European Mortgage Federation-European Covered Bond Council (EMF-ECBC)

Response

European Commission Consultation on a Renewed Sustainable Finance Strategy

15 July 2020

SECTION II: QUESTIONS TARGETED AT EXPERTS

The following section asks further technical and strategic questions on the future of sustainable finance, for which a certain degree of financial or sustainability-related expertise may be useful. This section is therefore primarily addressed at experts.

Question 6: *What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?*

Challenges:

- Lack of recognition in the current prudential, supervisory and regulatory framework of sustainability-related factors
- Usability is key for making the taxonomy work in practice. This requires the collection and management of reliable sustainability-related data, the creation of wider and international standards as much as possible, and the continuous revision and adaptation of the taxonomy in a predictable and transparent manner. At the same time, the governance of the taxonomy technical screening criteria (TSC), as well as rules related to products that are already on the market, must support a high degree of predictability and transparency for all involved stakeholders. We suggest that assets keep the classification of taxonomy aligned throughout the lifetime of the loan financing the asset. We consider the grandfathering-recommendation of the EU Green Bond for their entire tenor to be equivalent to considering the underlying assets as Taxonomy-eligible throughout the lifetime of the loans financing the assets.
- Striking the right balance in the setting of regulatory targets - these should be gradual in order to avoid market disruption in terms of financial stability and of the level playing field and accessibility for business and consumers. Furthermore, this could also help to avoid market bubbles in the future while avoiding treating sustainable investments as a nice market niche.

Opportunities:

- Role for the Mortgage Industry to finance the transition, potentially positioning itself over time as a multi sectoral “one stop shop”, combining private sector incentives and public grants
- Using real estate and institutional investors as key drivers of change in market mentality and best

practices and applying the taxonomy to all relevant bank activities, most importantly lending.

- Development of common best practices and market standardisation with a market-led Label Initiative for financial products (e.g. energy efficient mortgage loans for purchase and renovation)

Question 7: *Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making? Please provide a maximum of three examples [BOX max. 2000 characters].*

EU wide policies and regulations should ensure the development of a robust level playing field in national regulation with gradual and realistic regulatory targets, which promote and stimulate the development of sustainable finance.

One area where current policies and regulation present a potential obstacle to the development of sustainable finance is in relation to the collection and management of data on the energy demand or consumption of national building stocks across EU Member States, and specifically the access to and comparison of Energy Performance Certificates (EPC). Robust and comprehensive EPCs, based on transparent and comparable methodologies and publicly accessible in Member States would go a long way to unlocking the potential of private finance to support the energy transition. Clarification with regard to the handling and management of this data from a GDPR perspective would also be invaluable.

As indicated earlier, regulatory targets should also be realistic and consistent, e.g. the criteria on buildings and construction in the EU Taxonomy bases eligibility in relation to “acquisition of buildings” on the "15% best energy performance" when in some Member States there is no data available on how good the current building stock is, or the cut off dates for applicability of this threshold would result in lenders managing two sets of loan books with different measures and thresholds. Furthermore, “Do No Significant Harm” criteria are not deliverable by lenders and are partially not covered by existing EU regulation. Finally, the lack of a clear definition of the concept of “NZEB” is an obstacle. NZEB is defined differently from one country to another and in some countries, there are even regional differences constituting further undermining consistency.

Generally speaking, the taxonomy regulation provides for a binary taxonomy, which means, that an economic activity is either taxonomy-compliant or not. While this approach provides a clear definition of what is to be considered environmentally sustainable and not, the transformation of the society is more complex, and it increasingly becomes clear that certain incentives for becoming more sustainable are lost in strictly binary approach. A more nuanced approach to sustainable economic activities in the taxonomy would contribute to driving forward a more broadly based and effective transition.

Question 9: *As a corporate or a financial institution, how important is it for you that policy-makers create a predictable and well-communicated policy framework that provides a clear EU-wide trajectory on greenhouse gas emission reductions, based on the climate objectives set out in the European Green Deal, including policy signals on the appropriate pace of phasing out certain assets that are likely to be stranded in the future? Please express your view by using a scale from 1 (not important at all) to 5 (very important).*

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For scores of 4 to 5, what are, in your view, the mechanisms necessary to be put in place by policy-makers to best give the right signals to you as a corporate or a financial institution?

