**15 July 2020**

**Additional information in response to the European Commission consultation on a renewed sustainable finance strategy**

We would like to submit additional comments to the following questions, either because it was not possible to comment on a question unless a certain response was chosen or because we were not able to limit feedback to the maximum of 2,000 characters:

**Question 5**

FIA members believe that policy should aim at encouraging market participants to contribute to a more sustainable environment, instead of focusing on discouragement policies. A positive and encouraging approach would be more effective, and will likely produce similar or better results, without disrupting markets, by allowing for an appropriate transition to more sustainable activities.

If investment in or financing of potentially harmful activities were discouraged as such, companies that have assets that are not yet, or are perceived not to be, in line with environmental objectives (e.g. coal-fired power plants) will find it very difficult to obtain financing for their commercial groups. Finance is required for their day-to-day operations, but also to adapt their business and transition to a more sustainable business model. Also, companies may have already begun the transition, but the economy relies on a certain product output that perhaps is not yet one hundred percent achievable through sustainable resources, therefore a transition period is required to develop sustainable technologies. As example, in June 2020, the UK stated that it was able to rely entirely on sustainable resources to produce power for a period of 2 months[[1]](#footnote-1). While this is an encouraging development, it also shows that we are not yet in a position to be able to rely solely on renewable sources in order to provide end-users with the standard and quality of life they are used to and thus discouraging or prohibiting investors from financing in current technologies may lead to severe market disruption and a negative impact on end-users and the economy as a whole.

Encouraging investment in sustainable activities and technologies, however, will further the objectives of the Paris Agreement and enable the market to adapt businesses and to phase out less sustainable processes and technologies.

**Question 6**

Opportunities

Well-functioning, well supervised markets carry the potential to foster and promote market evolution by increasing capital flows into the markets through greater liquidity and providing efficiencies to price discovery and management of inherent market risks.

1. Development of new products

Markets have already begun a transition to more sustainable products with the various exchanges having listed sustainable contracts in parallel or in addition to traditional contracts. However, there is room for more products and innovations. Markets react to supply and demand from investors and market participants, who have recently been much more focused on sustainable products.

As an example, Eurex has offered ESG related derivatives on its exchange, especially in climate-oriented aspects. In recent years, increased customer demand for listed ESG derivatives has emerged, with asset managers seeking flexible solutions for liquid and cost-efficient alternatives to manage undesired sustainability risks, trade longer-dated maturities, and to align their ESG investment mandates. In response to the increased [customer demand](https://www.powerthesaurus.org/market_driven_demand/synonyms), in February 2019, Eurex introduced ESG index futures relying on benchmarks according to STOXX's exclusion methodology, which aims to provide investable Pan-European and Euro-region benchmarks focusing on ESG, Low Carbon and Climate Impact. Engaging in the ESG approach, Eurex also launched subsequently the first exchange traded ESG index options on a European benchmark, opening the ability for structured products issuers, for example, to hedge their risk books more accurately by deploying derivatives. Eurex is continuously responding to the market demand by expanding its ESG offering by launching ESG futures on further leading ESG benchmarks, as for example on MSCI ESG indexes in March 2020, covering developed markets, such as Japan and US, as well as emerging markets.

Overall, by June 2020, the Eurex ESG traded derivatives increased to 12 different futures and options products and volume amounted to about 600,000 traded contracts, which represents a tenfold number of traded contracts since introduction in Feb 2019, with a capital volume of €7.6 billion. The STOXX Europe 600 ESG-X index future at this stage is by far the most popular, with more than 580,000 contracts in the first half of 2020, capital volume of €7.5 billion and open interest at a value of €550 million end of June.

Another example is the Euronext Eurozone ESG Large 80 index[[2]](#footnote-2). The futures contracts were launched on June 1st with the support of market makers deeply committed to the development of sustainable finance (BNP Paribas, Optiver, DRW, Societe Generale). The index applies ESG exclusions to establish an Energy Transition/Climate Change benchmark in the Eurozone with real ESG exclusion.

The increasing proportion of investment practitioners are viewing ESG as integral to their strategies. These new ESG derivatives products provide exchange participants and buy-side firms with additional tools to implement sustainability-driven mandates and complement their efforts on the capital allocation angle, with ESG instruments in the risk transfer markets as well.

