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Renewed EU Sustainable Finance Strategy

Consultation contribution by
econsense – Forum for Sustainable Development of German Business

Introductory remarks on the nature of the econsense network

econsense – Forum for Sustainable Development of German business is a **network of large, internationally operating companies**, the majority of which are listed. Our members are dedicated to sustainability. **Our network covers the entire spectrum of corporate actors in the field of Sustainable Finance**. This includes financial and non-financial companies from a large variety of sectors, auditors, and consultancies. Some of our members are active in official Sustainable Finance expert groups on the national and European level. **We are not an industry association but a sustainability network.** Therefore, we do not speak for German business as such but contribute to this consultation based on the experience and knowledge of our members.

Answers to selected consultation questions that we would like to comment on:

General questions:

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:

a) Designing a coherent regulatory framework: Establishing sustainability as a core topic within the financial sector will require a regulatory environment that provides a clear and reliable guidance and at the same time ensures, and at best increases, the competitiveness of European companies. To this aim, national, European, and international frameworks need to be compatible and fit for purpose for practical application while bureaucratic burdens for companies should be minimized.

b) Quantifying sustainability issues: As of today, a large variety of definitions and methods are applied to assess sustainability issues. Mainstreaming sustainability in financial and corporate systems will require quantitative (next to qualitative) indicators. The EU Taxonomy is a good starting point to continue work on consistent, robust, and comparable sustainability criteria and metrics to evaluate costs and benefits without discrimination of single industries.

c) Leaving room for learning processes and adjustments: Mainstreaming sustainability will be an iterative process. Regulatory frameworks need to give companies adequate flexibility in developing and implementing measures.

Opportunities:

a) Harmonizing sustainability definitions: Mainstreaming can lead to a shared (European) understanding of qualitative and quantitative sustainability criteria. As an example, a holistic product life-cycle approach is needed to develop common definitions and methodologies. This should cover environmental, economic, and social issues.

b) Encouraging long-termism: Mainstreaming sustainability can alter short-term assessments and foster a long-term view, e.g. on climate risks. As the transition towards climate-neutrality is dynamic, future economic and technological developments need to be taken into consideration when necessary.

c) Creating incentives: Mainstreaming sustainability can provide incentives for (private and institutional) investors, companies, and public agencies to foster both sustainable and profitable investments. This can further link societal and business goals. Such an alignment will direct innovation and investments towards benefits to society. At the same time, this creates value for business by focussing on relevant future markets and increasing employer attractiveness.

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?

Policy coherence on the EU and national level is essential to reduce obstacles to the development of sustainable finance. Currently, there are several regulatory frameworks that define sustainability requirements. These include the Non-Financial Reporting Directive (NFRD, 2014/95), the Disclosure Regulation (2019/2088) as well as developments towards the integration of sustainability risks and factors into financial market regulation such as the Markets in Financial Instruments Directive (MiFID II, 2014/65) or the Insurance Distribution Directive (IDD, 2016/97). Some of these frameworks (such as the NFRD) are currently under revision or are not yet applicable (such as the Disclosure Regulation). At the same time, the Taxonomy Regulation and subsequent delegated acts will be further developed and introduced. With this broad variety of legislative pieces and overlapping processes, streamlining is essential to ensure consistency, compatibility, and effectiveness of requirements. It will be important that the upcoming Platform on Sustainable Finance, who will advise the Commission on the delegated acts of the Taxonomy regulation, carefully examines the final report of the Technical Expert Group (TEG) for inconsistencies with existing legislation. Such inconsistencies would create uncertainties over Taxonomy-eligible investments and could potentially contribute to the stagnation or stop of existing investments. Relevant industrial experts should be adequately represented in the Platform so that industry expertise is considered. Within the Platform, there should be a well- balanced mix of relevant stakeholders so that business and civil society actors enter a constructive dialogue. Furthermore, clear communication on the links between the above-mentioned regulation is needed. Another important aspect is predictability and traceability of framework conditions to give business enough time to adjust to necessary changes in regulatory framework conditions. The criteria and mechanisms described in the TEG recommendations should be checked against existing challenges in complex economic setups, such as collaboration across a group of companies and/or globally distributed value-creation chains. Currently, the TEG report annex has several hypothetical examples only.

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<u>Question 8</u>: The transition towards a climate neutral economy might have socio-economic impacts, arising either from economic restructuring related to industrial decarbonisation, because of increased climate change-related effects, or a combination thereof. For instance, persons in vulnerable situations or at risk of social exclusion and in need of access to essential services including water, sanitation, energy or transport, may be particularly affected, as well as workers in sectors that are particularly affected by the decarbonisation agenda. **How could the EU ensure that the financial tools developed to increase sustainable investment flows and manage climate and environmental risks have, to the extent possible, no or limited negative socio-economic impacts?**

Certainly, there will be structural changes which might have a negative impact on certain groups. A decarbonization of the economy is not possible without changes. The challenge is to leave no one behind by accompanying this process through creating opportunities and supporting people to manage the transformation in a sustainable way.

