European Commission
Sustainable Finance

EUI's Florence School of Banking and Finance

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European Commission
Directorate-General for Financial Stability, Financial Services and Capital Markets Union (FISMA)

Outline

1. EU and international policy context

2. High-Level Expert Group on Sustainable Finance

3. European Commission Action Plan on financing sustainable growth

4. Focus on "Taxonomy" proposal

1. EU and international policy context

- EU and international policy frameworks set ambitious climate change and environmental policy objectives (EU 2030 climate and energy framework; 7th Environmental Action Programme; Energy Union; Paris Climate Agreement; G20 work on green finance); broader sustainability agenda (UN 2030 Agenda)
- Growing activity in some Member States on green finance: need for a coordinated response to be effective and avoid market fragmentation
- Significant investment needs in clean energy, energy-efficiency in buildings, greener transport, infrastructure etc.; scale of funding requires mobilisation of private capital via capital markets
- Finance cannot correct underlying market/policy failures (mispricing), but sustainability policy without finance will fail
- Capital Markets Union (CMU) Action Plan of the EU includes dedicated action on sustainable finance

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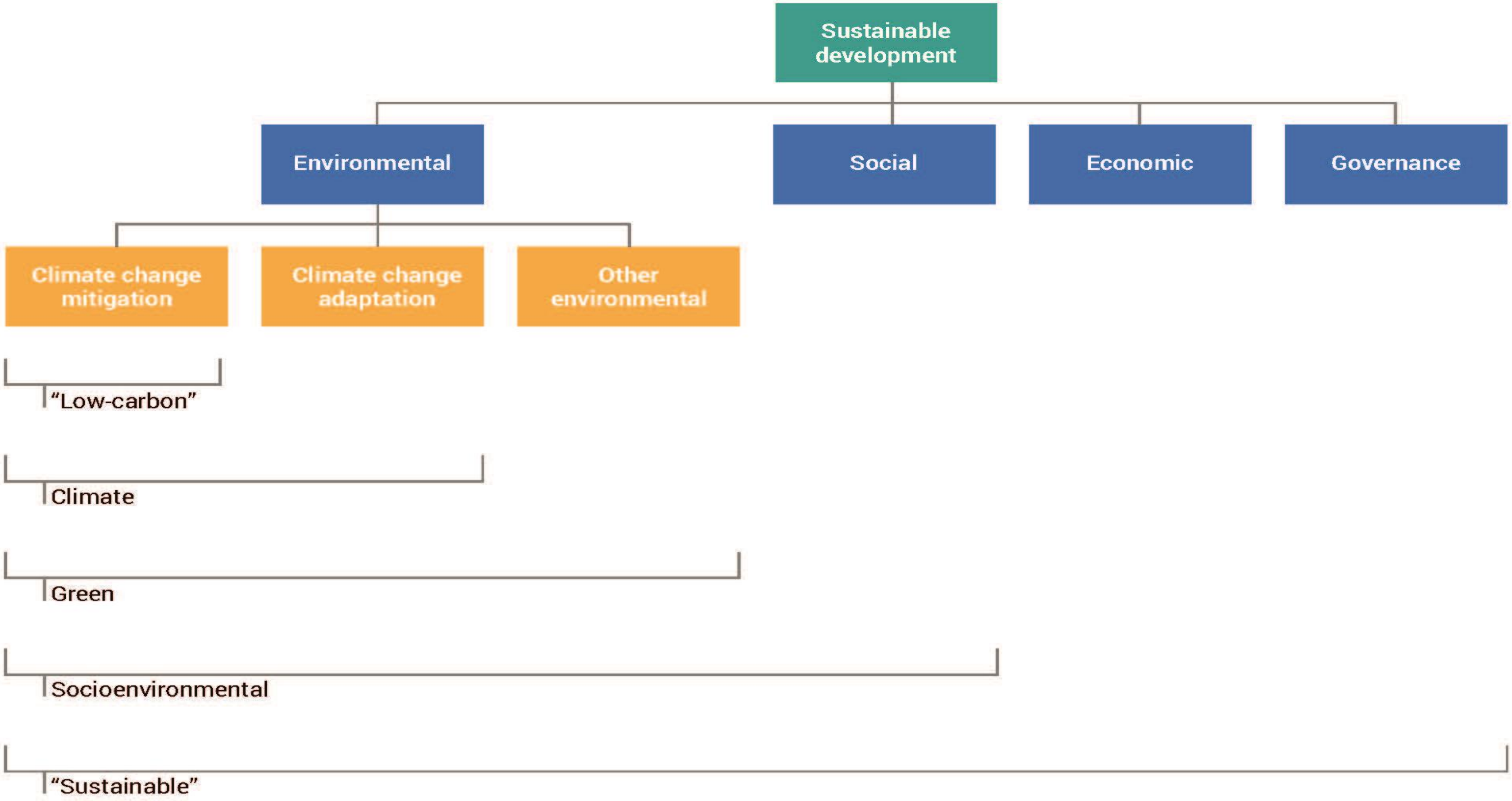
What is sustainable finance?