These new sustainable investment strategies require products with different and adapted risk-profiles, towards which market infrastructure providers will continue to innovate.

1. Momentum in the financial sector and beyond

With the European Green deal comes an increasing momentum within public and private actors that supports a transition to more sustainable products and policies. This provides the opportunity for the industry but also policy makers to achieve the goals and objectives of the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development.

Increased awareness will also result in sustainable business models in operational, financial and impact terms, as well as a better understanding and steering of own economic activities and better risk management.

Markets will innovative towards this demand for sustainable alternatives with adapted risk-managing products. The financial policy framework should use this momentum to ensure markets can adjust efficiently.

There will be opportunities not just for new products but also for investments in new technologies, and for Europe to attract capital from investors.

Disruption of markets will be inevitable, however, by carefully calibrating the transition to a more sustainable economy, the impact of transition risks will be significantly lower than the impact of climate risk. Any market disruption should be proportionate to the climate risks society is facing and measures should minimise the negative impact on end-users, while still achieving a more sustainable real economy.

**Challenges**

1. Identifying climate-related risks

Many of FIA’s member firms are active, or support firms that are active, in physical commodities and related derivatives markets, which are directly impacted by climate and other environmental factors. Climate change thus poses a range of challenges for FIA’s member firms, from operational, technological, to legal, regulatory and reputational, extending to all areas of the world where firms operate. In many cases, the challenges are just recently emerging and, as such, are not yet fully understood or even readily identifiable. The first step in being prepared is to identify the nature and scope of climate-related risks. Once identified, the risks can be studied and better understood. And, once understood, the public and private sectors can work together to mitigate them. Although the impact of climate change is not yet fully understood, this does not release the industry and regulatory authorities from acting on risks that are identified.

1. Global level playing field

Financial markets are global. Market participants can make use of arbitrage opportunities and conduct their trading and hedging activities where they are most effective (cost, liquidity, availability of products). Supply chains are also global. It will be challenging for Europe’s policy makers to ensure similar standards are applied globally to avoid industry or market participants moving to other regions that have different standards, which would reduce the effectiveness of ESG policies in Europe, lead to a loss in liquidity and higher prices for end-consumers.

Sustainable finance can only become mainstream if a holistic approach is taken, sustainable investments are sufficiently attractive and – most importantly – appropriately priced according to market developments. In this sense, it will be essential that financial policy complements and likely amplifies the actions already taken by energy and climate policy.

The EU should build on its successful leadership around initiatives such as the Emissions Trading Scheme and the recently adopted Taxonomy, to aid international coordination around common standards, frameworks and taxonomies.

1. Harmonisation

In the absence of harmonisation of ESG standards applying to different industries, market participants and associations have started to create their own standards. For example, see Annex C in the World Federation of Exchanges’ paper on sustainability for a list of just some of current sustainability standards[[3]](#footnote-3). Having to follow a variety of standards depending on the market location is challenging for producers and market participants alike, especially as there is a risk of conflicting standards. Compliance with many different standards will be a challenge for the industry and harmonisation of such standards, ESG data commonality and the alignment of legal frameworks (taxonomy, climate benchmarks etc) will be a challenge for policy makers and undermine the effectiveness of the sustainable finance movement.

Our members also note that greenwashing still undermines efforts to mainstream sustainability in the financial sector. For example, there are multiple ways in which the impact of a sustainability-linked product is evaluated and in addition, impacts are often not explicitly captured in the evaluation. That means that claims about sustainability benefits could be made without being substantiated by a transparent and rigorous evaluation of impacts.

**Question 9**

For FIA members, predictable and well-communicated policies are extremely important. FIA members need sufficient lead-in time to be able to adapt their commercial, operational and legal processes to new regulation and policies.

This underlines the importance of this renewed strategy consultation and, for example, the European Climate Law, which shows the potential to coordinate efficiently several EU initiatives. TheRenewedSustainable Finance Strategy should first and foremost ensure that financial initiatives effectively complement each other, and secondly, amplify the European climate actions and goals.

Certainty for investments through a reliable and effective CO2 price as well as through sector-specific policies for implementing non-disruptive roadmaps and objectives would be helpful measures. For instance, market participants require clear signalling from policy makers regarding which assets and technologies will be phased out and when (including a sufficiently long transition period), to improve predictability, avoid market disruption, allow budget considerations, and a timely assessment of stranded assets.