In the debate over socio-economic impacts, it would be valuable to clarify the considered timeframe of such impacts. Over the short term, negative socio-economic impacts are unlikely to be completely avoided, e.g. in the context of a production shift towards electric mobility. The mid- and long-term transformation of the European economy could however open new job opportunities as well. But this will take time. The EU Just Transition Fund can be a valuable instrument to support those most affected by the transformation.

Sustainable finance is linked to environmental, social, and governance issues. However, the social dimension of sustainability is still somewhat lacking attention in comparison to environmental issues. Therefore, in order to gear investment flows towards sustainable activities, a more holistic approach, including further work on social and governance factors, is needed. A compatible instrument regarding social issues, in addition to the currently developed green taxonomy, and an alignment between both instruments would be useful.

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<u>Question 9:</u> 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): 4

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?

Signals to financial and non-financial companies need to be consistent. In the context of the European Green Deal, upcoming technological developments as well as existing regulation need to be adequately considered, e.g. the EU Emissions Trading System, the EU Waste Framework Directive (2008/98) and the Registration, Evaluation, Authorisation and Restriction of Chemicals Regulation (REACH, 1907/2006). There should be a predictable trend in the availability of carbon emission rights/natural resources and the respective price trend for carbon/use of nature capital to speed up sustainable innovations and to achieve the necessary carbon emission reductions in an efficient way.

<u>Question 12:</u> 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?

In order to ensure an appropriate governance of the sustainable finance agenda, the European Commission should encourage a strong collaboration between all relevant stakeholders, especially industry experts, investors, and policy makers. This applies also to the Platform on Sustainable Finance which should include actors from all relevant stakeholder groups to ensure that going forward the Taxonomy criteria are taking into account complex economic structures. Ultimately, market mechanisms need to be strengthened, as only these can ensure a sustainable long-term allocation of capital. Consistent national application of the of the Taxonomy Regulation needs to be ensured. The focus should be on enabling all involved parties and not on creating an undue administrative burden. Overall, the governance of the sustainable finance agenda should be flexible enough to allow for innovative ways, which are technologically feasible and economically viable to create a carbon-neutral economy and society.

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Section 1.1. Company reporting and transparency

Question 14: In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

Yes/No/Do not know.

Theoretically, such a data space could be beneficial. In practice, however, there are several issues to consider before setting up such a database. Without standardization (e.g. a defined core set of sustainability indicators), data would not be comparable and therefore of limited use for all interested stakeholders. Such a core set of indicators would likely require sector-specific guidelines and supplements. Also, defining core indicators creates the risk of making further, more detailed, reporting obsolete and could therefore lead to a loss of reported corporate sustainability information.

It is difficult to separate non-financial/sustainability-related information from financial information. Typical sustainability-related information is quantitative and qualitative, but the qualitative information is difficult to be standardized in a data space. And quantitative data needs additional explanation in order to be adequately interpreted, which might not be possible in a data space. Therefore, this data would be taken out of context. With regard to the Taxonomy Regulation, practical experience with taxonomy-aligned assessments needs to be gathered first before data could even be provided. A common data space should be based on already existing global standards. Furthermore, all data needs to be verified in a reasonable way to ensure comparability. Additional costs should be avoided.

Furthermore, planned aggregation and data gathering of existing data providers (i.e. Bloomberg) and upcoming obligation to disclose information in machine-readable formats (ESEF, XBRL) have to be taken into account when discussing this question. Bloomberg is already adjusting its software towards the EU Taxonomy so that users or decision makers have the data available as soon as the regulation comes into force. The request for having financial and non-financial data in one place is already a reality. However, it has to be ensured that the data shown is valid and aggregated properly. A free-of-cost and publicly accessible request might not be assessed thoroughly. This is an important question yet to be discussed.

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/No/Do not know.

If yes, once the EU Taxonomy is established (end-2020 for climate change mitigation and adaptation),4 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). 4 If necessary, please specify.

All members of econsense make substantial contributions to the EU environmental goals according to the Taxonomy Regulation. Depending on the respective industry (see NACE Codes), a large number of green activities will be reported in the future. Some companies are not yet able to refer directly to the taxonomy, as no Technical Annex has yet been published. If the taxonomy logic succeeds in establishing itself on the markets, it is to be expected that the sales and CAPEX share of green activities will also be used for business decisions in the future.

Section 1.3 Sustainability research and ratings

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). 4
If necessary, please explain the reasons for your answer.

A distinction needs to be drawn between ESG rating agencies and ESG data providers (on data providers, please see our answer to the next question). Regarding ESG rating agencies, we do observe a tendency of market concentration, especially by US institutions. In a highly concentrated market, competition among ESG rating agencies might suffer, and ratings might be commercialized. In order to understand ESG rating results, it is important to carefully examine rating methodologies. Due to different approaches and weightings, ESG scores are often not directly comparable. Therefore, the use of multiple ESG reports rather than a single rating is often recommended for an appropriate performance indication. On the other hand, a focus on certain ratings might reduce reporting burdens. Transparency of rating criteria and weights is necessary to create trust. Like other markets, the rating market may have a tendency towards oligopolist structures. Therefore, this market needs smart regulation.

