

# EUROPEAN COMMISSION SEEKS STAKEHOLDERS' INPUT TO DEVELOP ITS RENEWED SUSTAINABLE FINANCE STRATEGY

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## European Policy and Regulatory Alert

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On 8 April 2020, the European Commission (Commission) launched a [consultation](#) on its Renewed Sustainable Finance Strategy (Strategy), which will be the main policy framework towards stimulating green investments and fully embedding sustainability in the financial services landscape.

By way of background, the [European Green Deal](#), presented by the European Commission in December 2019, is the most ambitious and far-reaching policy strategy delivered to date by the von der Leyen Commission. In the medium-to-long term, it aims at positioning Europe as the global leader in carbon neutrality and resource efficiency. The Strategy is to be read in conjunction with other key pillars of the European Green Deal, such as the [European Industrial Strategy](#), the new [Circular Economy Action Plan](#), and the [EU Climate Law](#), among others.

The Green Deal however comes with significant financing needs. In January 2020, the European Commission (Commission) presented the Sustainable Europe Investment Plan, which aims “to mobilise public investment and help to unlock private funds through the EU budget and associated instruments”, with the overall objective of mobilising at least €1 trillion of sustainability-related investments over the next decade. The Commission is also keen to ensure that the financial sector fully backs the green transition and is instrumental in achieving its environmental objectives, hence the launch of the Strategy. The consultations notes that “the financial system as a whole is not yet transitioning fast enough”, and that “substantial progress still needs to be made to ensure that the financial sector genuinely supports businesses on their transition path towards sustainability, as well as further supporting businesses that are already sustainable.”

The consultation is the next step in a process initiated by the Commission in 2018 with its [Action Plan on Financing Sustainable Growth](#) (Action Plan). Building on it, and on other relevant initiatives such as the [Taxonomy report](#) by the Technical Expert Group on sustainable finance, the Strategy will mainly focus on: i) strengthening the foundations for sustainable investment by adapting company reporting and transparency, accounting standards and corporate governance; ii) increasing opportunities for the financial industry and civil society to actively engage in the sustainable finance dialogue regarding green instruments, investments and investor protection, among others; and ii) managing and integrating green risks into the financial ecosystem.

Interested stakeholders can provide input to the Commission's consultation until 15 July 2020.

## STRENGTHENING THE FOUNDATIONS FOR SUSTAINABLE FINANCE

The Commission notes that in order to enable the scale-up of sustainable investments, it is crucial to have sufficient and reliable information from financial and non-financial companies on their climate, environmental and

social risks and impacts. To do this, the consultation emphasizes that companies also need to consider long-term horizons. Similarly, investors and companies need access to reliable climate-related and environmental data and information on social risks, in order to make sound business and investment decisions.

In this context, the consultation includes proposals to:

- Support the development of a common, publicly accessible, free-of-cost data space for companies' environmental, social and governance (ESG) information, including reporting under the Non-Financial Reporting Directive (NFRD);
- Identify whether existing financial accounting standards could impact sustainable and long-term investments;
- Explore possible measures to manage conflicts of interest and enhance transparency in the market for ESG assessment tools and metrics;
- Clarify the definition of sustainable finance products. The consultation develops extensively on the forthcoming EU Green Bond Standard, defined as any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer meeting the following requirements: (i) green bond framework; (ii) proceeds to green projects; and (iii) external verification for the alignment of the underlying green project with the Taxonomy and the actual allocation of proceeds to eligible green projects. Also, the Commission asks whether the EU Green Bond Standard verification should be subject to a special supervisory regime;
- Assess the development of a minimum standard for sustainably denominated investment funds aimed at retail investors. To this end, the Commission seeks input on the potential standardization of sustainability-linked bonds and loans, whose interest rates or returns are dependent on meeting pre-determined sustainability targets. Furthermore, it explores the feasibility of a broader “ESG benchmark” in line with the “EU Climate Transition” and “EU Paris-aligned” benchmarks;
- Evaluate whether the current capital markets infrastructure hampers the growth of sustainable financial instruments. In this regard, the Commission is considering the development of a sustainable finance oriented exchange for specifically trading in sustainable finance securities;
- Assist companies and investors towards integrating long-term horizons and sustainability in their decision-making processes. The recent reports of the European Supervisory Authorities on undue short-termism stressed the necessity of more explicit legal provisions on sustainability for credit institutions, in particular related to governance and risk management. In this respect, the consultation sets detailed questions on two aspects of the Shareholder Rights Directive II, the main EU regulatory framework affecting sustainable decision-making: (i) whether there should be a mandatory fraction of a company's directors variable remuneration linked to non-financial performance; and (ii) whether transparency requirements to better align long-term interests between institutional investors and their asset managers should be enhanced.

