



European Commission Consultation on its Renewed Sustainable Finance Strategy. International Bulletin of June 2020.

Introduction and background

On 8 April 2020, the European Commission (EC) published a consultation document on its Renewed Sustainable Finance Strategy. This strategy is part of the new European Green Deal published by the EC in a communication in December 2019, which aims to reinforce the EU's climate and environment policy to reach climate-neutrality by 2050.

The strategy follows other recent initiatives such as the proposed European Climate Law and the European Parliament's declaration of a climate emergency in November 2019, also endorsed by the Council.

The COVID-19 outbreak underscores the need to rethink our economic and financial policies and the importance of protecting the environment and biodiversity.

The EC considers that financing the European Green Deal, focusing on creating a sustainable EU economy, will increase the financial resilience of the economy, companies and citizens. The transition to a sustainable economy will entail significant investment efforts across all sectors, both public and private, as reaching the current 2030 climate and energy targets alone would already require additional investments of approximately €260 billion a year by 2030. However, the EC has stressed that the transition must be fair, and that the processes and adjustments made to the economy and the financial system cannot leave anyone behind. In this context, the European Green Deal Investment Plan was announced in January and it aims to mobilise public investment and help to unlock private funds through the EU budget in addition to other initiatives that will be accessible to all Member States. Further, in November 2019, the European Investment Bank published its new climate strategy and Energy Lending Policy, which notably sets out that the EIB Group will align all its financing activities with the goals of the Paris Agreement from the end of 2020.

However, the EU believes that the financial system as a whole is not yet transitioning fast enough. For this reason, it has published this consultation to carry out a comprehensive analysis of how the sector can contribute to a faster and more effective transition, considering that the financial and industrial sectors will have to undergo a large-scale transformation, requiring massive investment.

The consultation builds on the ten points set out in the Action Plan on Financing Sustainable Growth published in March 2018 and establishes three areas where efforts must be made to achieve the goals set down in the European Green Deal:

- 1. Strengthening the foundations for sustainable investment by creating an enabling framework, with appropriate tools and structures.**
- 2. Increased opportunities to have a positive impact on sustainability for citizens, financial institutions and corporates.**
- 3. Climate and environmental risks will need to be fully managed and integrated into financial institutions and the financial system as a whole, including social risks.**

The consultation will be open until 15 July and all citizens, public authorities, including Member States, and private organisations are invited to contribute. The document is divided into two main sections: section one is addressed to all stakeholders, while section two requires a certain degree of financial and related knowledge and is primarily addressed at experts, who will be asked about the three areas above and also very briefly about the social and economic impacts of the transition, the stranded assets, the alignment of the investment portfolios of financial institutions and institutional investors with the objectives of the Paris Agreement, the impacts of biodiversity loss

on corporates exposed to certain natural resources and the EU's long-term approach to sustainable financing.

Content of the specialised consultation

1. Strengthening the foundations for sustainable finance

The first area addresses several topics, underscoring the need for sufficient and reliable information on climate, environmental and social risks and impacts, in addition to ensuring access for investors and companies to reliable climate-related and environmental data in order to make sound business and investment decisions and to consider the long-term horizon. Labelling tools, among other measures, can provide clarity and confidence to investors and issuers, and the deployment of innovative digital solutions requires data to be available in open access and in standardised formats.

The importance of transparency in the sustainability information reported by companies is highlighted. In addition to the Non-Financial Reporting Directive, the complementary reporting requirements established in the Taxonomy Regulation will improve and expand the public information disclosed. The EC is considering a DLT common database to provide open, centralised access to the public information required by the Directive, as well as other sustainability disclosures from the company itself.

The suitability of current accounting standards and rules for measuring sustainability factors and long-term investments is questioned, specifically whether existing impairment and depreciation rules fully price in the potential future loss in value of companies that today extract, distribute, or rely heavily on fossil fuels.

The consultation also asks about the ratings and research of specialised agencies, rating agencies and data providers that analyse individual risks. In the autumn of 2019, the Commission launched a study on possible conflicts of interest and transparency in this area and aims to gather further evidence on the role of these companies through this consultation.

A wide variety of labels, definitions and terms are used for sustainable financial assets. The EC asks a series of questions to establish clarity and protect the integrity of and trust in the market, enabling easier access for investors, companies and savers. This section includes a number of questions regarding the EU Green Bond Standard, specifically on its authorisation and supervision systems, external verifiers and non-European issuers. It also asks about the need to expand or modify the current prospectus to include specific reporting requirements for green bond issues, the possibility of creating a specific label for green investment funds, the use of the future Taxonomy Regulation as a benchmark for some of these financial instruments and the creation of new environmental, social and good governance (ESG) benchmarks.

The document seeks views on whether the existing market infrastructure sufficiently supports sustainability or whether, for example, the EU should foster the development of sustainable exchanges or trading segments that cater specifically to trading in sustainable finance securities or ESG segments within existing trading venues.

It also asks about corporate governance issues, specifically the need to make long-term investment decisions that reflect long-term opportunities and risks, such as those connected to climate change and environmental degradation, as well as the need to engage investors and other stakeholders in business decisions. In the study carried out in the second half of 2019 by the three European Supervisory Authorities addressing the possible existence of short-term market pressure on corporations, some practices were observed that need to be corrected if sustainability is to be integrated into the business world, since it requires longer-term objectives. Views were also sought on the variable remuneration of directors and whether this should be linked to the reduction of greenhouse gas emissions by their companies. In relation to the role of the different stakeholders and in parallel with the study carried out by the EC on due diligence in relation to the identification and mitigation of adverse social and environmental impacts in a company's own operations and supply chain, the consultation asks about the possibility of developing an EU framework for a supply chain due diligence related to human rights and environmental issues so that company directors integrate the interests of these groups in their management approach.