- Reliable and consistent time schedule over the long-term

- Breakdown of EU-wide trajectories on specific business sectors
- Clear communication of agreed targets
- Adequate transition phases
- Involvement of all relevant stakeholders e.g. Platform for Sustainable Finance
- Consistent and reliable data

Question 10: *Should institutional investors and credit institutions be required to estimate and disclose which temperature scenario their portfolios are financing (e.g. 2°C, 3°C, 4°C), in comparison with the goals of the Paris Agreement, and on the basis of a common EU-wide methodology?*
§ Yes, institutional investors
§ Yes, credit institutions
§ Yes, both
§ No
§ Do not know

Yes both, but time will be needed to prepare (from 2022/2025 on) and whether or not it is realistic to do so will also depend on the supporting measures/incentives/obligations that will be enforced by authorities.

Question 12: *In your opinion, how can the Commission best ensure that the sustainable finance agenda is appropriately governed over the long term at the EU level in order to cover the private and public funding side, measure financial flows towards sustainable investments and gauge the EU's progress towards its commitments under the European Green Deal and Green Deal Investment Plan?*

A significant effort inside the Commission will be needed to ensure coordination between initiatives. Furthermore, it is our view that the Sustainable Finance Platform (SFP) will have a central role to play in involving the private finance sector: for this reason, we would recommend enlarging, both in terms of number of members and in terms of competences represented, the SFP compared to the current TEG configuration. Constant consultation on forthcoming initiatives and an ongoing dialogue with the main Finance Industry associations at European level would also be very useful.

Question 13: *In your opinion, which, if any, further actions would you like to see at international, EU, or Member State level to enable the financing of the sustainability transition? Please identify actions aside from the areas for future work identified in the targeted questions below (remainder of Section II), as well as the existing actions implemented as part of the European Commission's 2018 Action Plan on Financing Sustainable Growth.*

The most important aspect is coordination and full adoption at international level of all actions. Globalisation requires more international as well as institutional cooperation for the successful and effective transition to a sustainable economy. In fact, arbitrage in only one jurisdiction could severely dent efforts made by adopter States. It is also important to globally transmit information and training on issues related to sustainability both from the point of view of environmental protection and social justice. This will strengthen the internal thrust at country level towards adopting shared sustainability policies. Market stability and economic-political tensions are risks which arise as a result of short-sighted views. The launch of the recent International Platform on Sustainable Finance (IPSF) by the European Union and other important institutions from Argentina, Canada, Chile, China, India, Kenya and Morocco together with the International Monetary Fund (IMF) is a clear step forward. This is an example of coordinated and appropriate international cooperation that will cover capital market initiatives and will encourage sustainable investment globally. The current pandemic and economic crisis have reinforced the need for a comprehensive and global approach to cope with the heightened asymmetries, weaknesses and inequalities of our system that must be properly considered to achieve sustainable, inclusive and fair development.

In terms of succeeding with the sustainable transition of European society and achieving the political objectives, this requires a transformation, not only of the way the financial sector works, but the way the economy works. The efforts of the financial sector must be underpinned by the necessary fiscal and economic frameworks. Taxes, subsidies and guarantee funds should help promote sustainable production methods and investments and limit activities that are not compatible with a sustainable future. The scope of the climate challenge clearly emphasises an increasing need for taxes and subsidies to reflect the macroeconomic costs and gains in terms of the climate footprint and sustainability in the broad sense. When socioeconomic gains from sustainable activities are valued and reflected in market conditions, entrepreneurs and businesses can obtain financial viability of their projects. At the same time, it will strengthen banks' capacity to fund them. A concrete suggestion is for the EU to develop an EU model for measuring carbon footprints on first investments and later lending. Creating a voluntary EU model for measuring the carbon footprint would be useful for setting reduction targets by the sector, and thereby accelerating green investments (and lending) and would help reduce market fragmentation.

Question 15: *According to your own understanding and assessment, does your company currently carry out economic activities that could substantially contribute to the environmental objectives defined in the Taxonomy Regulation?*

Yes.

