting	• Allocation and Impact reporting become mandatory • Allocation report needs to be published annually until full allocation of the bond proceeds, and Impact report at least once at the full allocation, and both reports thereafter, in case of any material change.
Verification	• Issuers shall appoint an external verifier that needs to be accredited • Verification applies (i) to the Green Bond Framework and (ii) to the Allocation Reporting

Final report on Green Bonds: barriers and responses

Barriers to green bond market development	How the proposed draft EU GBS seeks to address the barriers
Lack of sustainable assets	• Clarify and potentially expand the universe of eligible Green Projects with the proposed EU taxonomy • The development of green finance should be facilitated and complemented by other types of direct policy measures and incentives in the real economy
Issuers concerns with reputational risks and green definitions	**Clarifying definitions, reporting requirements and roles:** • Definition of green with EU Taxonomy and Environmental Objectives • Expanded and standardized Green Bond Framework and templates for mandatory allocation and impact reporting • Mandatory verification of the Green Bond Framework and final Allocation reporting • Accreditation of verifiers
Absence of clear economic incentives	**Demand and supply side measures and incentives to stimulate market growth:** • Disclosure regime for institutional investors • Endorsement of the EU-GBS by issuers, investors and potentially Central banks • Potential subsidy to offset the additional cost of external verification • Other policy actions and measure together with a wider group of stakeholders
Complex and potentially costly external review procedures	**Standardised verification process** focusing on the essential components A grant-scheme to offset the (initial) additional cost of external verification
Uncertainty on the eligibility of various types of assets and expenses	**The GBS broadens and defines the scope of eligible expenditures**
Unclear expectations on the tracking of proceeds	**Streamlining of tracking of proceeds**

Sustainability benchmarks

EU Climate Transition Benchmarks	The EU Climate transition benchmarks brings the resulting benchmark portfolio on a **decarbonisation trajectory**, meaning a **measurable, science-based and time-bound trajectory to reduce carbon emissions**.
EU Paris-aligned Benchmarks	The EU Paris-aligned Benchmarks brings the resulting benchmark portfolio's carbon emissions **in line with the Paris Climate Agreement goal to limit the global temperature to 1.5°** compared to pre-industrial levels.
Benchmarks ESG Disclosures	The Benchmarks ESG disclosures ensures that **ESG and climate-related considerations can be integrated in the valuation** of assets across various asset classes

7 Disclosure on sustainability by financial market participants and financial advisers

Disclosure regulation places the following requirements on financial market paricipants

Scope	What to disclose	Where to disclose	Who should disclose
All investment products	**How negative impacts on financial returns arising from sustainability risks are integrated in risk policies**	Websites, pre-contractual information, marketing communication	all financial entities
	How the financial entity considers adverse impacts on sustainability factors (negative externalities)	Websites, pre-contractual information	compulsory for financial entities >500 and holding companies, other entities to disclose on a comply or explain basis
Investment products with sustainability characteristics or objectives	**How these sustainability characteristics or objectives are met**	Pre-contractual information, websites, periodical reports, marketing communication	all financial entities

Source: *European Commission: Proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (2018).*

9 EU law - The Non-Financial Reporting Directive

Currently under assessment: fitness check on corporate reporting

4 issues

- Environment
- Social & employee
- Human rights
- Bribery & corruption

5 areas

- Business model
- Policies and due diligence
- Outcomes
- Risks and risk management
- KPIs

Large listed companies, and banks and insurance companies, with >500 employees

Materiality: "to the extent necessary for an understanding of the undertaking's development, performance, position, and impact if its activities…"

9

Commission's climate reporting guidelines – updated in June

Climate reporting Guidelines – June 2019

- Consistent with Non-Financial Reporting Directive.
- Supplement to general guidelines on non-financial reporting published in 2017, which still apply.
- Integrate TCFD recommendations.
- Based on proposals from the Technical Expert Group on Sustainable Finance.
- Target audience: the +/- 6,000 listed companies, banks and insurance companies under the scope of the Non-Financial Reporting Directive.
- Not legally binding.