## **INCREASING OPPORTUNITIES FOR CITIZENS, FINANCIAL INSTITUTIONS, AND CORPORATES TO ENHANCE SUSTAINABILITY**

One of the Commission's top priorities is that the transition to a green economy works for all EU citizens. The Just Transition Mechanism specifically created to assist member states and industries with achieving climate neutrality, and the European Climate Pact, striving to mainstream sustainability, feature as the key Commission's initiatives for green public engagement.

In light of the above, the Commission consults on:

- Incorporating sustainability preferences of retail investors in the financial system and committing to raising awareness of sustainable finance among citizens and finance professionals. Importantly, the Commission will soon publish the amended delegated acts of MIFID II and Insurance Distribution Directive, which will require investment advisors to ask retail investors about their sustainability preferences;
- Developing effective metrics to assess the positive impact of sustainable finance in the financial sector. However, it notes that not that all financial products (e.g. shares, bonds, money market funds) have the same ability to allocate capital to sustainable projects;
- Mapping the role of securitizations in the increase of capital allocated to sustainable projects and activities as well as any regulatory barriers and the need for a dedicated framework;
- Deploying Artificial intelligence and machine learning to better identify and assess to what extent a company's activities, a large equity portfolio, or a bank's assets are sustainable;
- Tackling the regulatory barriers that impede the existing project pipeline (availability of bankable and investable sustainable projects) rendering it insufficient to meet current investor demand for sustainable projects. To this end, the consultation seeks views on whether sustainable investments could be scaled up through: (i) the provision of a revenue-neutral public sector incentives; (ii) the implementation of a green adjusted prudential treatment for which regulators have discerning views; and (iii) the increase of public guarantees or co-financing;
- Assessing the Taxonomy suitability for use by the public sector, for classification and reporting on green expenditures. The consultation also addresses whether public issuers, including Member States, could use the EU Green Bond Standard for their green bond issuances, including the issuance of sovereign green bonds; and
- Deepening international coordination on initiatives that are fundamental for private investors to identify and seize environmentally sustainable investment opportunities globally, in particular in the areas of taxonomy, disclosures, standards and labels. The Commission is already at the forefront of green diplomacy with its flagship International Platform on Sustainable Finance pursuing to promote integrated markets for environmentally sustainable investment at a global level.

## **REDUCING AND MANAGING CLIMATE AND ENVIRONMENTAL RISKS**

The Commission takes the view that it is necessary to develop further actions to improve the management of climate and environmental risks by all actors in the financial system. Moreover, the political agreement on the EU Taxonomy reached in December 2019 tasks the Commission with issuing a report on the provisions required for extending its requirements to activities that significantly harm environmental sustainability. The consultation thus includes questions on the following issues:

The need for 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;

- The suitability of the current banking and insurance prudential frameworks to mobilize the financial services industry to finance the transition and manage climate and environmental risks;
- Ways to improve the transparency and effectiveness of the integration of ESG factors into credit ratings by credit rating agencies taking into account ESMA advice on credit rating sustainability issues and disclosure requirements; and
- The financial management of physical risk caused by natural catastrophes. The consultation underlines that while the financial industry and specifically the insurance sector can play a leading role in managing the financial risk arising from adverse climate impacts by absorbing losses and promoting resilience, insurability is likely to become an increasing concern.

While the COVID-19 outbreak is likely to cause short delays to forthcoming and ongoing initiatives, the Commission is not willing to put its green ambitions on ice in favor of more pressing short-term needs. Work on the Green Deal is not expected to stop and the green transition will remain one of the Commission's key strategic objectives going forward. The consultation highlights that “the ongoing COVID-19 outbreak in particular shows the critical need to strengthen the sustainability and resilience of our societies and the ways in which our economies function.”

Stakeholders should engage early in this encompassing, long-term agenda. In particular, the consultation on the Renewed Sustainable Finance Strategy will inform the general direction of the forthcoming legislative and regulatory actions defining the role of the private sector in financing the EU green transition.

## KEY CONTACTS



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