
Key messages for the future EU Renewed Sustainable Finance Strategy

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Introduction

AFME welcomes the opportunity to comment on the European Commission's Renewed Sustainable Finance Strategy. We thank EU policymakers for the progress made to date on the 2018 Action Plan for Financing Sustainable Growth and agree that a comprehensive approach is needed to achieve the objectives set out in the European Green Deal. ***We think that the renewed Strategy should place a greater focus on the transition of the real economy (ie, non-financial sectors) and should be based on coherent, sequential and proportionate policies taking into account the implementation status of the existing legislative measures under the 2018 Action Plan and duly reflecting their uptake and effectiveness with a view to identifying possible issues and gaps.*** In this paper, we highlight our main views on the renewed strategy. Our detailed responses to questions raised in the consultation document are presented in **Appendix A** herein.

1. The post COVID-19 economic recovery should be sustainable

AFME fully agrees with the European Commission that the COVID-19 pandemic has further demonstrated the need to strengthen the sustainability and resilience of our economies and societies. The transition to a more sustainable economy will require significant investment efforts across all sectors and will be an important lever in supporting economic growth and innovation in the coming years. It is therefore vital that the delivery of the various elements under the EU Green Deal, including unlocking sustainable financing, are aligned with the strategy for the economic recovery post COVID-19 crisis.

With regard to specific measures, we note that all recommendations and considerations outlined in this paper were provided in view of the need for an integrated and holistic approach to delivering on the long-term economic strategy of the European Union, combining sustainability and economic growth objectives. A strong partnership of the public and private sector would be necessary to deliver on those objectives given the deep structural nature of the market transformation required.

2. A clear EU-wide trajectory for transition of real economy sectors is necessary

While the Paris Agreement provides the end goal in terms of net zero carbon emissions by 2050, investors need clarity and certainty on the roadmap towards the achievement of those targets, including steps and milestones across sectors. To this end, policy-makers should create a predictable and well-communicated policy framework that provides a clear EU-wide trajectory toward a more sustainable economy for relevant real economy sectors, based on the objectives set out in the European Green Deal (EGD). This should include policy signals on the appropriate pace of phasing out certain assets that are likely to be stranded in the future.

AFME opposes any direct penalising policy action towards financial institutions that invest in/lend to high carbon emitting sectors that are in their journey to transition, as these sectors require capital in order to transform. Overall, the EU, as well as governments globally, need to find the right balance between the transition ambition and the capacity of the economy to undertake this transformation. In view of this, whilst we fully support a framework improving reporting and disclosure around carbon intensive sectors, including those that cannot change their business models, we think that creating a detailed "brown" taxonomy would

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be premature and might have unintended negative consequences discouraging investments in those sectors/activities, ultimately hampering the needed transition. As noted above, AFME believes that EU policymakers should instead focus on establishing clear industrial transition pathways for a measured and gradual reduction in GHG emissions towards the 2050 goal.

3. Providing tools, incentives, and removing barriers to scale up sustainable finance

3.1 Availability of reliable and comparable data

Significant challenges continue to exist with respect to ESG data collection by financial institutions in support of good investment and lending decisions. Key challenges relate to (i) a lack of standardisation and common metrics; (ii) insufficient disclosure of ESG factors by non-financial corporations caused by the lack of harmonised reporting standards; (iii) inconsistent methodologies used by ESG rating agencies; and (iv) challenges for the collection of forward looking data (e.g. inconsistent modelling techniques across sectors/companies).

As noted in our response¹ to the Commission's consultation to revise the EU Non-Financial Reporting Directive (NFRD), AFME supports the development of EU-wide sustainability reporting standards that would help address various ESG data gaps. Digital technologies and tools, such as establishing a centralised ESG database or common data sharing space, would facilitate access to and processing of relevant information.

3.2 Incentives

We think that a strong cooperation between the private and public sectors is critical where mechanisms need to be established to incentivise both borrowers (investees) and finance providers (investors) to shift to sustainable finance models.

- Further consideration should be given to how **market-based carbon pricing mechanisms** can be structured effectively to contribute to transition funding.
- There should be a plan to **gradually phase out blanket government subsidies to high carbon emitting industries** (which can be incorporated as part of transition pathways for the real economy sectors as discussed in this paper above) and link them to sustainability targets instead.
- **Fiscal policy incentives (tax, subsidies)** to both green issuers/borrowers and investors/lenders should be considered. This would help to reduce the cost of funding for sustainable instruments and thus offset additional administrative cost associated with the issuance and verification/monitoring of such instruments.
- **Introducing risk-sharing mechanisms**, such as guarantee funds, aimed at providing guarantees to financial institutions (private banks or medium/long term investors such as funds or insurance companies) to support sustainable lending and investments. It would help reduce the cost of funding to the ultimate beneficiaries, which would be particularly necessary for SME sector (as being considered riskier and requiring higher level of support in its journey to sustainability due to lack of resources, including financial and human capital).