The policy framework should be technologically neutral. Explicit endorsement should be given to any technology with a potential to reduce CO2 emissions. No technology or activity that has the potential to contribute a combination of avoided abatement costs should be ruled out upfront.

The concept of “stranded assets” is not wholly consistent with the desire to be technology-neutral and not factual but rather speculative. Ultimately, the goal is to lower carbon emissions by any technology possible.

For example, some may regard gas infrastructure as possible future stranded assets; however, the existing gas transmission and distribution networks support the integration of renewable energy both in electric form (e.g. via power to gas) and gaseous form (biomethane, hydrogen, synthetic methane) into the energy system.

We recommend the European Commission use market-based policy signals such as EU ETS to help operators decide to comply or buy allowances for high fossil fuel CO2 emission assets that may be stranded in the future. This makes for an inclusive and technology neutral approach under the EU ETS cap.

Overall, FIA members support a process similar to the one followed for current European legislation, i.e. the use of public consultations and public hearings/meetings with stakeholders, enabling a dialogue with the industry impacted by new climate-related policies and phasing out of assets. In this sense, we welcome the European Commission’s transparent dialogue with stakeholders, enabling a dialogue with those directly or indirectly impacted by the new policies and market developments.

**Question 53**

Firms globally are showing more and more appetite to consider ESG objectives in their sustainable investment strategies. ESG objectives are being integrated across tangible and intangible assets and within core business activities.

While we agree that securities such as the ones listed above, might at first glance be most impactful for the purposes of capital allocation, we would like to raise awareness that derivatives can complement the efforts to optimise allocation of capital and support the development of sustainable projects and activities. The existing market infrastructure is supporting the issuance and liquidity of sustainable securities. Market participants have already begun a transition to more sustainable products in reaction to the demand from investors, not only in capital markets, but also in derivatives.

Mainstreaming ESG is key, this includes applying ESG factors and considerations to a broad range of financial products, such as liquid ESG benchmarks derivatives, which are a tool to encourage a transition towards ESG goals and contribute to new investment behaviour.

Sustainable activities and projects have diverging risk profiles, calling for adequate hedging possibilities. Well-functioning derivatives markets are an efficient basis for market integration of, for example, renewable power production. Energy derivatives markets bring together financial and physical players, ensuring the necessary liquidity for a market-based uptake of sustainable activities and projects with diverging risk profiles.

**Question 83**

We believe the approach taken, i.e. focusing on activities on the basis of greenhouse gas emissions and their reduction, is reasonable at this stage. We support the agreement reached by the co-legislators, including transitional and enabling activities, and we believe adding more granularity to the taxonomy would better reflect the diversity various activities and assets have on sustainability and as a result would benefit investors to determine how they can support the transition to sustainable activities. We also support the possibility to propose inclusion of further economic activities and services in the taxonomy to the platform in the future.

**Question 87**

We believe ESG considerations are already being sufficiently considered from a macro-prudential perspective by supervisors and central banks, in particular as part of current and future stress testing. We believe these tools are appropriate for the moment. There is also a need to fully assess the development of the ESG market, once the EU’s taxonomy regime is in place, in order to have a better evidence base and understanding of underlying risk related to ESG exposures.

**Question 88**

A risk-based prudential regulation can include climate or transitional assessments, reflecting exposure to such risks. However, prudential regulation should not be used to stimulate certain market behaviour. Prudential regulation and supervision are designed to increase the resilience of financial markets and to support the stability of the financial system overall. A green supporting factor or a brown penalising factor that would go beyond a risk-based approach might even transfer climate risk from corporates to the financial sector.

**About FIA**

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

FIA's mission is to:

* support open, transparent and competitive markets,
* protect and enhance the integrity of the financial system, and
* promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

1. <https://www.bbc.co.uk/news/science-environment-52973089> [↑](#footnote-ref-1)
2. <https://www.fia.org/articles/euronext-launches-futures-new-esg-index> [↑](#footnote-ref-2)
3. <https://www.world-exchanges.org/our-work/articles/wfe-sustainability-commodity-derivatives-white-paper> [↑](#footnote-ref-3)