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Dangers and risks of the EU's "sustainable" finance strategy

The EU Commission is setting a risky course

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With the measures contained in the "Strategy for Financing the Transition to a Sustainable Economy" of July 2021, the EU Commission wants to push the whole finance sector to become "more sustainable" and prioritise "sustainable" investment projects when it comes to financing.

- One major weakness of the green taxonomy is: the opinions as to what amounts to "sustainable" activities diverge significantly, such as in the case of nuclear energy and natural gas. The new plans to enhance the taxonomy do nothing to change this. In fact, they will add more fuel to the controversy and heighten conflicts between the various environmental objectives.
- The EU should not introduce mandatory quality labels for sustainable finance products because these would push out private sector quality labels and inhibit competition for the best label.
- The envisaged easing of the risk-based capital retention requirement for banks and insurance companies, in relation to the financing of "sustainable" investment projects, is fraught with danger. It could jeopardise the stability of financial markets because "sustainable" investments, however they may be defined, are by no means less risky than "non-sustainable" ones.

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1 Introduction

As part of the European Green Deal, the EU has set itself the target of achieving climate neutrality by 2050. In net terms, there will then be no more greenhouse gas emissions released in the EU. By 2030, greenhouse gas emissions shall already drop by 55% as compared with 1990. According to the Commission, the financial sector must also make a contribution in order for these targets to be met.

The EU Commission therefore submitted an initial Action Plan on Sustainable Finance in 2018 [COM(2018) 97, see cep**PolicyBrief**].[1] This proposed several measures to channel more public and private capital into sustainable investments, ensure greater integration of environmental and social risks into the risk management of financial market participants and make financial and business activities "more transparent and long term".

With the initial measures of the Action Plan already decided and currently being implemented (Section 2), the Commission has now proposed a new Action Plan on Sustainable Finance [COM(2021) 390]. The plans which it contains are summarised and assessed below (Section 3).[2]

2 What has the EU already done?

2.1 Green taxonomy

On 12 July 2020, the EU Taxonomy Regulation [(EU) 2020/852, see cep**Adhoc**] came into force. The Regulation sets out binding criteria to be used in the future for determining whether an economic activity qualifies as "environmentally sustainable." This is used to establish "the degree to which an investment is environmentally sustainable." In order to qualify as environmentally sustainable, economic activities must contribute "significantly" to at least one of six environmental objectives[3] and must not "substantially" harm any of these environmental objectives. Under the Regulation, the Commission must lay down, by means of delegated acts, "technical screening criteria" for each environmental objective which are used to determine the conditions under which an activity makes a "significant" contribution and does not "substantially" harm other environmental objectives.[4]

On 4 June 2021, the Commission submitted a delegated act containing the technical screening criteria for determining the activities which contribute substantially to the first two environmental objectives – climate change mitigation or climate change adaptation [C(2021) 2800, "EU climate taxonomy"][5]. The criteria will apply as of 1 January 2022.[6] Currently, the act only covers the economic activities of approx. 40% of EU listed companies. These belong to sectors which cause just under 80% of direct

1 EU Commission, COM(2018) 97, Communication of 8 March 2018: Action Plan: Financing Sustainable Growth

2 EU Commission, COM(2021) 390, Communication of 6 July 2021: Strategy for Financing the Transition to a Sustainable Economy

3 The environmental objectives are: (1) climate change mitigation, (2) climate change adaptation, (3) sustainable use and protection of water and marine resources, (4) transition to a circular economy, (5) pollution prevention and control and (6) protection and restoration of biodiversity and ecosystems.

4 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

5 EU Commission, C(2021) 2800, Commission Delegated Regulation (EU) .../... of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives.