Structure of the guidelines

5 reporting areas of the Non-Financial Reporting Directive

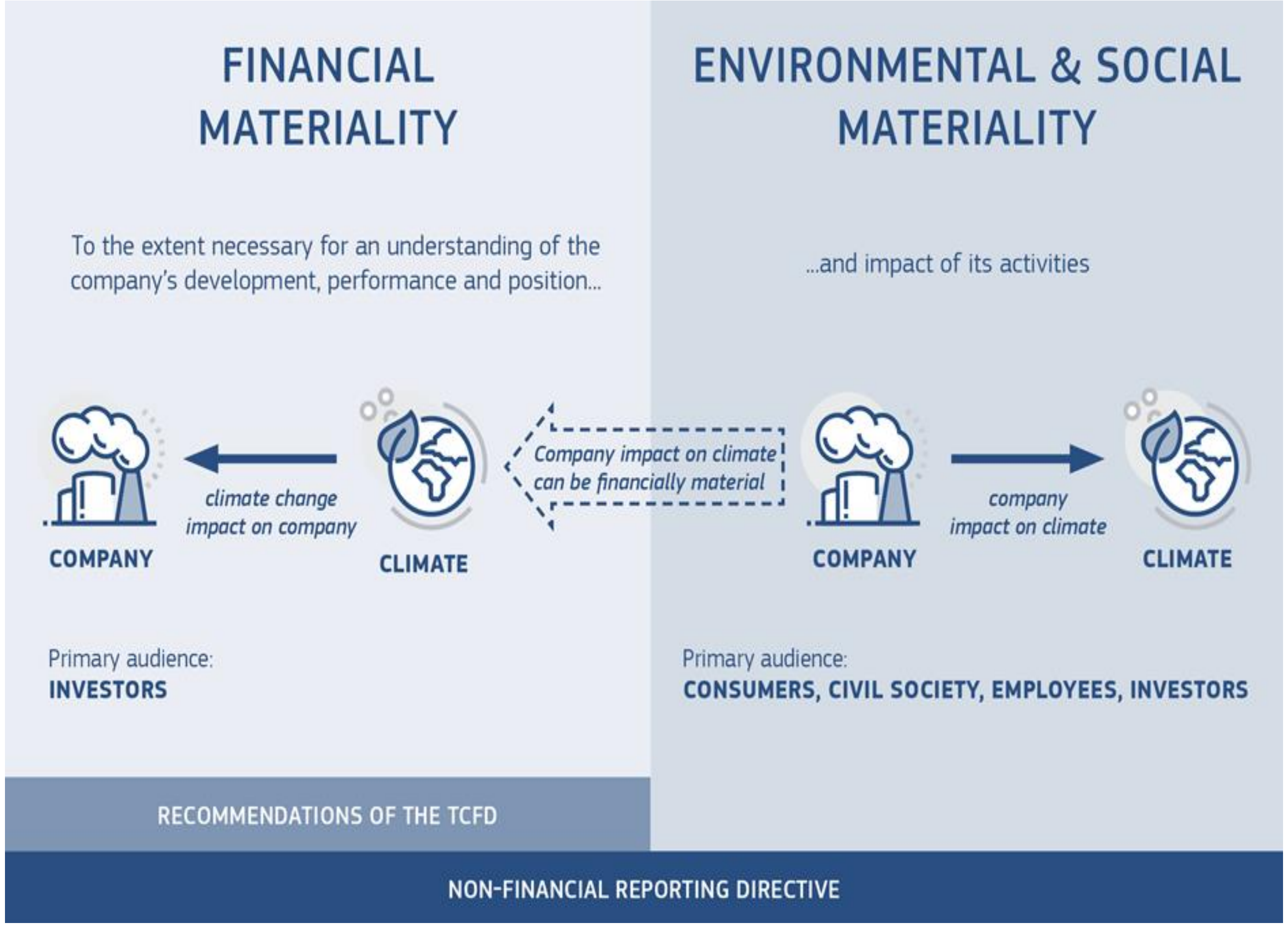
Business model | Policies | Outcomes | Risks | Indicators

