European Commission

EU Strategy on Sustainable Finance

TOKYO – October 2019

EU keeps on increasing ambition on climate change

Jean Claude Juncker, 2014

1 November
2014-2019

A Resilient Energy Union with a Forward-Looking Climate Change Policy

Target

- **40%** cuts in greenhouse gas emissions by 2030
- **32%** renewables in energy consumption
- **32,5%** energy savings

Progress

Climate and energy legislation, if implemented: 45% greenhouse gas emission by 2030

Ursula von der Leyen, 2019

1 November
2019-2024

A European Green Deal

Target

- **50%** cuts in greenhouse gas emissions by **2030**
- **Climate-neutral** continent by **2050**

European Commission

Financing the Green Transition

Ambition

Reaching climate neutrality by 2050 while ensuring that the transition is just and fair

Large-scale Investment

EU Budget	Commission's proposed target = at least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework
Blended Finance	InvestEU & European Fund for Sustainable Development (EFSD)
Private Finance	**Commission Action Plan on financing Sustainable Growth**

Commission Action Plan on financing sustainable growth

Reorient capital flow towards more sustainable investments

1. Establish a **Taxonomy** of environmentally sustainability activities
2. Create **standards and labels** for green financial products
3. Foster investment in sustainable projects
4. Incorporate **sustainability** in providing investment **advice**
5. Develop sustainability **benchmarks**

Mainstreaming sustainability in risk management

6. Better integrate sustainability in ratings and market research
7. Clarify institutional **investors**' and asset managers' **duties**
8. Incorporate sustainability in **prudential requirements**

Foster transparency & long-termism

9. Strengthen corporate **sustainability disclosure**
10. ↑sustainable **corporate governance** and ↓ short-termism

Key actions of the EU Commission

	Action	Objective	Legislation Level 1 (framework)	Technical advice	Legislation Level 2 (detailed technical criteria)
1	**Taxonomy**	Develop an EU common language on environmentally sustainable economic activities	*Status:* under negotiation ✓	Technical Expert Group (TEG) ✓	Pending the negotiation of level 1
2	**Standards and labels**	Develop EU standards (such as EU Green Bond Standard) and labels for sustainable financial products (via Ecolabel) to protect integrity and trust of sustainable finance market	To be considered/assessed	TEG: EU Green Bond Standard; JRC: ecolabel for financial products ✓	To be considered/assessed
4	**Disclosures by financial market participants**	Enhance transparency to end-investors on how financial market participants consider sustainability	*Status*: approved ✓	European supervisory authorities ✓	Delegated act under development
5	**Benchmarks**	Develop climate benchmarks and ESG disclosures for benchmarks	*Status*: approved ✓	TEG ✓	COM drafting secondary legislation based on TEG advice
8	**Sustainability in prudential requirements**	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)	Pending the result of technical assessment	EBA and EIOPA ✓	Pending the result of technical assessment
9	**Corporate sustainability disclosure**	Enhance climate and sustainability-related information provided by corporations	Depending on the result of the ongoing fitness check, possible amendment of the non-financial reporting directive*	TEG (climate-related information) COM fitness check on corporate reporting ✓	Pending the result of technical assessment

* The Commission issued guidelines on reporting climate-related information in June 2019

TEG on Sustainable Finance assists the Commission

35 experts - from July 2018 to year-end 2019

1 Disclosures (reporting)

guidance to improve corporate disclosure of climate-related information

January 2019

Call for feedback

2 Taxonomy

Technical screening criteria for environmentally sustainable economic activities

June 2019

Call for feedback

3 Benchmarks

Minimum standards for the two new types of climate benchmarks & Benchmarks ESG disclosures

Interim

June 2019

Call for feedback

September 2019

4 Green Bond Standard

An EU Green Bond Standard

Interim

Mars 2019

Call for feedback

June 2019

Commission proposal for an EU Taxonomy

Objective

Provide a **classification tool** to help investors and companies to make informed investment decisions on environmentally sustainable activities

We need a taxonomy that is **robust, science-based, and ambitious**, in line with our shared environmental objectives, including going towards climate neutrality in line with the Paris agreement

Use: is it obligatory ?