4. EU-wide and international coordination is critical to long-term, sustainable growth

Definitions, taxonomies, methodologies and reporting standards/practices related to sustainable finance need to be harmonised, specifically in what they mean for an economic activity, product and company overall.

¹ https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20ISDA%20NFRD%20revision%20consultation%20response_Final_11062020.pdf

Capital markets are global in nature and work across borders, which is why common standards and reduced fragmentation are important to enhance the efficient and effective allocation of capital.

While AFME fully acknowledges the sensitivities and challenges associated with the international alignment of approaches, standards and frameworks, we believe that the global nature of climate change and other ESG issues necessitate joint and coherent global action. We thus encourage EU policymakers to closely engage with international standard setters, such as IOSCO and BCBS, to promote consistency around future policy on sustainable finance. We also welcome the EU's effort for greater international cooperation, for example through the International Platform of Sustainable Finance (IPSF) and the Network for Greening the Financial System (NGFS).

5. Further legislative measures should be sequential and coherent

We fully acknowledge and appreciate that issues covered in recent sustainable finance legislation are extremely complex, wide-ranging and still very new. We recognize that reaching an agreement on these measures required unprecedented effort and consideration by EU policymakers, regulators, and other stakeholders. We note, however, that it is critical for all subsequent measures to be well coordinated with existing legislation and among each other, setting realistic and coherent timelines for their implementation.

We would also welcome further action to align, as much as possible, the measures under the existing legislative package where clear dependencies exist. For example, it is still unclear how financial market participants are expected to meet their obligations under the EU Disclosure and the EU Taxonomy regulations applicable from March 2021 and January 2022 respectively whilst relying on information from their investees/borrowers who are not mandated to provide the necessary volume and range of data on their end.

AFME welcomed² the Commission's initiative to revise the existing NFRD with the view to address such data gaps. However, we stress that until the revised NFRD is fully implemented, financial market participants will continue to face legal and operational uncertainties with regard to the implementation of the recent regulations. In addition, many corporates might not be in a position to provide all the necessary data yet given they would also need to, at the very least, make changes to internal processes to begin collecting and reporting relevant information. Therefore, we urge the Commission to ensure that appropriate time is allowed for implementation of the recently adopted as well as any future sustainable finance regulation to avoid unnecessary operational burden and double implementational costs.

6. Prudential treatment of “green” and “brown” should remain risk sensitive

We are supportive of the Commission's initiative to explore possible mechanisms in the banking prudential framework that could support green/sustainable investments and to consider doing so, on a faster timescale than that set out in the EBA mandates in CRR2. The adaptation of any prudential policy related to 'green' and 'brown' considerations must be balanced and requires the use of sensible and quantitative methodologies, based on experience and scientific data. Consequently, we urge caution in terms of how green and brown assessments should be reflected in the prudential framework at present, given the very limited data and lack of a clear correlation currently observed between the environmental impact classification and underlying risk of the asset. Any potential specific treatment distinguishing between 'green' or 'brown' assets needs to be consistent with the principles of traditional prudential regulation and should be agreed at an international level as far as possible. In the current absence of evidence of a risk differential between green, non-green and brown assets, the EC should encourage the development – ideally at international level – of risk assessment

² AFME response to the European Commission consultation on the revision of the EU Non-Financial Reporting Directive:
https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20ISDA%20NFRD%20revision%20consultation%20response_Final_11062020.pdf

methodologies that include a forward-looking perspective in addition to existing backward-looking analyses to enable a more accurate calibration of regulatory capital requirements reflecting the long term risk profile of assets. Furthermore, differentiating between brown and green assets should not be based on a static classification of economic activities established by the taxonomy, but done in a dynamic forward-looking risk-oriented way. In other words, the classification of an asset under the taxonomy should not be a proxy for its risk profile, nor lead to automatic risk weighting adjustment.

Conclusion

The consultation on the Renewed Sustainable Finance Strategy rightly provides for a comprehensive review to inform the future strategy to achieve the objectives set out in the European Green Deal. The EU's sustainability agenda is vital to ensure an effective and systematic transition of all sectors of the real economy, and capital markets play an important role in supporting this transition across Europe.

Whilst businesses across Europe are currently facing the unprecedented challenges resulting from the COVID-19 pandemic, the recovery measures put in place also present a chance to move towards a sustainable economy. We believe that the EU should take account of the implementation status of existing legislative measures to ensure that coherent, sequential and proportionate policies drive the transition ambition in the years forward. By providing a clear policy framework which, among others, ensures the availability of reliable and comparable ESG data, introduces appropriate incentives to support the transition, and is closely coordinated internationally, the EU can ensure successfully meeting the aims of the European Green Deal.

We would like to thank EU policymakers for the vital work accomplished so far and we look forward to continued engagement and dialogue on this important matter. We stand ready to discuss the content of this paper or to provide any further detail regarding the statements made.

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About AFME

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.