6 Art. 3 C(2021) 2800.

greenhouse gas emissions in Europe.[7] The Commission regards the act as a "dynamic" document that will still need to be adapted and updated in the future. New sectors and activities will be included. Thus, currently, agriculture is not included, clarification is still required on the classification of natural gas and related technologies, and no agreement has yet been reached on the classification of nuclear power.[8]

2.2 Disclosure rules

2.2.1 Regulation on sustainability-related disclosures in the financial services sector

The Regulation on sustainability-related disclosures in the financial services sector [(EU) 2019/2088, see cep**Adhoc**] has been in force since 10 March 2021.[9,10] It obliges both financial market participants – including asset managers and institutional investors – and financial advisers – including insurance intermediaries and investment advisers – to provide retail investors with information on how they integrate sustainability risks into their investment decisions and advisory processes. In addition, financial market participants with more than 500 employees, must report on how they take account of the "principal adverse impacts" which their investment decisions and advisory processes have on sustainability factors – including environmental, social and employee matters. Financial market participants with fewer than 500 employees do not have to report on this but must give reasons for not doing so.

2.2.2 Directive on corporate sustainability reporting

On 21 April 2021, the Commission published a proposal for a Directive on corporate sustainability reporting [COM(2021) 189, see cep**PolicyBrief**]. The Directive aims to ensure that all large capital-market-based undertakings[11], listed small and medium-sized enterprises (SMEs)[12], as well as banks and insurance companies, are obliged to publish information on environmental, social and employee issues, on respect for human rights and on combating bribery and corruption, thus significantly more companies than under the existing Non-Financial Reporting Directive [2014/95/EU][13]. Reporting will take place in the company's management report on the basis of uniform EU standards and in a single electronic reporting format. In addition, external auditors will examine whether reporting complies with the requirements of the Directive. The Council and the European Parliament are currently negotiating on the Proposal for a Directive. Under the Commission's plans, the Directive will take effect from 2023, and for SMEs from 2026.[14]

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7 EU Commission, COM(2021) 188, Communication of 21 April 2021, Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal, p. 1 and 2.

8 Ibid. p. 7.

9 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

10 Certain provisions of the Regulation have been in force since the end of 2019, others only come into effect from January 2022.

11 Large companies are deemed to be companies that meet at least two of the following criteria: (1) more than 250 employees, (2) balance sheet total of more than € 20 million, (3) annual turnover of more than € 40 million.

12 SMEs are deemed to be companies that meet at least two of the following criteria: (1) 50 to 250 employees, (2) balance sheet total of between €4 - 20 million, (3) annual turnover of more than €8 - 40 million.

13 The Non-Financial Reporting Directive only applies to capital-market-based companies of public interest, i.e. listed companies, banks and insurance companies with more than 500 employees.

14 EU Commission, COM(2021) 189, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

2.2.3 Green taxonomy

In addition to establishing a classification system for environmentally sustainable economic activities, (see Section 2.1), the EU Taxonomy Regulation [(EU) 2020/852, see cepAdhoc] also provides for specific disclosure obligations. As of 1 January 2022, all companies that are subject to sustainability reporting under the Non-Financial Reporting Directive [2014/95/EU] – in the longer term: under the Corporate Sustainability Reporting Directive (see Section 2.2.2)[15] – will have to report annually on how and to what extent their activities are linked to economic activities that are deemed to be environmentally sustainable under the EU Taxonomy Regulation. In addition, unless they are financial undertakings[16], they will have to publish "key performance indicators" (KPIs) showing what proportion of their turnover, capital expenditure (CapEx) and, where applicable, operating expenditure (OpEx), is related to environmentally sustainable economic activities. The annual reporting obligations aim to improve the ability of investors and the public to assess how far a company is focussing on environmental sustainability.[17]

On 6 July 2021, in a delegated act, the Commission specified the said disclosure rules in more detail [C(2021) 4987]. This covered the content and presentation required by the disclosure rules as well as the methodology to be used by the companies.[18]

2.3 Sustainability preferences within insurance and investment advice

On 21 April 2021, the Commission passed changes to the delegated act relating to the Markets in Financial Instruments Directive (2014/65/EU) [C(2021) 2616]. Until now, this act provided that, when assessing the suitability of clients and potential clients, investment firms offering investment advice or portfolio management only had to ask about their risk tolerance, their ability to bear losses and their investment experience and knowledge. The amended act obliges firms to find out about the sustainability preferences of their clients and potential clients and to take this into account when choosing the financial products which they recommend to the clients. Investment firms must also inform their clients ex post about the extent to which the recommended financial product corresponds to their sustainability preferences.[19]

On 21 April 2021, the Commission also passed similar amendments to a delegated act relating to the Insurance Distribution Directive [Directive (EU) 2016/97, Delegated Act C(2021) 2614]. The amendments provide, in particular, that insurance companies and intermediaries, offering advice on insurance investment products, must find out the sustainability preferences of their clients and potential clients and take this into account when choosing the investment products which they recommend to the clients.[20]

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[15] It is thus very likely that significantly more companies will have to meet the disclosure rules (see Section 2.2.2).