- Obligatory disclosures for institutional investors and asset managers marketing investment products as 'green' in the EU
- EU Member States are required to use the EU Taxonomy when creating public labelling schemes for 'green' investment products and corporate bonds

Further voluntary use by a range of actors

What is it?

A list of economic activities that are environmentally sustainable based on a **rigorous methodology**.To be included in the Taxonomy, an economic activity must meet the following criteria:

substantially contribute to 1 of the 6 objectives + Do not significantly harm any of the other 5 obj. + Minimum social* safeguards

6 environmental objectives

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use & protection of water
4. Circular economy, waste prevent & recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

* Observe International Labour Organisation (ILO) core labour conventions

What is it not?

- A rating of good or bad companies
- A mandatory list to invest in
- Making a judgement on the financial performance of an investment
- Inflexible or static

The TEG report on taxonomy – June 2019 (1/3)

TEG

Composed of **35 experts** from civil society, academia, business and the finance sector, as well as **10 additional** members and observers from EU and international public bodies

- All assessments made by TEG were based on **scientific evidence, literature and international practice**
- TEG report **initial** focus is on **climate change mitigation and adaption**

7 Sectors

67 activities

- highest-emitting macro sectors (represent 93.2% of GHG emissions in the EU)

Agriculture and forestry
Manufacturing
Electricity, gas, steam and air conditioning supply
Water, sewerage, waste and remediation
Transport
Information and Communication Technologies (ICT)
Buildings

Screening criteria

- Substantial contribution to one environmental objective (for climate change mitigation → e.g. GHG emission thresholds)
- Do not significant harm to any of the other environmental objectives

The TEG report on taxonomy – June 2019 (2/3)

Characteristics	Type of activity	Criteria	Example
"Greening of"	**Already low carbon** (very low, zero or net negative emissions). Compatible with net zero carbon economy by 2050.	Likely to be stable and long term	Electricity generation from solar PV
	Contribute to a transition to a zero net emissions economy in 2050 or shortly thereafter, but are not currently close to a net zero carbon emission level.	Likely to be revised regularly and tightened over time	Manufacturing of steel
"Greening by"	Activities that **enable emissions reductions** in either of the two previous categories.	Some likely to be stable and long term, some likely to be revised regularly	Manufacturing of wind turbines

Activities that undermine mitigation objectives are **not** included.

The TEG report on taxonomy – June 2019 (3/3)

Methodology for evaluating substantial contribution to climate change adaptation

- **Principle 1:** The economic activity reduces all material physical climate risks to the extent possible and on a best effort basis.
- **Principle 2:** The economic activity does not adversely affect adaptation efforts by others.
- **Principle 3:** The economic activity has adaptation-related outcomes that can be defined and measured using adequate indicators.

Substantial contribution to adaptation to climate change

Adaptation of **an economic activity**

A process aimed at ensuring that an economic activity can perform under a changing climate

Adaptation by **the economic activity**

An economic activity that contributes to adaptation of other economic activities

The TEG report on benchmarks – September 2019

- **Recommends minimum technical requirements for the methodology of both climate benchmarks and on ESG disclosures**

Climate Benchmarks

EU Climate Transition Benchmark (EU CTB)

Minimum of **30%** relative decarbonisation

Green to brown ratio must be at least equal

EU Paris-aligned Benchmark (EU PAB)

Minimum of **50%** relative decarbonisation

Green to brown ratio must be at least 4

Both types of climate benchmarks must:

- demonstrate a **significant decrease in GHG emissions intensity** compared to their underlying investment universes or parent indices.
- be sufficiently **exposed to sectors** relevant to the fight against climate change.
- **demonstrate their ability** to reduce their own GHG emissions intensity on a year-on-year basis.

Benchmarks ESG disclosure

- ESG factors are one of the key elements of the benchmark methodology
- All benchmarks should disclose whether or not they pursue ESG objectives and disclose key ESG factors in the benchmark statement; also should report on their degree of alignment with the Paris Agreement.

Asset Classes

All, except interest-rate and currency benchmarks

KPIs

Relevant to each asset class

supported by global standards

Climate Scenario Alignment

Which temperature scenario?