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<u>Question 18:</u> 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). 3

Investors increasingly tend to buy data directly from data providers to conduct their own corporate ESG-analysis and -assessments. Currently, there are stark differences in provided data in terms of quality, timeliness, suitability, completeness etc. Because of these different levels of quality, the establishment of minimum quality standards for data providers would be valuable.

<u>Question 19:</u> 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

We observe a broad spectrum of quality regarding ESG research material. This varies from extensive, detailed ratings (with the possibility of feedback by stakeholders) to less understandable ratings (partly without the possibility of feedback by stakeholders).

<u>Question 21:</u> In your opinion, should the EU take action in this area?

Yes/No/Do not know.

Clear and transparent guidelines for methodologies of ESG rating agencies would lead to a fruitful competition between ESG agencies and eventually lead to better data and higher comparability. Similarly, a quality standard including a set of minimum requirements for ESG data providers would be helpful.

Section 1.4 Definitions, standards and labels for sustainable financial assets and financial products

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

Yes, at a national level

No

Do not know

If necessary, please explain the reasons for your answer

Accreditation and authorization should be used to strengthen the independence of verifiers. In this context, ethical codes, verification standards, processes as well as criteria for internal and external quality assurance would be useful. Supervision could be useful as well, but at the same time over-regulation should be avoided in order to encourage further verifiers to enter the market.

Question 24: The EU GBS as recommended by the TEG is intended for any type of issuer: listed or non-listed, public or private, European or international. Do you envisage any issues for non-European issuers to follow the proposed standard by the TEG?

Yes/ No/ Do not know

If necessary, please specify the reasons for your answer

In our view, there are no issues for non-European issuers to follow the proposed standard by the TEG on a voluntary basis. However, we cannot estimate whether this will be applied in practice or not.

Section 1.6 Corporate governance, long-termism and investor engagement

Question 46: Due regard for a range of 'stakeholder interests', such as the interests of employees, customers, etc., has long been a social expectation vis-a-vis companies. In recent years, the number of such interests have expanded to include issues such as human rights violations, environmental pollution and climate change. **Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?**

Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.

Yes, as these issues are relevant to the financial performance of the company in the long term.

No, companies and their directors should not take account of these sorts of interests.

I do not know.

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Question 47: Do you think that an EU framework for supply chain due diligence related to human rights and environmental issues should be developed to ensure a harmonised level-playing field, given the uneven development of national due diligence initiatives?

Yes/No/Do not know.

Question 48: Do you think that such a supply chain due diligence requirement should apply to all companies, including small and medium sized companies?

Yes/No/Do not know.

If yes, please select your preferred option:

- All companies, including SMEs.
- All companies, but with lighter minimum requirements for SMEs.
- Only large companies in general, and SMEs in the most risky economic sectors sustainability-wise.
- Only large companies.

If necessary, please explain the reasons for your answer.

Large companies will only be able to conduct a supply chain due diligence if they receive adequate information from suppliers in critical supply chains, which is why requirements in line with the UN Guiding Principles on Business and Human Rights should apply to all companies. However, considering the limited financial and human resources of SMEs, requirements should be designed in such a way that they can be applied in practice.

Section 2.9 Promoting sustainable finance globally

Question 77: What can the Commission do to facilitate global coordination of the private sector (financial and non-financial) in order to deliver on the goals of the Paris Agreement and/or SDGs? Please list a maximum of three proposals.

- Evaluate impacts of policy measures: The European Commission should regularly evaluate the market effects of policy initiatives and adjust measures where necessary. In this evaluation, a multi-stakeholder-approach would be valuable in order to build on external expertise, including from industry and academia.
- Foster and support sector coupling: A single sector will not be able to deliver on the Paris goals, a joint effort by all relevant sectors is necessary (e.g. electrification of mobility & decarbonization of the energy sector). Therefore, cooperation between sectors should be encouraged.
- Stimulate sustainable consumer behavior and provide incentives for the private sector: As companies act in response to market demand, this can be an important lever to foster sustainability in a variety of sectors. Furthermore, incentives that motivate private sector actors to improve their efforts could be helpful, such as carbon-oriented pricing of goods and energy.

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Section 3.1. Identifying exposures to harmful activities and assets and disincentivizing environmentally harmful investments

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.
If no, please explain why you disagree

A "brown" taxonomy would set the wrong signal as it restricts investments and would therefore create an obstacle to a fast transition of the European economy. The taxonomy should rather take a positive approach to steer capital investments towards sustainable activities. A brown taxonomy would discourage investments which lead to significant CO_2 reduction although not considered "green", such as fuels switch from coal-fired power plants to gas turbines, and this would create obstacles to the overall transition path. Finding the right incentives, as outlined in the answer on Question 77 could help here.

Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

Yes/No/Do not know.

3.4 Natural capital accounting or “environmental footprint”

Question 98: Are there any specific existing initiatives (e.g. private, public or other) you suggest the Commission should consider when supporting more businesses and other stakeholders in implementing standardised natural capital accounting/environmental footprinting practices within the EU and internationally?

Yes/No/Do not know.

3.5 Improving resilience to adverse climate and environmental impacts

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.