If yes, once the EU Taxonomy is established (end-2020 for climate change mitigation and adaptation), how likely is it that you would use the taxonomy for your business decisions (such as adapting the scope and focus of your activities in order to be aligned with the EU Taxonomy)? Please use a scale of 1 (not likely at all) to 5 (very likely).

5, very likely. However, if the obstacles mentioned in question 6 are correctly addressed, this could increase and facilitate the use of the EU Taxonomy.

Question 17: *Do you have concerns on the level of concentration in the market for ESG ratings and data? Please express your view by using a scale of 1 (not concerned at all) to 5 (very concerned).*

3. Current levels of concentration with recent mergers between credit rating agencies and ESG rating providers will professionalise the market for ESG ratings and data. However, concentration in and of itself does not address the fundamental concerns regarding ESG quality. To us, it is not a question of the level of concentration but at matter of quality.

We observe that methodologies of ESG rating and data are of varying quality and suffer from a lack of reliability, transparency and even validity – all of which are all critical elements for both investors and rated companies when relying on ratings and for agencies to achieve/maintain market confidence.

With an increasing investor and stakeholder focus on ESG factors, in large part also driven by other EU regulatory actions following the EU Action Plan on Sustainable Finance, we believe it is similarly important to accelerate market developments, to increase the quality of ESG ratings.

In the worst case, there is a risk that existing ESG-ratings risk mislead investors and other stakeholders. The typical report and its associated rating actions are almost invariably backward looking, and we observe a conceptual lack of tools to express forward-looking analysis.

Furthermore, we observe a general lack of enough resources within the ESG rating agencies, both in terms of skills and staff numbers, in order to be able to produce high-quality analytical output.

To accelerate market maturity, maintain investor confidence and support ESG based investments, there is an urgent need for standardisation of definitions, increased transparency on methodologies in a way that leads to valid, reliable and transparent ratings criteria / methodologies in order to increase the quality of the ESG ratings and data.

We are furthermore concerned about those cases where there is a conflict of interest between producers of ratings (the agencies) and consultancy (second division of rating agencies).

Question 18: *How would you rate the comparability, quality and reliability of ESG* ***data*** *from sustainability providers currently available in the market? Please express your view by using a scale of 1 (very poor) to 5 (very good).*

2 - Lack of resources and limited earnings potential under the existing set-ups can lead to simplistic and formulaic analysis, which may be undertaken by low-skilled labour in low-cost countries. This will frequently lead to misunderstandings as ESG analysis is complex and require substantial knowledge of local conditions that in turn require local language skills as well as understanding of how to access information.

In addition, the raters build their business on subscription models from investors who define the 'investment universe'. This coupled with the scope of the methodology/model results in great variety. An in-depth company analysis model will always have a smaller scope as compared to a screening model which scans the internet for anything that fits with the search string.

Comparability is poor due to different methodologies across providers. Quality is poor as the sources of information vary considerably, with weighting to parameters within ESG data undisclosed to the public and therefore unchallenged. Reliability of ESG data is also questionable as it is almost invariably backward looking and lacks methodologies for forward looking analysis.

The comparability, quality and reliability of ESG data from sustainability providers currently available in the market could be increased by improving the transparency in rating methodologies and data. This will make ESG ratings more useful to market participants and it would be possible to compare ESG data or ratings.

For instance if ESG rating providers offer visibility into the metrics they evaluate and the level of materiality they assign to each metric, market participants could get af better understanding of if some measures are considered more material in some sectors than others or what specific elements should be present in the company's policies, sustainability report etc. to be considered best in class/robust. This is currently not possible.

Finally, data seem to lack update promptness and need to be double checked. Banks often also engage with issuers in order to ascertain or complement the ESG data from providers.

Question 19: *How would you rate the quality and relevance of ESG* ***research*** *material currently available in the market? Please express your view by using a scale of 1 (very poor) to 5 (very good).*

3. Even if there is some high quality and relevant research material available in the market, more often we observe that methodologies are of varying quality and suffer from a lack of reliability, transparency

and even validity – all of which are all critical elements for both investors and rated companies when relying on ratings and for agencies to achieve/maintain market confidence.