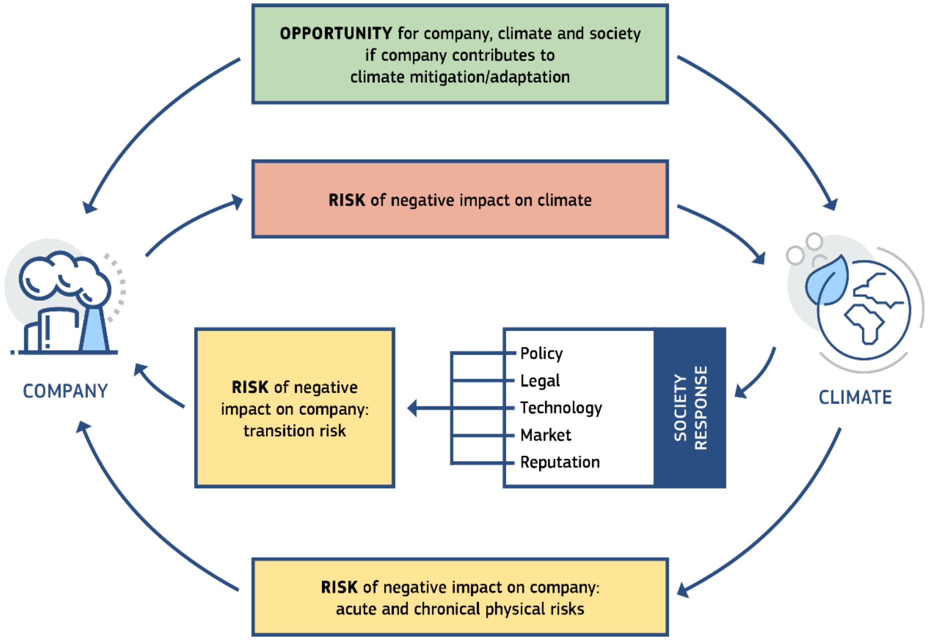
13 recommended disclosures and 10 KPIs
indicating which ones are TCFD recommended disclosures

Further guidance
+ specific further guidance for banks and insurance companies

9 Corporate reporting - double materiality

Two important perspectives are considered in COM work on corporate disclosures…





Scaling up sustainable finance: a global challenge

Industry-led initiatives: *UN Environment Programme Finance Initiative (UNEP-FI), Principles for Responsible Investment (PRI), Task force on climate-related financial disclosures (FSB-TCFD), Network of Financial Centers for Sustainability (FC4S), etc.*

Governments: *Coalition of Finance Ministers for Climate Action (CAPE), International Platform on Sustainable Finance*

Central banks, supervisors and market authorities: *Network for Greening the Financial System (NGFS), Sustainable Banking Network (IFC-SBN), Sustainable Insurance Forum (SIF), IOSCO-Sustainable Finance Network*

These fora provide innovative ideas to mainstream sustainable finance

International Platform on Sustainable Finance (IPSF)

EU launched an International Platform on Sustainable Finance in October 2019 together with major like-minded jurisdictions worldwide

The IPSF will deepen international coordination on approaches and initiatives that are fundamental for private investors to identify and seize environmentally sustainable investment opportunities globally

Objectives

- Scale up mobilisation of global private capital towards environmentally sustainable investments
- Avoid market fragmentation and allow markets to operate globally

Mandate

- Exchange and disseminate information to **promote best practices** in sustainable finance
- Compare the different initiatives and identify **barriers and opportunities** to help scale up environmentally sustainable finance internationally
- Respecting national and regional contexts, enhance international coordination where appropriate

Main focus

- **Green taxonomies** (i.e. classification of sustainable economic activities)
- **Green financial product standards and labels** to provide more confidence to investors and
- **Disclosures of sustainability-related information**

Members & observers of the IPSF

Members

Observers

OECD

UNEP FINANCE INITIATIVE

European Investment Bank

European Bank for Reconstruction and Development

OICV-IOSCO

NGFS Central Banks and Supervisors Network for Greening the Financial System

Thank you!