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2. High-Level Expert Group on sustainable finance (HLEG)

- European Commission established the HLEG in December 2016 to help develop a consistent EU strategy on sustainable finance
- Composition: 20 experts (banking; asset managers; insurers; pension funds; stock exchanges; academia; NGOs/ civil society) plus 9 observers (international organisations)
- HLEG's mandate:
  - Identify challenges and opportunities of sustainable finance
  - Provide policy recommendations on how to mobilise capital while strengthening financial stability; how to reform the EU financial policy framework
  - Scope: Starting with climate change and environmental ("green") issues; extending to broader sustainability whenever possible
- Final report on 31 January 2018; eight key policy recommendations (including common EU taxonomy/ EU Green Bond Standard; investors' duties)

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3. EC Action Plan on financing sustainable growth

On 8 March, the Commission adopted its strategy on sustainable finance with the following aims:

Reorient capital flows towards a more sustainable economy

- Europe has to close a yearly investment gap of almost €180 billion to achieve EU climate and energy targets by 2030
- EU budget and the Investment Plan for Europe (EFSI) are already supporting climate-relevant and environmentally -friendly investments
- Need to mobilise finance from various sources and capital markets

Mainstream sustainability in risk management

- Environmental and climate risks are currently not always adequately taken into account by the financial sector
- Social factors may also have concrete consequences for financial institutions including legal risks

Foster transparency and long-termism

- Strengthening transparency through better disclosure
- Sustainability and long-termism go hand in hand

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EC Action Plan on financing sustainable growth

1. Establish an EU classification system for sustainability activities
2. Create standards and labels for Green financial products
3. Foster investment in sustainable projects
4. Incorporate sustainability in providing investment advice
5. Develop sustainability benchmarks
6. Better integrate sustainability in ratings and market research
7. Clarify institutional investors' and asset managers' duties
8. Incorporate sustainability in prudential requirements
9. Strengthen sustainability disclosure and accounting rule-making
10. Foster sustainable corporate governance and address short-termism in capital markets