Quality of ESG research is too often poor as ESG information is not integrated into sell side research. ESG research should be incorporated into mainstream financial research and not be separate. ESG research material also lacks standardised processes - research processes vary and are often carried out ad hoc. Furthermore, ESG research is scattered across various providers. Finally, ESG research appears to too often rely on media reports.

Question 21: In your opinion, should the EU take action in this area? Yes/No/Do not know.

Yes, the EU should ensure that there is no conflict of interests.

The ESG rating industry is often – as opposed to the existing credit rating industry – characterised by lack of structure, process and standardisation to the detriment of both investors, companies and even rating agencies themselves.

At present, credit rating agencies are integrating with ESG rating agencies (S&P + Robeco SAM; Moody's + Vigeo Eiris; DBRS Morningstar + Sustainalytics). This trend illustrates that ESG or sustainability assessments have a natural link to credit ratings. In fact Sustainalytics is defining its rating as the impact from E, S and G factors on the financial flexibility of a company, which in practice implies a credit rating.

This serves to illustrate that ESG ratings should fall under the same type of regulation as credit rating agencies. This would require more consolidation and would likely result in viable size agencies capable of maintaining necessary administrative and compliance resources as well as skills in sufficient quantity.

We therefore believe that an EU Taxonomy and existing regulation applying to credit rating agencies should guide the Commission's deliberations going forward.

Question 22: *The TEG has recommended that verifiers of EU Green Bonds (green bonds using the EU GBS) should be subject to an accreditation or authorisation and supervision regime. Do you agree that verifiers of EU Green Bonds should be subject to some form of accreditation or authorisation and supervision?*

Yes, at European level.

Question 23: *Should any action the Commission takes on verifiers of EU Green Bonds be linked to any potential future action to regulate the market for third-party service providers on sustainability data, ratings and research?*

Yes, the Regulation on CRAs could serve as a model here e.g. consistency of methodology should be assessed.

Prospectus and green bonds

Question 25: *In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing? Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree). If necessary, please specify the reasons for your answer [BOX, 2000 characters]*

3. Requirements to disclose specific information would prevent greenwashing. It does not necessarily have to be a requirement in the prospectus. Requirements of bonds being green is already stated in the Green Bond Framework, which is verified by a third-party.

Question 26: *In those cases where a prospectus has to be published, to what extent do you agree with the following statement: "Issuers that adopt the EU GBS should include a link to that standard in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus"*

4. A link to the EU GBS in the prospectus should suffice as declaration of the bonds being green. However, project description or category description could be described in the framework disclosed in the prospectus..

Question 32: *Several initiatives are currently ongoing in relation to energy-efficient mortgages[1] and green loans more broadly. Should the EU develop standards or labels for these types of products?*
Yes/No/Do not know.
If yes, please select all that apply: - a broad standard or label for sustainable mortgages and loans (including social and environmental considerations); - a standard or label for green (environmental and climate) mortgages and loans; - a narrow standard or label only for energy-efficient mortgages and loans for the renovation of a residential immovable property; - other: please specify what type of standard or label on sustainability in the loan market you would like to see [BOX, 2000 characters]

Experience from the Covered Bond Label[2], established by the EMF-ECBC in 2012, shows the value of a market-led Label, which lays down eligibility conditions and sets a quality benchmark. Drawing on the success of this Label for the specific context of energy efficient mortgages, the EMF-ECBC, as coordinator of the Energy Efficient Mortgages Initiative (EEMI)[3], is currently establishing an Energy Efficient Mortgage Label, to stimulate market development in relation to energy efficient mortgages by providing access to relevant, quality and transparent information for market participants, and therefore supporting recognition of and confidence in EEM.

Definitions and format of the disclosed information will be based on the EeDAPP data protocol and will be standardised by way of a harmonised disclosure template (HDT) to increase comparability and transparency between mortgage products and between jurisdictions. The disclosure requirement stimulates the creation of a positive incentive chain across the mortgage value chain for more consistent and standardised data collection and management as well as for better linking loan information, property and energy efficiency characteristics in a single common template.

By improving the access to relevant and transparent mortgage information for homeowners, investors, regulators and other market participants via a consistent reporting template, the Label will become a powerful communication tool to further help the securitisation and issuance of green bonds. The EEM Label is intended to allow easier access to energy efficiency financing, green bond markets, better tracking of EEM performance and to provide greater transparency of climate risks and portfolio resilience.