Methodology and data used

Disclosure templates

1. Methodology
2. Benchmark statement
3. Climate Scenario Alignment

EU law: sustainability disclosure by financial market participants and financial advisers

Disclosure regulation places the following requirements on financial market participants

Scope	What to disclose	Where to disclose	Who should disclose
All investment products	**How negative impacts on financial returns arising from sustainability risks are integrated in risk policies**	Websites, pre-contractual information, marketing communication	all financial entities
All investment products	**How the financial entity considers adverse impacts on sustainability factors (negative externalities)**	Websites, pre-contractual information	compulsory for financial entities >500 and holding companies, other entities to disclose on a comply or explain basis
Investment products with sustainability characteristics or objectives	**How these sustainability characteristics or objectives are met**	Pre-contractual information, websites, periodical reports, marketing communication	all financial entities

TEG report on Green Bonds Standard – June 2019

Proposed core components

Alignment with EU taxonomy

Publication of a Green Bond Framework explaining the voluntarily alignment and investment strategy

Mandatory Reporting
Allocation report
Impact report

Mandatory Verification by external reviewer

How would the EU-GBS work?

BEFORE OR AT ISSUANCE

GRADUAL ALLOCATION…................…..FULL ALLOCATION

Publication of Green Bond Framework

Issuer's Green Bond strategy and alignment with the

EU TAXONOMY

Description of types of Green Projects to be financed

Description of methodology and processes regarding allocation and impact reporting

Use of proceeds specified in the legal documentation

…

Annual Allocation Reports

Confirmation of alignment with EU GBS

Breakdown of allocated amounts per project or portfolio

Geographical distribution of Projects

Final Allocation Report

Impact Report

Impact reporting at least once (at full allocation), or annually

ACCREDITATION OF EXTERNAL VERIFIERS

DOCUMENT VERIFIED BY ACCREDITED EXTERNAL VERIFIERS

EU law - The Non-Financial Reporting Directive

Currently under assessment: fitness check on corporate reporting

4 issues

- Environment
- Social & employee
- Human rights
- Bribery & corruption

5 areas

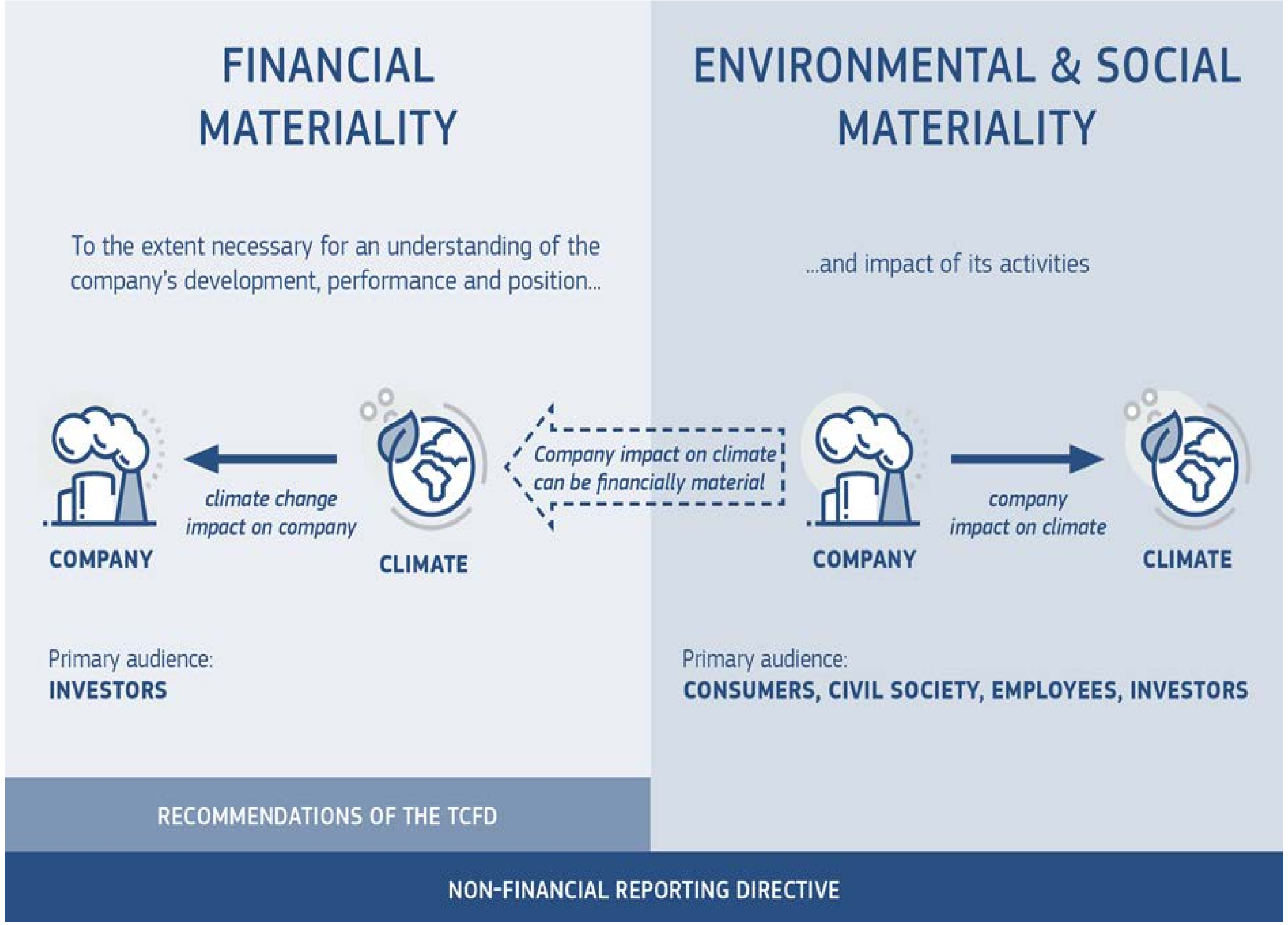
- Business model
- Policies and due diligence
- Outcomes
- Risks and risk management
- KPIs

