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Société Générale- Key messages for the future EU Renewed Sustainable Finance Strategy

Introduction

Société Générale is fully and unambiguously committed into the transition to a more sustainable economy. As one of the world leaders in energy financing, **Société Générale shares the conviction that speeding up energy transition is vital** to mitigate climate change and that directing financial flows to sustainability-oriented companies and projects is definitely part of the solutions.

It is from this perspective that **we support policymakers' initiatives to build a regulatory framework for sustainable finance**.

In this paper, we highlight our main views on the renewed strategy.

- **The transition should be as inclusive as possible**

Sustainable development must be mindful of social impacts. This calls for a clear transition path based on the adhesion of the civil society and determining gradual decarbonization trajectories. This is a precondition to ensure that everyone has access to energy at affordable costs.

Banks play a role to ensure that the transition is as fair and as inclusive as possible. In that respect, governments will have to increase their commitment and accompany the necessary transition, and collaboration of private and public sector is of essence.

As the accounting of activities eligible to the taxonomy will be one of the key metrics to monitor the shifting toward a carbon-neutral economy **, it is essential that this tool takes into account activities in transition. Hence, the EU taxonomy for sustainable investments should be completed with a transitional approach in order to incentivize as much as possible all activities/sectors to embark on a decarbonization path.** While it provides the global *target*, i.e. shifting investments towards the most sustainable activities identified that already meet all the required criteria/thresholds, the taxonomy could be much more impactful by including the *trajectory*, i.e. activities and companies that are transitioning towards the objectives, thereby allowing banks to finance their transition. **Inclusion and incentivization should be the norm, rather than exclusion**.

In the same vein, **the pace of the transition will not be the same in all geographical areas**: this calls for a differentiated treatment as clearly stressed by the Paris agreement at its inception. From a technical standpoint, the taxonomy is based on EU high level standards, which are challenging to assess in the context of financing green projects in non-EU countries, in particular in emerging economies. In that context, **it would require more international cooperation in order to ensure**

that EU credit institutions will take part in financing the transition of those emerging economies.

- **Brown taxonomy proposals should be approached with caution**

Although we understand the rationale behind proposals for a brown taxonomy, we see practical impediments to any quick development of such a taxonomy, as the definition of criteria for substantial contribution to an environmental objective is already proving very challenging (granularity of analysis, taking into account evolving conditions..).

Moreover, we are concerned that the use of such a taxonomy would prove punitive and might restrict in the availability of financing for companies engaged in needed energy transition which are the ones that need to develop technological solutions to reduce their carbon footprint. The risk is that the brown taxonomy fails to reflect the transitioning of companies towards a green economy (given the focus on economic activities, and not on companies' practices), and might then deter funding from companies that invest heavily in their transition and that are essential to climate change mitigation[1].

As a consequence, we would in any case ask for a careful impact assessment of such a taxonomy before any introduction in legal texts, including an assessment of potential social impacts.

- **Prudential treatment in the context of banking regulation should remain risk sensitive**

As highlighted by the Commission consultation, adjusted prudential treatment could incentivize funding of green activities. That being said, it has to be carefully considered as prudential requirements are provided to ensure financial stability. In this regard, the prudential framework should continue to be based on risks. As yet, there is no evidence of a systematic risk differential between green, non-green and brown assets. Hence adjusted prudential treatment should be only envisaged for green assets where a lower prospect of financial risk related to the ESG factors can be demonstrated on a forward-looking basis.

- **Diverse funding tools will be needed to ensure reorientation of the capital flows**

Projects and companies focused on sustainable issues present a great variety of funding needs. Therefore, the **corresponding spectrum of funding solutions should logically be made up of an equally diverse product offering.**

[1] The focus on economic activities for the green taxonomy is easily understandable, as it is meant to incentivize companies to engage in such activities, thus contributing to climate change mitigation. On the contrary, the focus on economic activities for the brown taxonomy is a punitive approach as it does not take into account the internal strategies from companies to perform a change in their activity mix and the corresponding investments they need to achieve it.

In that context derivative products and various ESG strategies such as "best in class" have an important role to play:

- **no long-term ESG market without a secondary market whose liquidity is indirectly dependent upon the existence of derivatives**

With regard to ESG investments, a focus is often made on the need to provide new funding for the greening of the economy.
Impact finance is meant here of which green bonds are a common example.

While this new funding /primary-market concern is legitimate, it is equally important not to lose sight of the complete life-cycle of ESG investments.
Absent a reflection on secondary markets, no ESG market may be truly sustainable (this remark would be true for any other class of investments).

Once having funded ESG projects or invested in securities issued by "sustainable companies", primary investors will generally seek secondary-market solutions.
This is quite natural as their primary mission is often more to identify and to provide early support to sustainable projects than to carry these investments on their own books for the long term.

Ensuring such a perennial secondary market implies developing an entire eco-system of market players.
The spectrum of required actors ranges from primary funders to asset-managers, wholesale brokers and market-makers.

From the project sourcing to the intermediation and price-making and to the longer-term secondary-market investment, each of them brings a vital contribution to the market and each is directly totally interdependent on the others.

In this eco-system, the liquidity-provision function of market-makers plays a central role. In turn, the long-term sustainability of their involvement is highly dependent on their capacity to hedge their global-netted positions on derivatives markets (in complement to their no-less sizable hedges on cash markets).

- **Acknowledging how best-in-class and exclusion strategies also contribute to a very sizable impact on ESG goals**

  Despite its usefulness ESG impact finance (ESG project funding) remains limited in size.

  Best-in-class and exclusion strategies represent a much bigger share of ESG strategies, both in terms of number of securities concerned, but also in terms of resulting A.U.Ms.
  While these strategies are essentially relying on secondary markets, they certainly indirectly contribute to making primary markets perennial as exposed above (no primary market may durably exist without a full investment life-cycle).

In addition, these index-based strategies, generally affecting very large portfolios, tend also to have a massive impact on the markets and valuation of the related securities.
And, quite importantly, this impact also includes cash-rich companies.
Those issuers that could otherwise almost ignore impact-finance activism – which target their access to new funding on the primary markets- can certainly not stay immune from variations of their equity shares on secondary markets.
In this regard, best-in-class and exclusion indices constitute a very effective retribution/penalty mechanism for inducing these companies to adopt a greener agenda.

- **Promotion of ESG products**

We support the objective of promoting a richer ESG product offering.
We believe that investments firms should be encouraged to foster a better investor awareness of the various ESG products and strategies.

However, we believe that promoting ESG products towards retail clients as a default option may entail potential risks for retail clients, such as mis-selling and fuelling speculative bubbles on illiquid assets.
Product Governance (PG) is undisputedly one of the great successes of MIFID2.
The underlying logic of PG is, whenever possible, to promote a balanced consideration of the five key criteria in the ultimate investment decision.
When an investor expresses no clear preference for any objective, the balanced approach is even more needed to ensure that its interests are well preserved.
In this respect, it is very important to stress that, unsurprisingly, he/she is often the less-experienced and less affluent clients that express no clear investment preference or objective. Those investors are the most exposed and most in need of protection.

If ESG products should be considered as the default option for clients having no clearly expressed objectives, there might be a strong risk that the other key target market criteria (e.g. knowledge and experience, risk appetite, ability to bear losses, etc.) could be overlooked. This could create a risk of mis-selling unsuitable products to those exposed clients.

We believe a voluntary system relying on an enhanced disclosure at firms' level may prove more effective and more respectful of clients' interests and needs. Informed investors will be in a better position to assess for themselves the sustainability approach that they consider the most suitable to their ESG preferences or absence thereof.