Importantly, the EEM Label will be managed through a strong governance structure led by a Label Committee which will be charged with the guidance and supervision of the management of the Label Convention that will enshrine the EEM definition, and an Advisory Council consisting of policy makers and national competent authorities to provide policy advice and guidance. Importantly, the Label Committee and Advisory Council will ensure alignment between the EEM Label and EU's policy objectives and

[1] See for instance the work of the EEFIG (Energy Efficiency Financial Institutions Group set by the EC and the United Nations Environment Program Finance Initiative or UNEP FI) on the financial performance of energy efficiency loans or the energy efficient mortgages initiatives.
[2] www.coveredbondlabel.com
[3] www.energyefficientmortgages.eu

taxonomy in order to make sure that lenders are able to meet the proposed criteria and avoid market confusion, fragmentation and inconsistencies.

Of particular relevance will be the annual review exercise managed by the Label Committee in consultation with the Advisory Council and based on market feedback. This will ensure the incremental 'raising of the bar' of the Label's eligibility criteria for new loans to create a dynamic process that will allow the market to realign around the common quality benchmark, ensuring constant enhancement of the Label over time. Therefore, the Label Committee will advise on the progressive development and update of the EEM definition enshrined in the Label Convention.

With all of these considerations in mind, we believe that this market-led initiative represents the most efficient and effective way of labelling EEM, responding to market developments through a regular review exercise and thus stimulating market development in this area.

Question 51: *Should the EU support the development of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals?*

We strongly support the development by the EU of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals.

Question 66: *In your view, does the EU financial system face market barriers and inefficiencies that prevent the uptake of sustainable investments? Please express your view on the current market functioning by using a scale of 1 (not well functioning at all) to 5 (functioning very well). Please specify your answer. [BOX max. 2000 characters]*

3. Even if there are already a variety of financial products available in the market, the EU financial system faces important barriers and inefficiencies which impact on the current functioning of the market:

- The biggest challenge is lack of good quality data. With the standardisation and creation of sector-specific green criteria the uptake of sustainable investments is starting to become more widespread. However, benefits are largely still reputational, which is mainly relevant to larger companies.
- To recall, the EMF-ECBC, together with its partners, is designing a data gathering, processing and disclosure infrastructure for energy efficient mortgages specifically, as well as an Energy Efficient Mortgage Label which will be underpinned by a Harmonised Disclosure Template.
- Asymmetric composition of EU Member States' business sectors. Countries characterised by a higher concentration of SMEs face particularly difficult challenges in pursuing sustainable investments. Verifying taxonomy compliance of activities and/or investment often involves burdensome processes for SMEs and Start-up. In this context, regulation should carefully balance the data requested from different companies. While start-ups and SMEs have the potential to be a major driver of innovation for sustainable development, further attention should be given to their financial needs to support the "brown" companies in their transition to more sustainable business models.
- Public authorities and financial institutions should cooperate to identify mechanisms to complement traditional sources of credit for SMEs operating in the green economy with more sophisticated financial instruments that allow a longer-term view. Emerging solutions to be taken into consideration could include fintech, crowdfunding for sustainable projects and impact finance.
- Potential synergies not yet explored in sustainable finance, such as that of a supply chain approach. The chain approach may allow for integration of opportunities and environmental risk analysis along the whole value chain.

- Capital requirements associated to certain sustainable investments/exposures that have robust prospective reduced financial risk should be lower compared to non-sustainable ones (see also question 88)The EMF-ECBC is currently conducting a comprehensive analysis of the correlation between building energy performance and credit risk with a view to determining the appropriate (lower) prudential treatment of energy efficient mortgages.
- There should be synergies between economic policies and technology investments as the European Commission does with the IPCEI framework (for instance on electrolysis storage).
- Green-washing has been a crucial barrier so far, hopefully after putting in practice the EU taxonomy this barrier will be removed.

Question 67: In your view, to what extent would potential public incentives for issuers and lenders boost the market for sustainable investments? Please express your view on the importance of financial incentives by using a scale of 1 (not effective at all) to 5 (very effective).