2. Increasing opportunities for citizens, financial institutions and corporates to enhance sustainability

To mobilise retail investors and citizens in general, the EC will soon publish the amended delegated acts of MIFID II and IDD, which will include changes in the suitability tests to ensure investors' ESG preferences are taken into account to offer them products more suited to their personal values. However, the EC believes that it may also be necessary for financial advisers to have guidelines to better inform their clients in this area or offer sustainable financial products by default when they meet the preferences expressed in the suitability test.

It also considers how to measure the effect of sustainable products on the real economy to better understand the positive impact of sustainable finance. It asks whether the current regulatory framework creates barriers for green securitisation, whether a new set of regulations is required or whether this securitisation should contribute to risk diversification and financing in the transition stage.

The consultation does not ignore the important contribution made by digitalisation in green finance, but at the same time warns of the risk of financial exclusion that this entails. Technological innovation such as artificial intelligence and machine learning can help to better identify sustainable business activities, portfolios or banking assets and their valuations. It asks whether the public authorities should promote the development of these instruments and even if they should be used to finance sustainable projects, or whether more EU policy action is needed.

The EC considers that the existing project pipeline is not sufficient to cover investment demand and seeks to identify (through a series of questions on SMEs, innovation and development, national energy and climate plans) the regulatory and market obstacles and determine the measures that should be undertaken to remedy this deficiency.

The incentives to scale up sustainable investment are assessed. While markets for sustainable financial assets and green lending practices are growing steadily, they remain insufficient to finance the EU's environmental and climate action objectives. The purpose of this section is to identify whether there are market failures or barriers and what kinds of public financial incentives could help rectify this (tax exempt subsidies for issuers, de-risking mechanisms, technical assistance, access to financing for sustainable SMEs, etc.).

It seeks views of what the scope of the future Taxonomy Regulation should be, as one of the tools available to the public authorities, asking whether it is suitable for use by the public sector for its own expenditures, and in the area of green public procurement or green bond issues (including green sovereign bonds).

The consultation also addresses intra-EU and international activity undertaken by the EU and considers how to improve the financing of green projects at intra-EU and international level, through instruments such as the International Platform created in 2019, the current EU framework for investment protection coordination with the private sector, the integration of emerging and developing economies in sustainable projects and the use of the future Taxonomy Regulation by development banks to attract private investment.

3. Reducing and managing climate and environmental risks

Climate and environmental risks, including relevant transition risks, can have a disruptive impact on our economies and financial system, if not managed appropriately. The three European Supervisory Authorities have each developed work plans on sustainable finance, to improve the management of these risks by all actors in the financial system. In particular, the political agreement on the Taxonomy Regulation tasks the Commission with publishing a report on the provisions required for extending its requirements to activities that do significantly harm environmental sustainability (the so-called "brown taxonomy"), the suitability of which is assessed, in addition to other activities classified between green and brown.

When analysing financial stability risk, physical risks and transition risks, the EC seeks views on the measures taken by companies and whether they consider the current prudential framework sufficient to identify and manage the financial stability risk stemming from climate change.

In the specific case of insurance and reinsurance companies, the EC asks whether it is necessary to develop additional practices to those identified by EIOPA, in the Review of Solvency II Directive, that should be adopted by insurance companies to ensure that sustainability risks are duly taken into account in companies' risk management.

In the banking sector, the EC considers that the recent reviews of legislative texts to include sustainability factors in banking activity (Directives and Capital Requirements Regulations) are not sufficient for a rapid transition to a sustainable economy or to increase the resilience of physical assets to environmental and climate risks and asks how banks can mobilise faster to support this transition.

In the securities markets, it seeks views on whether asset managers must take into account the double materiality (the adverse effects on sustainability factors) of their investment decisions.

In relation to pension providers, questions are asked about how to integrate beneficiaries' sustainability preferences, improve the information they receive on current legislation and how they contribute to the

achievement of the EU's climate and environmental goals in a more proactive way.

For credit rating agencies and taking into account that since April 2020 the ESMA Guidelines on disclosure requirements for credit ratings apply, the EC asks about the integration of ESG factors in credit ratings, their effectiveness and the advisability of further actions in this area.

In regard to the transition, the EC will support companies that develop an environmental footprint according to European and international standards and asks which of these standards or initiatives should be taken into account.

Lastly, the EC raises the need to improve resilience to adverse climate and environmental impacts, for which it recommends an improvement in climate-related loss and physical risk data, as well as their access, use and comparability. Regarding financial risk management, the EC considers that the financial industry can lead this task by absorbing losses and promoting resilience. However, EIOPA has warned that insurability of climate-related risks is set to become a growing concern. Therefore, public measures are required, such as social and catastrophe bonds, and other types of products and initiatives, as well as long-term studies on the effects of a given financial project on the climate or the environment.

In summary, the EC consultation document exhaustively covers the environmental factor of sustainability, with special attention to the climate aspect. Governance and social factors are also addressed (the latter to a lesser extent), and the EC will continue to integrate the social element in sustainable finance; in fact, the Taxonomy Regulation is expected to be amended to include the social aspect. Many other consultations are being carried out in parallel to this one (or are expected to be carried out in the coming months) that seek to identify and underscore the actions of the financial sector in the transition towards a more sustainable economy.

Useful link:

[CONSULTATION ON THE RENEWED SUSTAINABLE FINANCE STRATEGY](#)