[16] Financial undertakings are e.g. banks, asset managers, investment firms and (re-)insurance companies.

[17] Art. 8 Regulation (EU) 2020/852.

[18] EU Commission, C(2021) 4987, Commission Delegated Regulation (EU) .../... of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation.

[19] EU Commission, C(2021) 2616, Commission Delegated Regulation (EU) .../... of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms.

[20] EU Commission, C(2021) 2614, Commission Delegated Regulation (EU) .../... of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences

The new obligations for investment firms, insurance companies and insurance intermediaries must be transposed within 12 months of publication of the delegated acts in the Official Journal of the European Union. This is likely to be in the 3rd quarter of 2022.

2.4 Climate benchmarks

On 30 April 2020, the Climate Benchmark Regulation[21] [(EU) 2019/2089] came into force. The Regulation establishes uniform minimum requirements for two climate benchmarks which aim to make it easier for financial market participants to align their investment strategies with the EU's climate-related and environmental objectives whilst at the same time avoiding greenwashing. In the case of the "EU climate transition benchmark," the "underlying assets must be selected, weighted or excluded" in such a way "that the resulting benchmark portfolio is on a decarbonisation trajectory." In the case of the "Paris-aligned benchmark," the "underlying assets values must be selected, weighted or excluded" in such a way that the "resulting benchmark portfolio's carbon emissions" are in line with the targets of the Paris Agreement. Benchmark administrators[22] must publish information on "whether or not and to what extent, a degree" of alignment with the target of reducing carbon emissions, or the attainment of the objectives of the Paris Agreement, is ensured, and they must also publish the methods for calculating the benchmarks.[23]

2.5 EU green bond standard

On 6 July 2021, the Commission published a proposal to establish an EU standard for green bonds (European Green Bond Standard, EU GBS) [COM(2021) 391, cep**PolicyBrief** to follow]. The standard can be used by private and public actors, from both the EU and from third countries, to finance sustainable investments. The standard is voluntary, i.e. issuers can decide whether or not they want to use it. The standard provides that issuers must use all funds mobilised by way of the green bond only for projects that are compatible with the requirements of the green taxonomy (see Section 2.1). Issuers must also fulfil reporting requirements in order to provide transparency about the use of the mobilised funds. External auditors will examine whether the green bonds meet the requirements of the Regulation and whether the proceeds are being used in accordance with the taxonomy. Auditors must be registered with and will also be supervised by the European Securities and Markets Authority (ESMA).[24,25,26]

into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products.

21 "Benchmarks" are indices which help in determining inter alia the value of a financial instrument.

22 "Administrators" are actors that have control over the provision of a benchmark.

23 Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.

24 EU Commission, COM(2021) 391, Proposal for a Regulation of the European Parliament and of the Council on European green bonds.

25 Special rules on external auditing apply to state issuers.

26 In a cep**Input**, cep has already taken a critical look at the proposals, made by a group of experts appointed by the Commission, on establishing a European standard for green bonds. Numerous ideas from the group of experts have now been included in the Commission's proposal for a Regulation.

3 What is the EU planning for the future

On 6 July 2021, the Commission published a Communication on a "Strategy for Financing the Transition to a Sustainable Economy" [COM(2021) 390].[27] Here it presented numerous measures, planned for the coming months and years, which with the support of the financial sector are to make the European economy more sustainable. The key measures of the strategy are analysed in more detail below.

