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ANNEX – POLICY RECOMMENDATIONS

Building on the points raised above, we make the following specific recommendations for the European Commission to consider in its finalisation of the renewed Sustainable Finance Strategy.

1) International policy coordination

We recommend the Commission works to foster international policy alignment through the International Platform on Sustainable Finance and promotes a greater role for international standard setters to achieve convergence.

More global collective action is required to achieve a low-carbon, just and sustainable transition in all regions. This is especially true across Asia, Africa and the Middle East, where investment is required to promote low-carbon alternatives and ensure that per capita emissions do not reach the levels of high-income countries and thus 'carbon lock-in' for decades to come. Emerging markets are the most impacted by, and least prepared for, climate change and have benefited the least from the industrialization and globalization that has caused it.

The EU is responsible for 10% of global emissions. Its actions alone cannot prevent climate change, so it is vital that the EU policy response contributes to a global transition. A policy response that creates barriers for EU and international investors to finance transition activity in emerging markets and channel capital to where it is needed the most, risks the unintended consequence of accelerating climate change. The development of a unified international approach, combined with supervisory cooperation, is also imperative due to the cross-border nature of financial risks arising from climate change.

We recommend the Commission pursues international regulatory convergence on taxonomy, disclosures, data quality, product standards, risk management and regulatory incentives.

The Commission has already undertaken notable work in pursuit of international regulatory alignment, including forming the International Platform on Sustainable Finance (IPSF) with members from Standard Chartered's footprint, including India and China. In addition to its work through the IPSF, we recommend the Commission promotes these objectives in its interaction with international standard setting bodies. Specifically, we support a stronger role for the Financial Stability Board and the Basel Committee on Banking Supervision, analogous to their role post-financial crisis.

We recommend the Commission carries out an assessment as to whether EU standards need to be modified for application in emerging market countries, in particular as it develops a transition taxonomy.

Science-based targets can play a critical role in allowing companies across all sectors and countries to set long-run decarbonisation goals consistent with the Paris Agreement. With particular regard to emerging markets, the Commission should allow for national climate plans

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and/or transition plans towards the Paris Agreement, as well as other sustainable outcomes such as those expressed via the UN Sustainable Development Goals.

2) A socially sustainable transition

We recommend the Commission acknowledges economic activity that has strong social objectives as well as environmental goals in its classification of 'sustainable activity'.

We support the Commission in expanding its approach beyond a focus on 'climate' and environmental outcomes to include social factors, such as social exclusion, access to essential services, as well as the related socio-economic impacts.
The social safeguards in the EU Taxonomy are helpful but should be expanded upon to provide certainty to the market on the broader term of 'sustainability' objectives and avoid perverse outcomes, for example preferencing a strong environmental outcome to the detriment of social ones.

To bring about a just transition, we recommend the Commission gives further thought to the formal acknowledgement of economic activity that has strong social objectives as well as environmental goals (i.e. it does no significant harm but may not be fully taxonomy aligned) in its classification of 'sustainable activity', though we accept that activity which is not fully taxonomy aligned cannot benefit from any preferential regulatory treatment. Phasing out of assets may become necessary in the event that the market does not lead to such change, though the Commission should consider all facets of sustainability (such as alignment with the UN Sustainable Development Goals) in its definition of 'stranded'.

3) The development of the EU Taxonomy

We support the development of a science-based 'brown' taxonomy.

The development of a 'brown' taxonomy will facilitate a more detailed assessment of 'do no significant harm' and the extent of harm that is caused by 'brown' activity. This will ensure greater level of disclosures as it will allow companies to disclose against 'brown' to give all market participants a view of financial and non-financial actors' relative 'green' and 'brown' activity or financing levels. This also provides more information to shareholders and investors on a company's true portfolio as to activity aligned to doing significant harm.

We do not support the creation of a 'brown' taxonomy as a basis for the application of other policy tools, such as capital surcharges. We do not believe the data is available to support such policy measures, nor is there the level of sophisticated profiling of 'brown' from a financial risk perspective. Finally, we strongly believe that any such policy intention would jeopardise the transition, particularly in emerging markets.