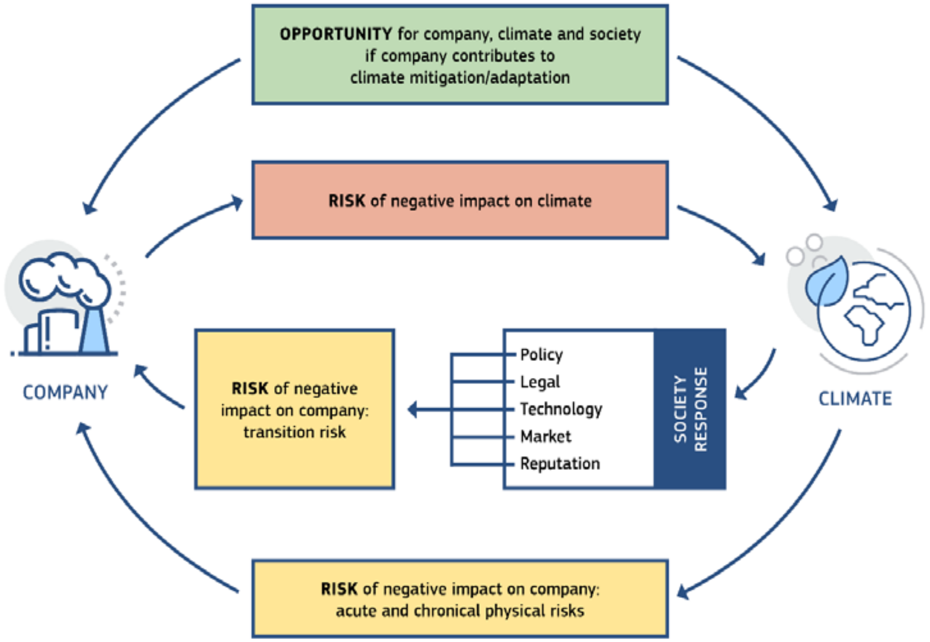
Large listed companies, and banks and insurance companies, with >500 employees

Materiality: "to the extent necessary for an understanding of the undertaking's development, performance, position, and impact if its activities..."