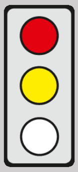
3.1 Green taxonomy

According to the Commission, the green taxonomy is currently focussed primarily on economic activities that can already be considered as environmentally sustainable. It therefore wants to take the following measures:[28]

- It wants to examine new legislation to recognise and support the financing of activities that will help the transition to climate neutrality by 2030 ("transition activities"[29]); in this regard it is thinking primarily of the energy sector including natural gas.[30]
- It will consider whether to extend the scope of the green taxonomy to include "activities with an intermediate level of environmental performance" in order to mobilise finance for economic activities that are on a credible pathway towards sustainability.
- At the end of 2021, it will publish a report on how the scope of the green taxonomy could be extended to include activities with and without significant impact on environmental sustainability.
- In November 2021, it will probably amend the delegated act on the climate taxonomy, which was submitted on 4 July 2021 (see Section 2.1), so as to include economic sectors that have not yet been covered. This includes agriculture, certain energy sectors and nuclear energy. In addition, it will also cover natural gas and related technologies as "transition technologies," although a "sunset clause" will be considered in this regard.
- In the first half of 2022, it will submit a delegated act for the other four environmental objectives – (1) sustainable use and protection of water and marine resources, (2) transition to a circular economy, (3) pollution prevention and control and (4) protection and restoration of biodiversity and ecosystems – which is to take effect as from 2023.[31]

[27] EU Commission, COM(2021) 390, Communication of 6 July 2021, Strategy for Financing the Transition to a Sustainable Economy.
[28] COM(2021) 390, p. 5 and 6.
[29] "Transition activities" are activities which contribute substantially to climate change mitigation (1st environmental objective under the taxonomy), have no technically and economically feasible low-carbon alternative, produce greenhouse gas emissions that are substantially lower than the sector or industry average, do not hamper the development and deployment of low-carbon alternatives and do not lead to a lock-in of assets incompatible with the objective of climate neutrality [Recital 41, Regulation (EU) 2020/852].
[30] The Platform on Sustainable Finance already issued initial recommendations on this in March 2021, see here.
[31] The Platform on Sustainable Finance already submitted an initial draft report on 3 August 2021 which makes initial recommendations on technical screening criteria for the economic activities containing the associated substantial contribution and avoidance of significant harm (DNSH) in relation to the four environmental objectives (see here).

Assessment



- There is no need to lay down a mandatory green taxonomy because there is no objective or uniform definition of "sustainability," nor can there be one. It is perfectly legitimate to classify sustainable activities according to different criteria and give them different weightings in the event of a conflict between different environmental objectives. The dispute about including certain technologies – e.g. nuclear power and natural gas – in the green taxonomy speaks volumes.
- Supplementing the green taxonomy with criteria for transitional activities will partially alleviate the problems of a narrow definition of sustainability, but irrespective of which technologies the Commission decides to add to or leave out of the green taxonomy, there will always be actors who will see the result as a failure to respect their sustainability preferences and who will therefore have little confidence in the taxonomy.
- Supplementing the green taxonomy with additional environmental objectives makes logical sense because environmental protection should not be restricted only to mitigating climate change. However, it will further increase the complexity of the taxonomy and even lead to more conflicts of interest between the various environmental objectives.

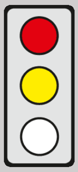
3.2 Standards and labels

According to the Commission, standards and labels for sustainable finance could increase market transparency and prevent greenwashing. It therefore wants to take the following measures:[32]

- By 2022, it will ensure that the EU Ecolabel[33] is extended to include green financial products for retail investors; in this regard the green taxonomy will be used as a screening criterion.
- By 2022, it will develop quality labels for "transition bonds"[34] and "sustainability-linked bonds"[35].
- By 2023, it will consider introducing a general framework for labels for financial instruments.
- By the end of 2022, it will submit a report on the creation of a quality label for Environmental, Social and Governance (ESG) benchmarks.
- By the end of 2022, it will adjust the Prospectus Regulation [(EU) 2017/1128, see cep**PolicyBrief**] to create minimum requirements for prospectus disclosures on ESG securities.

32 COM(2021) 390, p. 6 - 7.
33 Regulation (EC) No. 66/2010 of the European Parliament and of the Council on the EU Ecolabel.
34 "Transition bonds" are bonds issued to finance transition technologies aimed at a low-carbon economy, e.g. natural gas projects to replace carbon projects that are more detrimental to the climate.
35 "Sustainability-linked bonds" are bonds for which the interest rate depends on whether certain sustainability objectives defined in the conditions are met within a specific time frame. Unlike e.g. green bonds, the proceeds arising from the bond issue do not have to be used for environmentally sustainable projects.