Answer:

Types of incentives	Bonds	Loans	Equity	Other
Revenue-neutral subsidies for issuers	4	5		
De-risking mechanisms such as guarantees and blended financing instruments at EU-level	2	4		
Technical Assistance		5		
Any other public sector incentives Please specify in the box below: preferred tax treatment for bond investors and lenders of loans	4	4		

Question 68: *In your view, to what extent would potential incentives for investors (including retail investors) help create an attractive market for sustainable investments? Please express your view by using a scale of 1 (not effective at all) to 5 (very effective).*

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For scores of 4 to 5, in case you see a strong need for incentives for investors, which specific incentive(s) would best support an increase in sustainable investments?
- *Revenue-neutral public sector incentives?*
- *Adjusted prudential treatment?*
- *Public guarantee or co-financing?*
- *Other?*

Other. For retail investors, the incentive would be preferential fiscal treatment. For professional, institutional investors, incentives would depend on the type of investor (e.g. a bank investor could be best incentivised by a lower risk-weighting for sustainable investments, whereas an asset manager might prefer other incentives.

Having said this, possibly the best incentive is transparency. Retail investors according to market research studies note the "lack of sufficient ESG information" as the biggest barrier to their understanding.

Question 69: *In your view, should the EU consider putting in place specific incentives that are aimed at facilitating access to finance for SMEs carrying out sustainable activities or those SMEs that wish to transition? Yes/No/Do not know? If yes, what would be your main three suggestions for actions the EU should prioritise to address this issue? [box max. 2000 characters]*

Yes.

- Establishment of a dedicated platform that would allow SMEs to access easily technical assistance services by ESG experts and, implicitly, decrease the costs related to these services;
- Introduction of financial and/or tax incentives for green investments and for transition ones;
- Definition of guidelines and/or general "green covenants" for sustainable loans granted to SMEs - possibly differentiated based on the sector/ industry the counterparties belong to (e.g. definition of "positive covenants" or contractual clauses providing benefits for counterparties that achieve the expected sustainability objectives)
- Furthermore, as already indicated in the EMF-ECBC Contribution to the Joint Recovery Plan, the EMF-ECBC has been working on an initiative to create a new pan-European dual-recourse long-term funding instrument called the European Secured Notes (ESN). This instrument would allow for the financing of asset classes beyond the traditional covered bond collateral types of mortgages and public sector assets such as SMEs and/or green/infrastructure assets. We are furthermore confident that, as part of efforts to build a Capital Markets Union, the combination of European Secured Notes to channel funding to SMEs and the Energy Efficient Mortgages and Covered Bond Label Initiatives will position the mortgage and covered bond industries at the heart of a new, multisectoral green/ESG value chain, which will stimulate a change in mentality from consumers, to SMEs, to public authorities and institutional investors, deliver robust ESG data and boost the renovation of the EU's building stock.

***Question 82**: In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called "brown taxonomy") at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation? Yes/No/Do not know?*

Yes. We understand that at a certain point in time, it will be necessary and useful to expand the taxonomy, however, we do not believe that the existing taxonomy should be complemented with a brown taxonomy right now. Now the focus should be on finalising the green taxonomy and encouraging banks and investors to steer their portfolios towards sustainable/green activities. This approach is preferable as a start because, if correctly developed, it could promote the financing of sustainable activities, instead of identifying business sectors that should not be financed by European banks. In any case, it would be far more more urgent to complement the taxonomy with social aspects, in particular in a post COVID-19 recovery scenario).

If yes, what would be the purpose of such a brown taxonomy? (select all that apply)

- ✓ Help supervisors to identify and manage climate and environmental risks.
- ✓ Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.
- ✓ Identify and stop environmentally harmful subsidies.
- ✓ Other, please specify: Developing a brown taxonomy will help to identify a third group of economic activities, those, that are neither green, nor brown. With the Green Taxonomy, all non-green activities may be considered brown, although they may be neutral or in the process of transformation or could be incentivised to transform through dynamic targeting (KPIs).