We recommend greater clarity on the transition element of the EU taxonomy.

We are agnostic to the tool that the Commission wishes to use in pursuit of this goal, however, any outcome must remain science-based and the Commission should clarify the use case given the outcomes enabled by having a green and brown taxonomy. Specifically, we recommend that the Commission carries out further work on:

(1) *Timelines*. We note that the EU Technical Expert Group's (TEG) report already counts financing which achieves alignment with the Taxonomy's technical screening criteria over 5 years as taxonomy aligned. However, more work is needed to develop science-based transition timelines for all sectors and geographies to avoid carbon lock-in (as an equal rate of reduction is not always scientifically supported). This should be supplemented by risk-sensitive measures to reflect the inherent risks in a sector or geography.

(2) *Additional economic activities*. We note that the EU Taxonomy includes most of the economic activity in the EU that counts towards the majority of EU emissions, but that more economic activity can be included (particularly when using the source of global emissions as a base).

(3) *Greater geographical representation*. As the EU taxonomy becomes relevant for global banks and investors, and EU financial institutions investing in third countries (where the greatest proportion of emissions come from), countries' transition pathways to international climate objectives that sit outside of the current EU taxonomy should be considered

4) Regulatory incentives and barriers

We recommend a horizontal review of the EU regulatory framework to ensure rules allow for sustainable investment and long-term finance where it is needed most.

The post-crisis EU regulatory framework creates barriers to investing in certain asset classes, certain tenors, and in emerging markets. In addition, tax and national subsidies may represent barriers to investment. To identify and address these, the Commission should conduct an assessment of the regulatory framework to ensure capital can flow freely to the projects and countries that it is needed most.

This exercise should also consider the introduction of appropriate and harmonised incentives for sustainable finance across the regulatory framework.

The identification and mitigation of regulatory barriers alone will not alone be enough to encourage more investment in, and financing for, transition activity. Specifically, we believe that regulatory incentives that reduce the cost of capital and/or lead to a pricing difference will be more meaningful over other options, such as administrative and technical support, or the waiving of accreditation fees. For example, the introduction of preferential capital treatment for 'green exposures' or 'green securitisation' can provide a real incentive to grow the market.

We continue to support a risk-based approach for regulatory capital requirements. However, the implementation of risk-based changes will take many years, just for data collection and analysis. Therefore, we support green RWA relief as an <u>interim measure</u> and as one part of the overall solution. Ideally, capital adjustments would be globally coordinated. Such incentives should apply to exposures from outside the EU to increase sustainable financing activity globally.

In its consideration of capital relief as a regulatory incentive, to encourage the pace of transition, we recommend the Commission to explore a scaled approach.

This can be in line with the 5-year period as mentioned in the EU TEG report or any progress on transition timelines in a transition taxonomy. Scaling the relief available over the lifecycle of the financial instrument would seek to facilitate financing activity in the short-term to prevent carbon lock in, as well as provide an incentive for longer-term project financing and for activity to align to the EU taxonomy over time. While we accept that such relief is non-risk based, a scaled approach can avoid a 'blunt instrument', promote long-termism and alleviate a 'cliff edge' on both the relief available for financial institutions and any individual or system-wide stability concerns.

***We recommend the Commission explores the greater use of public incentives (such as guarantees, blended finance and public-private partnerships) which are particularly relevant for infrastructure finance*.**

Regulatory incentives, such as green RWA relief, in isolation can only form one part of an overall solution. Greater holistic consideration is needed of public, demand-side and supply-side incentives. In addition to capital relief, an EU synthetic securitisation framework, hair-cuts for central bank eligibility schemes and green repos, bespoke liquidity limits, and subsidies for green and/or transition projects should be considered. We support work at the EU level to remove subsidies for 'brown' and high-carbon activity.

5) Data and transition tools

We recommend the Commission prioritizes work to address the data gap, particularly from emerging markets.