Assessment



- The EU should not introduce its own mandatory quality labels for sustainable financial products. They are certain to push out quality labels from the private sector. Competition for the best quality labels preferred by investors would be inhibited.
- The EU should only bring in legislation if quality labels give rise to supervisory or regulatory concerns.
- Additional prospectus disclosures solely for ESG securities result in competitive disadvantages vis à vis non-ESG securities, as they increase the relative cost of issuance. If the Commission introduces sustainability-related disclosures for prospectuses, they should therefore apply uniformly to all securities.

3.3 Inclusion of retail investors and SMEs

According to the Commission, the inclusion of retail investors and SMEs will be key on the path towards a sustainable EU. Many sustainable projects are implemented on a local level and are small. The Commission therefore wants to take the following measures:[36]

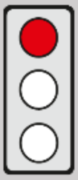
- By the 2nd quarter of 2022, it will ask the European Banking Authority (EBA) to develop a definition for “green retail loans and green mortgages”[37] and will support the uptake of such loans and mortgages.
- By the end of 2022, it will assess the support for “energy-efficiency mortgages”[38]. This will take place as part of the revision of the Directive on credit agreements for consumers relating to residential immovable property [2014/17/EU].
- It wants to strengthen the expertise and qualifications of financial advisers and the skills of citizens with regard to sustainability issues.
- It wants to facilitate greater access to sustainability advisory services for SMEs in order to improve their sustainability competences and support them with reporting obligations under the green taxonomy.
- Jointly with the European Financial Reporting Advisory Group (EFRAG), it will develop a simplified voluntary sustainability reporting standard for SMEs.

[36] COM(2021) 390, p. 7 and 8.

[37] “Green retail loans and mortgages” refer in particular to loans whose loan amounts are used for verifiable environmental benefits and these must be quantifiable for the borrower.

[38] “Energy-efficiency mortgages” refer in particular to mortgages which give house owners the incentive to invest in the energy efficiency of their houses at favourable conditions.

Assessment



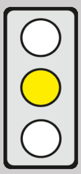
- There are already several market-based initiatives with criteria for "green loans."[39] As long as these do not give rise to any supervisory or regulatory concerns, the EU should refrain from developing its own.
- Whether green and energy-efficient loans and mortgages are in fact less risky has not yet been proven. Promoting such loans is only acceptable, however, if the risk-based approach to lending is not neglected. Otherwise there is a risk of bubbles forming which could jeopardise financial market stability.
- The EU can support the Member States on educational matters but has no responsibility for teaching content [see Art. 165 (1) TFEU]. It can only therefore recommend that Member States include "sustainable finance" in the educational canon and the training programme for financial advisers.
- The Proposal for a Directive on corporate sustainability reporting [COM(2021) 189, see cep**PolicyBrief**] obliges in particular large companies to undertake sustainability reporting. For their part, they are often dependent on information from SMEs which form part of their supply chain. Large companies can only comply with the obligation if SMEs are also subject to corresponding reporting obligations; voluntary reporting standards are not sufficient. The reporting obligations on SMEs must in any case be proportionate.

3.4 Digital technologies

According to the Commission, digital technologies – e.g. artificial intelligence (AI), blockchain or the internet of things – support the transition to a sustainable society. It therefore intends to take the following measures:[40]

- It will oblige companies to add their financial and sustainability-related information, about which they must report, in a database, the European Single Access Point (ESAP).
- By 2023, it will consider an extension to the "climate taxonomy" (see Section 2.1) allowing it to take adequate account of sustainable digital solutions; the Commission expresses doubts about the environmental impact of data centres and crypto-currencies such as bitcoin.

Assessment



- Establishing a database for financial as well as sustainability-related information, may increase transparency on the financial markets, strengthen capital market efficiency and reduce reporting costs.
- The Commission rightly points at the negative environmental impact of many digital technologies. These can be most efficiently internalised via inclusion in the EU Emissions Trading System, with direct regulation a secondary alternative. Taking a detour via the financial markets and climate taxonomy is inefficient.