COM guidelines and NFRD work with double materiality

Two important perspectives are considered in COM work on corporate disclosures…





Commission ongoing fitness check on the Non-Financial Reporting Directive

Material information not reported

Information not reliable

Information not comparable

Some companies do not report even though users want them to

Information not easy to find

Coherence with other requirements

Companies are confused and face additional info demands

Commission's climate reporting guidelines – updated in June

Climate reporting Guidelines – June 2019

- Consistent with Non-Financial Reporting Directive.
- Supplement to general guidelines on non-financial reporting published in 2017, which still apply.
- Integrate TCFD recommendations.
- Based on proposals from the Technical Expert Group on Sustainable Finance.
- Target audience: the +/- 6,000 listed companies, banks and insurance companies under the scope of the Non-Financial Reporting Directive.
- Not legally binding.

Structure of the guidelines

5 reporting areas of the Non-Financial Reporting Directive

Business model | Policies | Outcomes | Risks | Indicators

↓

13 recommended disclosures and 10 KPIs
indicating which ones are TCFD recommended disclosures

↓

Further guidance
+ specific further guidance for banks and insurance companies

International Cooperation on Sustainable Finance

- Europe cannot act alone
- Working with international partners to **support them in the implementation of their Nationally Determined Contribution (NDC)** is and continues to be a priority for the EU
- The EU's approach to global climate action is going beyond the public sphere, with initiatives to **mobilise international private investors across the globe.**

- The global nature of financial markets offers a great potential to help all countries on their transition path by linking financing needs to global sources of funding. This potential however, is still largely untapped
- To mobilise international investors => promoting **integrated markets for environmentally sustainable finance** and, develop a coordinated approach, while respecting national and regional contexts.
- Together with like-minded jurisdictions from all around the work, the EU is preparing to launch the

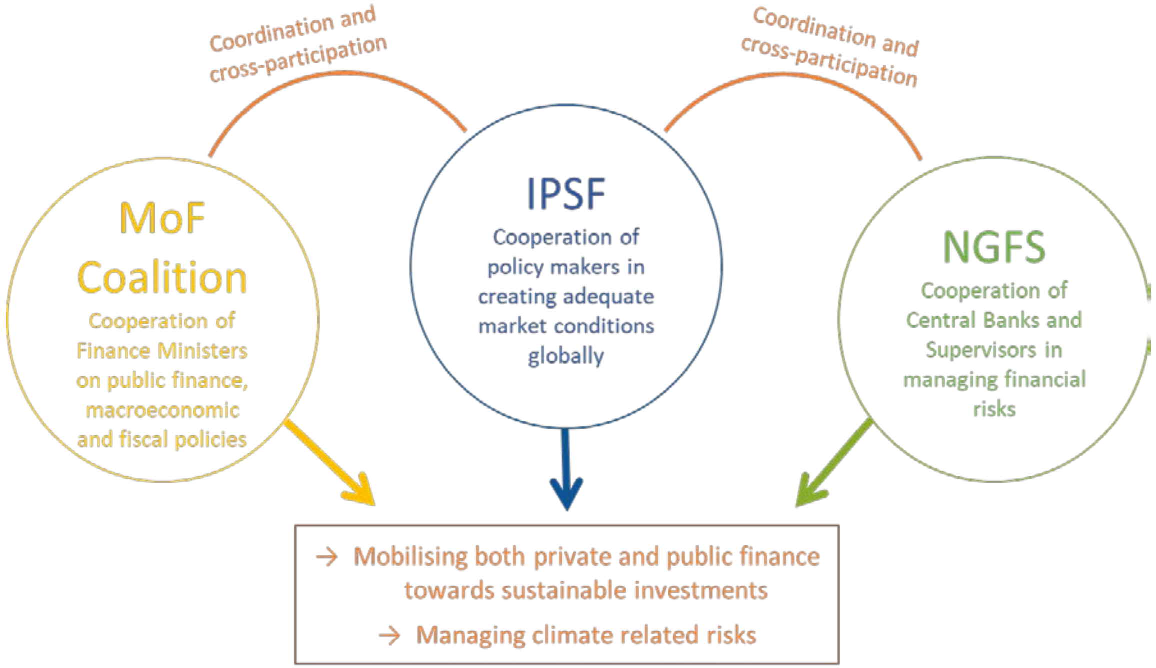
International Platform on Sustainable Finance (IPSF).