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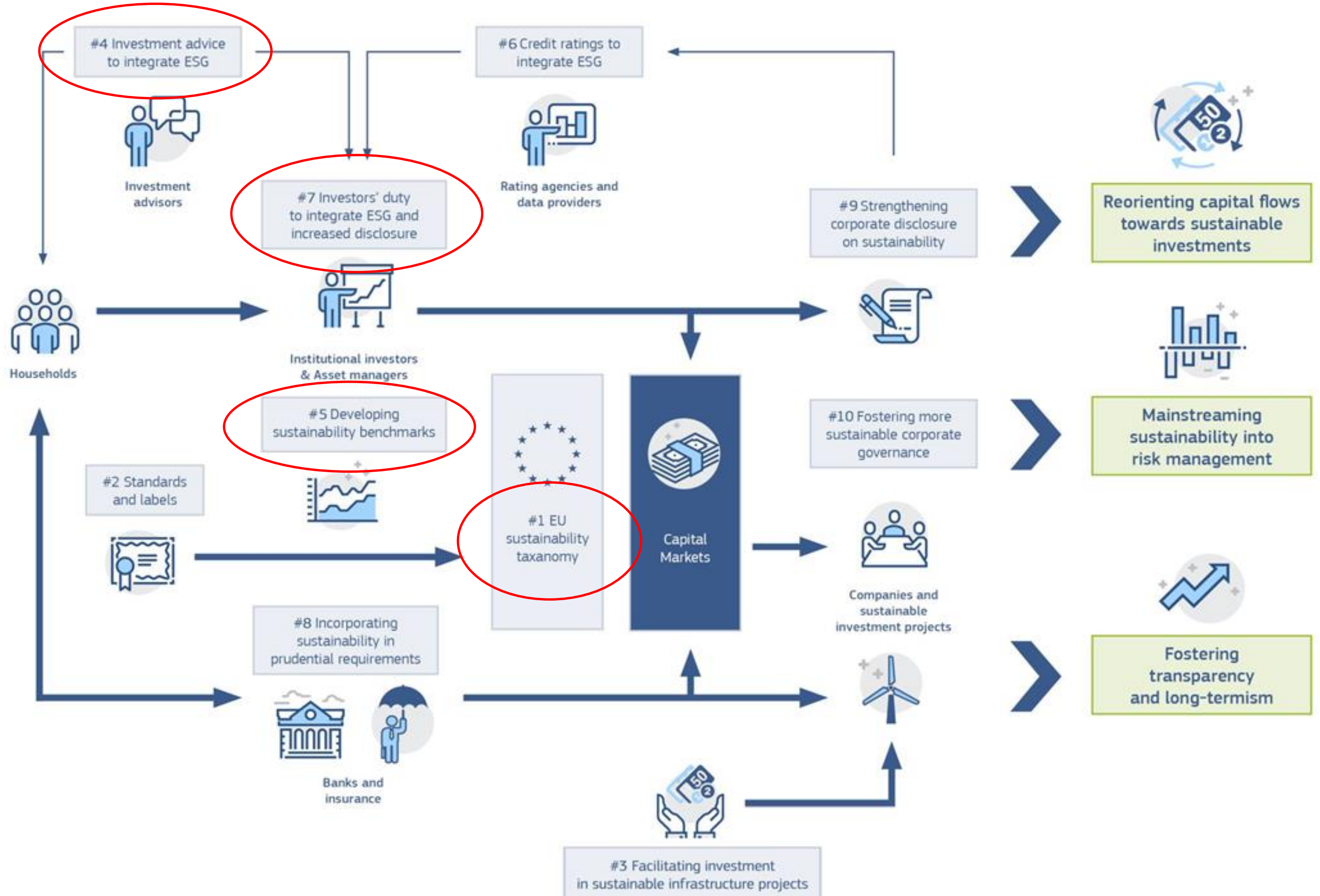
EC Action Plan on financing sustainable growth



May 2018 Package – 4 concrete actions

1) Establish an EU taxonomy of sustainable activities (Focus of the second part of the presentation)

Issues: Create a transparent, EU-wide classification system for green and sustainable activities

Actions: Legislative proposal on 24 May; Technical Expert Group will develop climate and environmental parts until mid-2019; started in July

4) Incorporate sustainability in providing financial advice

Issues: Investment firms and insurance distributors play an important role when advising clients; advice and "suitable" products should take account of clients' green or sustainability preferences

Actions: Commission will amend MIFID II and Insurance Distribution Directive (IDD) after public consultation; ESMA to include provisions on sustainability in guidelines (suitability assessment) in 4Q 2018

May 2018 Package – 4 concrete actions

5) Developing sustainability benchmarks

Issues: Indices/ benchmarks important to allocate capital; traditional benchmarks not "sustainable"; insufficient transparency of low-carbon indices

Actions: Increase transparency; proposal to amend current Benchmark Regulation on 24 May; development of low-carbon indices for benchmarks by 2Q 2019 (also by Technical Expert Group)

7) Clarify institutional investors and asset managers' duties

Issues: Institutional investors and asset managers must act in the best interest of clients (**investors' duties**); relevant EU legislation (MIFID II; UCITS; AIFMD etc.) does not include reference to sustainability factors

Actions: Legislative proposal on 24 May requiring assets managers to integrate ESG factors in their investment decision process (board competence; investment strategy; risk management) and be more transparent towards end-clients.