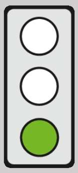
[39] These include e.g. the "Green Loan Principles" of the Loan Market Association.
[40] COM(2021) 390, p. 8.

3.5 Insurance against climate and environmental risks

According to the Commission, greater insurance protection against climate risks and natural disasters may significantly reduce costs to the taxpayer and governments. It therefore wants to take the following measures:[41]

- By mid-2022, it will call on the European insurance watchdog (EIOPA) to develop a natural disaster dashboard to inter alia indicate potential insurance coverage gaps in Member States.
- By 2022, it will initiate a wide-ranging "Climate Resilience Dialogue" to identify ways to reduce the insurance gaps. For this, it will either make recommendations or revert to voluntary commitments from the sector.

Assessment



- ▶ In view of the predicted increase in natural disasters, it is understandable that the Commission is pushing for the population to have comprehensive insurance coverage. Government compensation for loss due to disasters is certainly not a feasible proposition as it provides an incentive for people not to take out insurance cover ("moral hazard") and to settle in disaster-prone areas.
- ▶ Any recommendations from the Commission should emphasise the advantage of risk-based insurance tariffs as only these provide the necessary incentive for effective loss prevention. The Commission should certainly not push for a general insurance obligation with single premium rates. Although this would counteract the lack of risk awareness of many citizens and relieve the state as provider of assistance, it would overburden citizens living in low-risk areas and would not provide any incentive for risk prevention.

3.6 Social investments

The Commission sees an increased interest and need for "social investments", i.e. investment opportunities "with positive social outcomes and promoting human rights". It therefore wants to take the following measures:[42]

- Before December 2022, it will clarify disclosure rules for financial market participants, which apply to the "adverse impacts of their investment decisions" in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery.[43]
- It will publish a report on a social taxonomy by the end of 2021; the "Platform on Sustainable Finance" already submitted initial drafts of this on 12 July 2021[44].
- Still in 2021, it will submit a legislative proposal on sustainable corporate governance. It is likely to oblige companies to bring the "long-term interests" of management, shareholders, stakeholders and society more into line with one another rather than focussing on "short-term interests". In addition, companies will have to take measures to combat the negative impact of their business activities on sustainability.[45]

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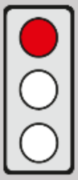
[41] COM(2021) 390, p. 9.
[42] COM(2021) 390, p. 9 and 10.
[43] This will take place as part of a review of the regulatory technical standards provided for under the Regulation on sustainability-related disclosures in the financial services sector [(EU) 2019/2088].
[44] The draft reports by the Platform on Sustainable Finance are available here.
[45] EU Commission, Inception Impact Assessment, Sustainable corporate governance, Ref. Ares(2020)4034032, 30/07/2020.

Assessment



- Just as there is no need to lay down a mandatory green taxonomy, there is also no need for a social taxonomy because there is no objective or uniform definition of "social" economic activities, nor can there be one. Here too, conflicts of interest are unavoidable, and it is perfectly legitimate to classify social activities according to different criteria and give them different weightings.
- Companies should not be forced to give more weight to "long-term" interests than to "short-term" interests. Long-term strategies are not necessarily superior to short-term ones. Business owners and investors should decide for themselves on the best weighting from their own point of view. Also, the impact of business models on sustainability should not be handled via corporate governance but, where necessary, via direct regulation. That is more effective.

3.7 Resilience of the financial sector and contribution to sustainability

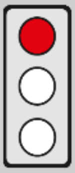
According to the Commission, the financial sector must do more to deal with the risks of climate change and environmental damage and to contribute to greater sustainability. The Commission therefore wants to take the following measures:[46]

- It will support initiatives on global standardisation for integrating sustainability issues into financial reporting.[47]
- In the 1st quarter of 2023, and taking account of ESMA's assessment, it will take action to ensure that ratings agencies include "relevant" sustainability factors in credit ratings and credit outlooks; the Commission currently thinks there is a lack of transparency.
- It will revise the supervisory framework for banks[48] and insurance companies[49] to ensure that banks and insurance companies integrate sustainability factors into their risk management.[50]
- It will ask the European Banking Authority (EBA) and the European insurance watchdog (EIOPA) to assess, by 2023,[51] whether the prudential treatment of risk positions of banks and/or insurance companies, related to assets or activities pursuing environmental and/or social objectives, should be adjusted.[52]
- It will ask the European Supervisory Authorities (ESAs) and the ECB[53] to carry out regular climate-change-related stress tests in the "relevant" financial sectors in order to test their resilience to shocks.
- It wants to assess whether the macro-prudential instruments of the banking regulatory authorities should be adjusted in order to deal adequately with the financial-stability risks arising