European Commission

The International Platform on Sustainable Finance

Objective

- Countries will exchange best practices and coordinate efforts on environmentally sustainable finance initiatives in the areas of taxonomies, disclosures, standards and labels.
- The IPSF is members-driven and open to those jurisdictions which are taking actions and willing to promote international cooperation in the area of environmentally sustainable finance.
- Building coherent international strategies such as the **IPSF is vital** to stimulate investment and redirect capital flows towards our climate objectives at the scale required for the most important economic transition of our times.



- **The IPSF will complement**

  ⇒ the **Network of central banks and supervisors for Greening the Financial System (NGFS)**

  ⇒ the **Coalition of Finance Ministers for Climate Action**.

- Public authorities of different jurisdictions have decided to cooperate and coordinate their efforts on:
  - **supervision and prudential practices**;
  - **public finance, macro-economic and fiscal policies;**
  - **approaches and initiatives (including regulatory tools) for capital markets**.

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Thank you!

The TEG report on taxonomy – June 2019

Example – Mitigation activity

Sector classification and activity	
Macro-Sector	C – Manufacturing
NACE Level	3 and 4
Code	C24.1, C24.2, C24.3, C24.5.1, C24.5.2
Description	Manufacture of iron and steel
Mitigation criteria	
Principle	Manufacturing of iron and steel at the level of performance achieved by best performing plants is considered to make a substantial contribution to climate change mitigation. Additionally, secondary production of steel (i.e. using scrap steel) is considered eligible due to significantly lower emissions than primary steel production.
Metric	GHG emissions (tCO_2e) / t product GHG emissions must be calculated according to the methodology used for EU-ETS benchmarks.
Threshold	Manufacturing of iron and steel is eligible if the GHG emissions (calculated according to the methodology used for EU-ETS benchmarks) associated to the production processes are lower than the values of the related EU-ETS benchmarks. As of June 2019, the EU-ETS benchmarks values for iron and steel manufacturing are: • Hot metal = 1.328 tCO_2e/t product • Sintered ore = 0.171 tCO_2e/t product • Iron casting = 0.325 tCO_2e/t product • Electric Arc Furnace (EAF) high alloy steel = 0.352 tCO_2e/t product • Electric Arc Furnace (EAF) carbon steel = 0.283 tCO_2e/t product Additionally, all production of steel in EAF using at least 90% of scrap steel is considered eligible.

The TEG report on taxonomy – June 2019

Example – Mitigation activity

Do no significant harm assessment	
(2) Adaptation	The economic activity must reduce all material physical climate risks to the extent possible and on a best effort basis and the economic activity must not adversely affect adaptation efforts of others.
(3) Water	For operations situated in areas of water ensure that water use/conservation management plans, developed in consultation with relevant (local) stakeholders, exist and are implemented.
(4) Circular Economy	Appropriate measures are in place to minimise and manage waste and material use in accordance with BREF for iron and steel production.
(5) Pollution	Ensure emissions to water and air are within the BAT-AEL ranges set in the BREF for iron and steel production
(6) Ecosystems	Ensure an Environmental Impact Assessment (EIA) has been completed in accordance with the EU Directives on Environmental Impact Assessment (2014/52/EU) and Strategic Environmental Assessment (2001/42/EC) (or other equivalent national provisions or international standards

The TEG report on taxonomy – June 2019

TEG Guidance on taxonomy use

Five steps to implement taxonomy

Step 1:

Identify activities conducted by the company, issuer or covered by the financial product (e.g. projects, use of proceeds) that could be eligible.

Step 2:

For each activity, assess whether the company or issuer meets criteria for a **substantial contribution**, e.g. electricity generation <100g CO_2/kWh.

Step 3:

Verify that DNSH criteria are being met by the issuer. Investors using the Taxonomy would most likely use a due-diligence like process for reviewing the performance of underlying investees.

Step 4:

Conduct due diligence to avoid any violation to the **social minimum safeguards** stipulated in the Taxonomy regulation (article 13).

Step 5:

Calculate alignment of investments with the Taxonomy and prepare **disclosures** at the investment product level.

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The Taxonomy in practice: Equities