Data quality, availability and traceability remain fundamental challenges to financing the transition. There remains a large gap in the level of interest, understanding, as well as disclosure and action between European clients and clients from across our wider footprint. We recommend the Commission undertakes work to increase the accuracy, availability and quality of emissions data that is reported by all sectors. In addition, more work is needed to ensure data reported on sustainability factors is reliable, traceable and accessible.

We recognise that the EU Sustainable Finance Taxonomy, combined with other aspects of the Sustainable Finance Strategy including renewed disclosure requirements for corporates and the creation of an accessible 'environmental data space', endeavours to ensure that data availability is not an impediment in assessing any company's transition readiness or to providing finance to further such readiness. It is, however, important to acknowledge there will be a time lag whilst these measures are adopted and implemented.

We believe that foundational tools need to be developed and standardisation needs to be established within industry and across markets before they can reach the stage of being regulated.

The development of transition tools also presents a significant barrier. The ability to access and use transition tools to encourage clients to move through the transition is critical but faces material practical limitations.

6) Product standards and harmonisation

We recommend that any work by the Commission on product standards is carried out following a review of industry standards and the functioning of those markets, and in full consultation with such industry bodies and their members.

We support EU-level rules and accreditation to ensure a level playing field at EU level and standardisation in the market where the product is very well developed and understood. Rules can be helpful to achieve scale and harmonisation of definitions can help grow the market. We note that there has been considerable industry work on 'green' or 'sustainable' product frameworks carried out by industry associations, such as the International Capital Market Association guidance on sustainability-linked bonds, and the Loan Market Association guidance on Green Loan Principles. To ensure any legislative proposals will add additional clarity, value or incentives, we recommend as a first step the Commission conducts a review of those market standards and the functioning of those markets.

For less established products, we recommend that any regulatory work should be principles-based to incentivise as much take-up as possible.

While we see merit in the Commission developing frameworks that support well-established products, in contrast space needs to be left for the market to innovate given it is nascent and has strong potential for new product development. The Commission should avoid technical and lengthy accreditation processes that may incentivise the market to pursue other options or investors to take up non-ESG aligned investments.

7) Climate risk and integrating wider environmental and social risks

We recommend that wider environmental, social and governance risks are assessed from a financial risk perspective once the climate risk approach matures.

We support the integration of wider environmental, social and governance risks to drive common definitions, risk management practices and improve disclosure and comparability. Climate risk (of several environmental risks) is urgent and should be prioritised to understand the financial and non-financial risk implications, which links to the prudential capital framework.

We believe that the stress test / scenario analysis frameworks for climate risk that have been, or are being, developed by central banks (most notably the Bank of England) are the appropriate tool for accounting for climate risk at this stage, with links to the ICAAP and Pillar 2 for physical or transition risk. This needs coordination at the EU level, as well as the international level through the Network for Greening the Financial System and the Basel Committee on Banking Supervision, including on home-host cooperation.

We support a science-based approach to climate risk. There are three areas where we encourage further regulatory work to support the further development of this:

(1) An agreed set of scenarios for modelling transition risk for example as recently set out by the Network for Greening the Financial System

(2) Acknowledgement and support for a variety of different emerging analysis techniques (technology / warming / emissions metrics) and their use to establish pathways which can aid risk decision-making best suited to different financial services or activities

(3) Encouraging the development of further data from the real economy to aid analysis

In exploring the integration of wider environmental, social and governance risks, the Commission should prioritise the necessary pre-conditions and analyse the interaction with existing prudential rules.

Once the approach to climate risk has been consistently achieved, the Commission should explore factoring in a wider range of environmental and social risks. We recommend the Commission begins with efforts to increase data, standardisation, harmonisation, and definitions for both social and governance issues. We also recommend the Commission explores the interaction with existing prudential requirements, including financial and non-financial risk types, for example on operational or conduct risk, as well as the relationship with other regulatory initiatives such as corporate governance reform.

We do not believe that the Commission should go beyond this, for example to brown capital charges or to wider capital penalties based on environmental or social factors. The data is not available to support such a policy choice, and this presents a danger to the transition and to the flow of finance to emerging markets, where – in fact – the biggest opportunity sits.