46 COM(2021) 390 p. 11– 15
47 In this regard, it will analyse, together with EFRAG, ESMA and the International Accounting Standards Board (IASB), how the international financial reporting standards (IFRS) can integrate sustainability risks more effectively.
48 Capital Requirements Directive (2013/36/EU) and Regulation (EU) No. 575/2013.
49 Solvability II Directive (2009/138/EC).
50 The Commission has already presented proposals in this regard on 22 September 2021 in the context of the revision of the Solvency-II Directive [COM(2021) 581] and on 27 October 2021 in the context of the revision of the Capital Requirements Regulation [COM(2021) 664].
51 The EBA has already been commissioned to carry out this assessment by 2025. It will now be brought forward.
52 The Commission has already presented proposals in this regard on 22 September 2021 in the context of the revision of the Solvency II Directive [COM(2021) 581] and on 27 October 2021 in the context of the revision of the Capital Requirements Regulation [COM(2021) 664].
53 On 22 September 2021, the ECB published such a climate stress test. More on the results here.

from climate change; in the medium term, it will also assess such an instrument for use in other financial sectors.

Assessment



- Uniform global standards are appropriate for interlinking sustainability and financial reporting. However, by developing its own EU reporting standard for sustainability reporting (see cep**PolicyBrief**) the Commission is undermining these efforts. If the Commission is going to pursue this plan, it absolutely has to align itself with global initiatives.
- Ratings agencies should not be forced to include sustainability factors in their ratings and outlooks; if the factors are of relevance, agencies will have their own interest in taking account of them because investors will demand them. Transparency rules, on whether and to what extent sustainability factors must be considered, are sufficient.
- When considering sustainability factors in the risk management of banks and insurance companies, and a change to the prudential treatment, under no circumstances should there be any softening of the risk-based approach. It remains open, however, whether “sustainable” investments are in fact less risky than “non-sustainable” ones. Softening up the risk-based regulatory approach will increase the risk to financial market stability.

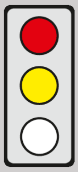
3.8 Contribution of the financial sector to sustainability targets

According to the Commission, the European Green Deal will only be successful if the financial sector incorporates it into their long-term financing strategies and decision-making processes. It therefore wants to take the following measures:[54]

- It will strengthen, by way of guidance, the credibility of voluntary pledges from the financial sector to adopt their own climate and sustainability targets; it would like the financial sector to align itself with the green taxonomy.
- By 2022, it wants to ask EIOPA to assess whether and how the Directive on institutions for occupational retirement provision (IORPs) [(EU) 2016/2341, see cep**PolicyBrief**] should be adjusted, and particularly
  - whether their duty to act in the “long-term best interest of members and beneficiaries” should be extended to include sustainability preferences and comprehensive social and ecological objectives, and
  - whether IORPs should be required to give greater consideration to the sustainability impact of investment decisions and whether to that end the “prudence principle” should be more clearly defined.
- By 2022, together with the ESAs, it will assess whether further fiduciary duties are necessary for financial market participants and financial advisers so that the latter can keep a closer eye on the sustainability impact of their investment decisions and advice.
- In the 4th quarter of 2023, it will hold a public consultation on ESG ratings and, by no later than the 1st quarter of 2023, it will submit regulatory measures to improve the reliability, comparability and transparency of ESG ratings.

[54] COM(2021) 390, p. 14-16.