***Question 84**: Climate change will impact financial stability through two main channels: physical risks, related to damages from climate-related events, and transition risks, related to the effect of mitigation strategies, especially if these are adopted late and abruptly. In addition, second-order effects (for instance* *the impact of climate change on real estate prices) can further weaken the whole financial system. What are in your view the most important channels through which climate change will affect your industry?*

- Physical risks: Physical risk will show its major impacts in a wider timeframe, but its effect will include not only damages from climate related events, but also second order effects. For real estate valuation a judgement of longer-term physical risk is necessary e.g. If higher frequency of damages on the property due to flooding. Physical risk assessment / economic quantification is yet to be made – we would prefer an academic/standardised approach to this challenge rather than banks each developing models. In Denmark for example, the Danish National Weather Service has published a 'climate atlas': An assessment of future (year 2050 and 2100) expected extreme weather scenarios in different regions in Denmark. Furthermore, geological data are available (e.g. risk of flooding due to rising sea level or heavy rainfall)
- Transition risks: Transition risk in the near future will probably affect more the financial stability of companies based in some regions.
- Second-order effects: The combination of physical and transition risks will have repercussions for banks' portfolio that will depend on its composition in terms of business sectors, geographies and characteristics of the counterparties (e.g. technology in use, business model).

Question 85: *What key actions taken in your industry do you consider to be relevant and impactful to enhance the management of climate and environment related risks? Please identify a maximum of three actions taken in your industry [BOX max. 2000 characters]*

1) Collection of relevant data / data management, green bond impact reporting
2) Cooperation with experts on climate and environment related risks to identify high risk sectors
3) Cooperation with customers, actively engaging those most exposed to climate and environment related risks, creating awareness, incentivisation of loans for green buildings and help customers to transition or ensure that new customers are more resilient than today

Question 88*: Do you consider that there is a need to incorporate ESG risks into prudential regulation in a more effective and faster manner, while ensuring a level playing field? Yes/No/Do not know?*

Yes. We recommend a risk-based realignment of capital requirements for those exposures that:

- are classified as sustainable under the EU taxonomy;
- belong to clusters of economic activities that - by the application of forward-looking risk evaluation methodologies on sample of those clusters – have shown a reduced financial/credit risk due to their sustainability profile.

This will not only stimulate the adoption of the Taxonomy by banks, but improve banks' understanding of their ESG risks and provide the necessary relief to enable them to contribute fully to funding the transition to a more sustainable economy.

If yes, is there any category of assets that could warrant a more risk-sensitive treatment? Are there any other prudential measures that could help promoting in a prudentially sound way the role of the EU banking sector in funding the transition to a more sustainable economy?

- One of the key premises of the Energy Efficient Mortgages Initiative is that energy efficiency has a positive impact on credit risk and can contribute to financial stability. Energy efficiency frees up disposable income which can positively impact borrowers' ability to service their loan, thereby lowering the Probability-of-Default (PD). Improved energy efficiency can also increase the value of the property, thereby lowering the loss for the bank in the case of default, i.e. the Loss-Given-Default (LGD). Given the fundamental role of these risk indicators in the calculation of banks' capital requirements, establishing a correlation between energy efficiency and PD and LGD provides a strong business case for lenders to originate energy efficient mortgages.

In this respect, existing literature already points to a correlation between building energy performance and increased property value and lower probability of default. The innovation brought by the EEMI is to conduct analysis on banks' current loan books and to enable banks to track performance over time. With regard to the latter, the EEMI has delivered a data protocol and is designing a portal to collect and access large-scale empirical evidence relating to energy efficient mortgage assets allowing a comprehensive analysis of de-risking energy efficient features.

Early research conducted under the EEMI confirms the correlation between building energy performance and lower credit risk but also points to the fact that a correlation cannot be concluded only by looking at one-time snapshots of narrowly defined market segments. As such, this preliminary analysis laid the foundations for additional research and, at the time of writing, banks and other stakeholders are participating in a more in-depth and extensive quantitative assessment, the results of which will be available by August at the latest.

Once this positive correlation has been established under the EEMI using the large-scale empirical evidence described earlier, we believe that the lower risk of energy efficient mortgages could be recognised by regulators via a realignment of the capital requirements for these exposures. This recognition would help to reinforce the business case for lenders, underpin the virtuous circle of positive spill-overs for all stakeholders in the value chain and scale-up market development.