EU Taxonomy - Introduction

Goal: Provide a common language on what is "green" for the purposes of finance, in order to:

- **Prevent fragmented markets (to help both financial sector & real economy)**
- **Prevent 'greenwashing'**
- **Serve as a building block for future EU policies on sustainable finance**

Context:

- **Help the greening of brown sectors**
- **Start 'light burden' requirements**

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EU Taxonomy - What is it? (1)

Definition → A harmonised classification system indentifying economic activities that deliver on EU sustainability objectives.

Scope → Environmental taxonomy, but with intention to extend to social in the long-term.

Key features → Granular enough to minimise ambiguity about "greenness" of an activity and flexible enough to cater to technological and market developments.

EU Taxonomy - What is it? (2)

6 environmental objectives derived from EU environmental and climate acquis.

An economic activity is considered environmentally sustainable when it:

Substantially contributes to one of the environmental objectives

Does not significantly harm any of the other environmental objectives

Complies with minimum social safeguards

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EU Taxonomy - What is it? (3)

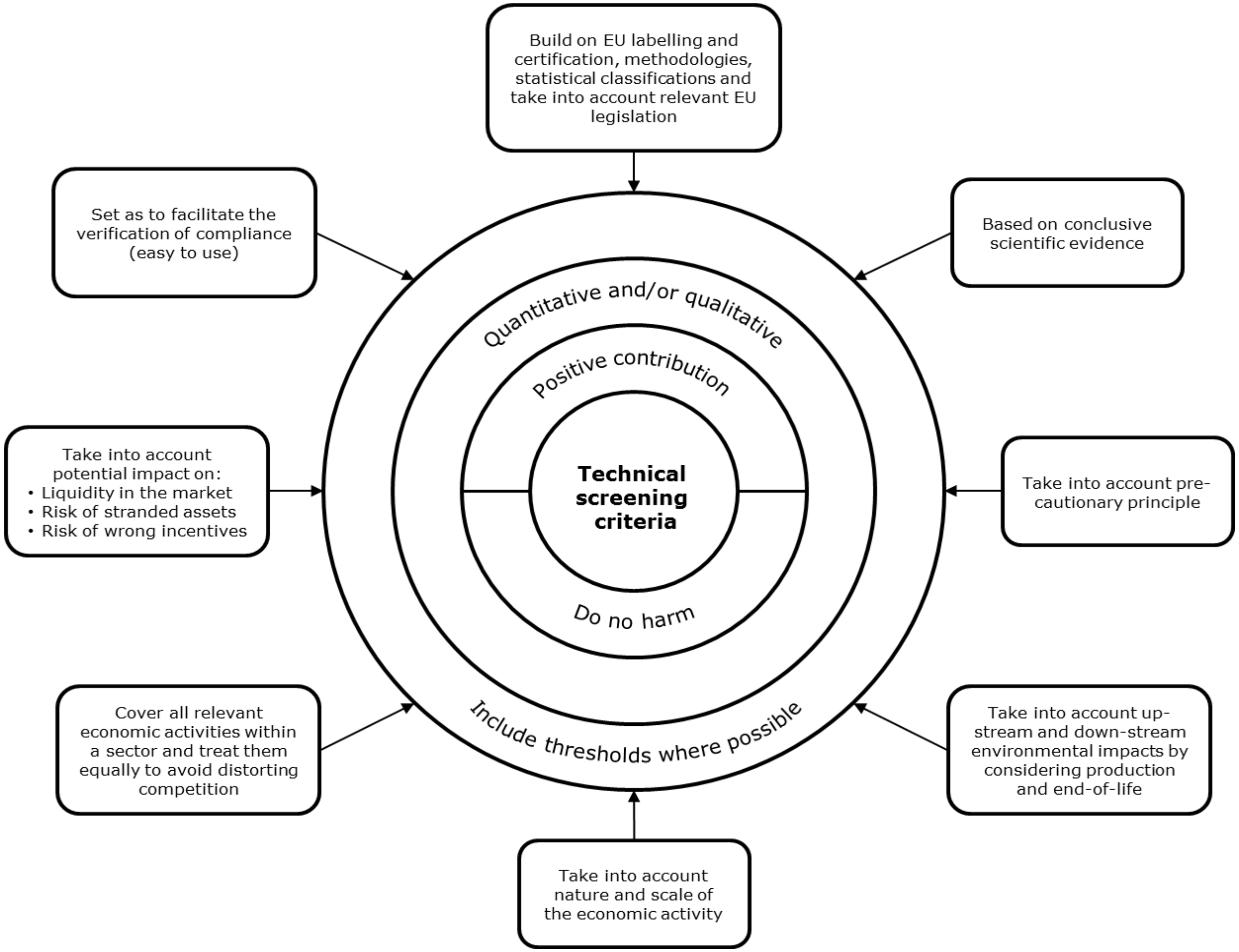
Commission to develop technical screening criteria for specifying “substantial contribution” and “significant harm”.