Assessment



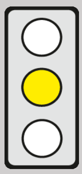
- If companies in the financial sector want to become "more sustainable," it should be left up to them to decide whether in doing so they want to align themselves with the green taxonomy. The EU should not claim to have a monopoly on the true definition of sustainability.
- Institutions for occupational retirement provision (IORPs) are in a position to decide for themselves whether and how sustainability preferences will be included in investment decisions.
- Financial market participants and financial advisers should not be forced to incorporate sustainability considerations into their investment decisions. If their clients want them to consider these aspects, financial market participants and financial advisers will do this for themselves. Otherwise they would be acting in breach of duty contrary to their clients' wishes.
- Greater transparency regarding ESG ratings and regarding the data and methods used to obtain the rating may strengthen investor confidence and improve the comparability of ratings. Providers should not however be forced only to use certain data and methods. This would undermine competition for the best ESG ratings.

3.9 Greenwashing

According to the Commission, greenwashing poses a risk of reputational damage and may weaken trust in sustainable financial products and the financial system. It therefore wants to take the following measures:[55]

- Together with the ESAs, it will assess whether the competent financial supervisory authorities have sufficient supervisory and enforcement powers to effectively combat greenwashing. It sees a solution in closer cooperation between the ESAs.

Assessment



- Greenwashing can lead to reputational damage and weaken trust in financial products. Closer coordination between the ESAs could remedy this. It is, however, crucial that the ESAs do not focus solely on the green taxonomy's theory of sustainability but also consider other classifications that are considered credible and accepted by the market.

3.10 Monitoring the transition to sustainability

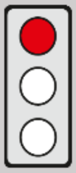
According to the Commission, it is necessary to monitor the process of transition to sustainability in order to meet the EU climate targets. It therefore wants to take the following measures: [56]

- In conjunction with the Platform on Sustainable Finance, it will - using a "robust monitoring framework" - measure the capital flows to sustainable investments.
- It will call on Member States to assess, by June 2023, the extent to which their financial markets are focussed on the climate and environmental objectives.

[55] COM(2021) 390, p. 16.
[56] COM(2021) 390, p. 17 and 18.

- By the 1st quarter of 2023, it will carry out an initial analysis of the long-term investment requirements and investment gap for achieving the climate and environmental objectives and, by the end of 2023, will submit a report on the progress of EU financial markets towards transition.

Assessment



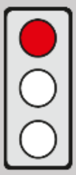
- Monitoring the flow of capital into sustainability investments and the sustainable alignment of financial markets is superfluous. If the EU bases its environmental and climate change policy on market-based instruments, such as the EU Emissions Trading System, this will automatically create incentives to channel capital into environmentally and climate friendly activities because activities that are detrimental to the environment and/or the climate will become less profitable. Appropriating the financial sector for the purpose of EU environmental and climate policy objectives should certainly be rejected. Direct regulation is clearly preferable to that.

3.11 Global ambitions

The Commission sees the EU as a pioneer of sustainable finance and thus as a source of inspiration for other jurisdictions. It considers an ambitious and robust international architecture to be necessary for sustainable finance. It therefore wants to take the following measures:[57]

- It will push for incorporation of the "concept of double materiality"[58] when developing international initiatives and standards on sustainable finance, and for agreement on collective objectives for sustainable classification systems - such as the green taxonomy.
- It will expand the mandate of the Financial Stability Board (FSB) to cover the contribution of the financial system to global climate and environmental objectives.
- It will strengthen the governance structure of the "International Platform on Sustainable Finance (IPSF)"[59], increase the membership of the platform and assign to it the new subject areas of biodiversity and transition finance.
- It will support partner countries, particularly those with low and medium-sized incomes, to develop their own sustainable financial sector and to develop sustainability-related financial instruments.

Assessment



- International coordination and exchange of information on policies for sustainable finance reduce the costs of implementing these policies, particularly for financial market stakeholders and companies in the real economy that operate across borders.
- The primary aim of the Financial Stability Board has to be the stability of the financial markets. Extending this to include sustainability objectives must not under any circumstances jeopardise this aim.

[57] COM(2021) 390, p. 18.

[58] The "concept of double materiality" states that companies should consider both the impact of their activities on environmental factors ("inside-out perspective") and the impact of environmental factors on their business operations, results and financial position ("outside-in perspective").

[59] The IPSF is a body which has set itself the goal of mobilising more capital for environmentally sustainable investment. Its total of 17 members include the United Kingdom, Canada, China and the EU.

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