- Linked to the point above, the improvement of energy efficiency in the social housing sector could be a driver for market transformation towards more sustainability in the whole building sector. However, the social consequences of energy renovation would have to be taken into account in the (ESG-) risk assessment. It would be desirable if the EU incentivised financing the improvement of energy efficiency in social housing.

- Another group of economic activities, those, that are neither green, nor brown may be neutral or in the process of transitioning and could be incentivised to transition through dynamic targeting (KPIs).

Question 89: *Beyond prudential regulation, do you consider that the EU should take further action to mobilise banks to finance the transition and manage climate-related and environmental risks? Yes, one or both, please specify which action would be relevant [BOX max. 2000 characters]. No. Do not know?*

Yes (specification as in questions 67 and 68)

Question 99*: In your opinion, should the European Commission take action to enhance the availability, usability and comparability of climate-related loss and physical risk data across the EU? Yes/No/Do not know?*

Yes.

- Loss Data: Comparable, standardised and widely accessible loss data is critical for the risk management functions of financial institutions and the future integration of ESG scenarios into financial institutions strategy. Thus far, reliable and granular loss data is scarce and concentrated in a few private data-providers. Risk data: Comparable, standardised and widely accessible physical risk data is critical for the risk management functions of financial institutions the future integration of ESG scenarios in financial institutions strategy. Thus far, reliable and granular physical risk data is scarce and concentrated in a few private data-providers.

As indicated above, the EMF-ECBC, together with its partners, is designing a data gathering, processing and disclosure infrastructure for energy efficient mortgages specifically, as well as an Energy Efficient Mortgage Label which will be underpinned by a Harmonised Disclosure Template.

- ***Question 100:*** *Is there a role for the EU to promote more equal access to climate-related financial risk management mechanisms for businesses and citizens across the EU? Yes/No/Do not know?*

Yes

If yes, please indicate the degree to which you believe the following actions could be helpful, using a scale of 1 (not helpful at all) to 5 (very helpful) and substantiate your reasoning:

- Financial support to the development of more accurate climate physical risk models.
4

- Raise awareness about climate physical risk.
4

- Promote ex-ante "build back better" requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe.
4

- Facilitate public-private partnerships to expand affordable and comprehensive insurance coverage.
5

- Reform EU post-disaster financial support.
5

The financial sector finances sustainable projects and activities and helps to move society in a sustainable direction. Many initiatives have been taken to support this development. However, implementation of the Basel III output floor into EU legislation will work in the opposite direction and will undermine the ability of European banks to finance the transition through significant increases in capital requirements, thus also harming the European economy already in a severe situation.

Risk sensitivity in the allocation of capital for loans is important for efficient, low cost funding of e.g. low risk green projects (see questions 66 & 88). Implementation of the output floor can make projects which are beneficial for society and investors more expensive to finance or even make them economically unattractive for banks and investors meaning lower social welfare for society. In the current Covid-19 crisis context, it is even more evident that serious and careful consideration should be given to the implementation of the output floor in the EU context.

- Support the development of alternative financial products (e.g. catastrophe bonds) offering protection/hedging against financial losses stemming from climate- or environment-related events.

5

- Advise Member States on their national natural disaster insurance and post disaster compensation and reconstruction frameworks.
4

- Regulate by setting minimum performance features for national climate-related disaster financial

management schemes.
3

- Create a European climate-related disaster risk transfer mechanism.
3

Question 102: *In your view, should investors and / or credit institutions, when they provide financing, be required to carry out an assessment of the potential long-term environmental and climate risks on the project, economic activity, or other assets? Yes / No / Do not know? § If yes, what action should the EU take? Please list a maximum of three actions?*

Yes, we believe this is important, and in fact, in some cases, is already market practice. We also believe this will be done gradually through the development of stress tests and extension of credit risk models for large institutions with ESG risks which will affect credit policy. Action is already being taken by the EBA from mandates in the CRR/CRD and the effects should be evaluated before further action is taken. But it will likely be warranted with Guidelines to clearly define how the assessment should be carried out. The EU should furthermore provide access to relevant data in order to facilitate climate risk assessments.