Necessary in order to:

- *Adapt to the specificities of different sectors*
- *Stay up-to-date with technological and scientific developments*

Step-by-step approach, starting with climate

EU Taxonomy - What is it? (4)



Eu Taxonomy – concrete illustrative examples

List of mitigation activities	EU environmental objectives					
NACE codes	#1 Climate change mitigation	#2 Climate change adaptation	#3 sustainable use and protection of water and marine resources	#4 Circular economy, waste prevention and recycling	#5 Pollution prevention and control	#6 Protection of healthy ecosystems
XXXX	list of "positive" technical screening criteria for a given economic activity to qualify as environmentally sustainable contributing substantially to objective #1	empty cell	hot spot: water leakage (compliance with water directive framework sufficient)	hot spot: waste management (need to go beyond EU legislation - the economic activity is required to xxxxx)	empty cell	empty cell
YYYY	list of "positive" technical screening criteria for a given economic activity to qualify as environmentally sustainable contributing substantially to objective #1	empty cell	empty cell	empty cell	empty cell	empty cell
ZZZZ	empty cell	empty cell	empty cell	empty cell	empty cell	empty cell

The three activities in the example will all be considered green because contributing substantially to climate change mitigation:

- Type zzzz are automatically eligible (no technical criteria)
- Type yyyy can qualify if meeting the positive technical criteria (no significant harm on 2 to 6 is expected)
- Type xxxx can qualify if also meeting not significantely harm criteria

EU Taxonomy – How? (1)

The EU taxonomy will be developed in two steps:

EU Regulation → will define the EU environmental objectives activities need to contribute to, the minimum social safeguards and sets the framework for determining when an economic activity can be considered environmentally sustainable.

Delegated acts → will specify the technical criteria for determining under which condtions a specific econonomic activity contributes to or causes significant harm to an environmental objective.

EU Taxonomy – How? (2)

Stakeholder involvement → It will be built on existing (market) initiatives and, given its complexity, will be developed gradually with input from scientific, technical and financial experts as well as co-legislators.

Technical expert group → tasked with advising the Commission on a first list of environmentally sustainable economic activities and assessing the potential impacts.

Member States → Set up a dedicated expert group to exchange views, present progress and feed discussion at technical and political level.

EU Taxonomy – How? (3)

Technical Expert Group:

Around 40 experts representing public as well as private sector (both financial and "real economy" sectors) together with academia and NGOs working on 4 tasks:

1. technical screening criteria for environmentally sustainable economic activities under the EU taxonomy;
2. an EU Green Bond Standard;
3. a category of "low carbon" indices for use by asset and portfolio managers as a benchmark for a low carbon investment strategy; and
4. metrics allowing improving disclosure on climate-related information.

Set up in July 2018, mandate until June 2019

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