ICAEW
REPRESENTATION 47/20

THE RENEWED SUSTAINABLE FINANCE STRATEGY

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ICAEW welcomes the opportunity to comment on the renewed sustainable finance strategy published by the European Commission on 8 April 2020, a copy of which is available from this link.

There is a pressing need to expedite the sustainable rebuilding of economies the world over. Given the urgency of the challenge of transitioning to fairer, sustainable, and resilient systems, we welcome the EU's prioritisation of action with regard to the financial system. The financial system must play a leading role in accelerating the mainstreaming of sustainability across the broader economy.

For change to happen, business has to respond. Improved reporting on environmental and social issues will be central to efforts to encourage system change. Financial actors, in particular, need to both better understand of the implications of environmental and social factors on their activities and be accountable for their impact on nature, people and the economy.

We believe that there is an urgent need for greater focus on –

- The financial services organisations themselves. Greater transparency around the green and sustainable credentials of financial actors must be based on better measurement and reporting.
- The products that the financial sector issues and invests in – reliable, consistent and comparable reporting is needed to ensure that such products are truly sustainable
- The corporates providing energy, goods and services - financial services organisations need better information on the overall performance and impact and dependencies of the companies and organisations they are providing services to.
- The retail users – outside of the corporate environment, most individuals will have limited options to exercise their preferences. Pensions funds may be a major area where individuals can exercise influence, provided they have the opportunity to do so and that they have the financial literacy skills and sustainability awareness to do so. Greater focus on ESG principles within the default options could be an efficient way to increase the proportion of sustainable investment.
- The public sector bodies – we consider that public sector bodies should also make use of existing tools, including the EU Taxonomy, to help access green financing.

We note that the transition to a greener, sustainable economy will not take place overnight. It will be important to encourage this shift from 'brown' to 'green' economic activities by enabling investors to make transitional options along a spectrum, rather than forcing binary choices.

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SECTION I: QUESTIONS ADDRESSED TO ALL STAKEHOLDERS ON HOW THE FINANCIAL SECTOR AND THE ECONOMY CAN BECOME MORE SUSTAINABLE

Question 1: With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that (please select one of the following):

X Major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.

Incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.

No further policy action is needed for the time being.

Question 4: Would you consider it useful if corporates and financial institutions were required to communicate if and explain how their business strategies and targets contribute to reaching the goals of the Paris Agreement?

Yes, corporates;

Yes, financial institutions;

X Yes, both;

If no, what other steps should be taken instead to accelerate the adoption by corporates and financial sector firms of business targets, strategies and practices that aim to align their emissions and activities with the goals of the Paris Agreement?

Do not know.

SECTION II: QUESTIONS TARGETED AT EXPERTS

Question 6: What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?

The economic consequences of the COVID-19 pandemic present significant challenges and opportunities for mainstreaming sustainability. While attention is understandably focused on dealing with the short / mid-term impact of the coronavirus, we recognise that many are taking the opportunity to rethink the way they do business.

We believe there needs to be focus on –

- The products that the financial sector issues and invests in. Reliable reporting is needed to ensure that such products are truly sustainable.
- The financial services organisations themselves. There is a need for greater transparency around the green and sustainable credentials of such entities: this requires better measurement and reporting.

In both cases, there is a lack of capacity for reliable measurement and insufficient standardisation.

Question 7: Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?

The EU non-financial reporting directive needs to be updated to extend reporting requirements and ensure this information is reliable by requiring assurance. We support the commission’s workplan in this area and encourage it to take this workstream forward.

Question 10: Should institutional investors and credit institutions be required to estimate and disclose which temperature scenario their portfolios are financing (e.g. 2°C, 3°C, 4°C), in comparison with the goals of the Paris Agreement, and on the basis of a common EU-wide methodology?

X Yes, both

Question 11: Corporates, investors, and financial institutions are becoming increasingly aware of the correlation between biodiversity loss and climate change and the negative impacts of biodiversity loss in particular on corporates who are dependent on ecosystem services, such as in sectors like agriculture, extractives, fisheries, forestry and construction. The importance of biodiversity and ecosystem services is already acknowledged in the EU Taxonomy. However, in light of the growing negative impact of biodiversity loss on companies' profitability and long-term prospects, as well as its strong connection with climate change, do you think the EU's sustainable finance agenda should better reflect growing importance of biodiversity loss?

Yes

If yes, please specify potential actions the EU could take.

- Support and promote the implementation of the Natural Capital Protocol and its accompanying sectoral guidance – including forthcoming specific biodiversity guidance – and toolkit, while encouraging the further alignment of methods and metrics that companies and investors can use to assess impacts and dependencies on biodiversity and natural capital.
- Support the implementation of available methods and metrics on biodiversity and natural capital through capacity building, for instance by encouraging the establishment of Communities of Practice at European, national and sectoral levels.

1. Strengthening the foundations for sustainable finance

1.2 Accounting standards and rules

Question 16: Do you see any further areas in existing financial accounting rules (based on the IFRS framework) which may hamper the adequate and timely recognition and consistent measurement of climate and environmental risks?

No

If yes, what is in your view the most important area (please provide details, if necessary):

o Impairment and depreciation rules.
o Provision rules.
o Contingent liabilities.
o Other, please specify.

1.4 Definitions, standards and labels for sustainable financial assets and financial products

Question 22: The TEG has recommended that verifiers of EU Green Bonds (green bonds using the EU GBS) should be subject to an accreditation or authorisation and supervision regime. Do you agree that verifiers of EU Green Bonds should be subject to some form of accreditation or authorisation and supervision ?

Yes, at a national level

If necessary, please explain the reasons for your answer

The supervision regime can and should evolve to accommodate EU legislative changes, policy objectives and developments such as EU Green Bonds.

We believe that a differential verification regime is unnecessary as the necessary safeguards could be achieved through relying on existing registration and supervision arrangements such as those for statutory auditors. This has the benefit that it can be rapidly put in place and already has robust and reliable controls, as well as mechanisms for identifying and implementing lessons from supervision. Statutory auditors are already bound by ethical and professional principles, and provide assurance services in line with internationally recognised standards. They also invest extensively in expertise and training. This is vital to ensure that verification incorporates consideration of the underlying issues associated with green finance, in addition to compliance with investment rules and procedures.

Question 25: In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing?

Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree)

5

If necessary, please specify the reasons for your answer

As yet, the market for sustainable finance is not mature and the extent and nature of information must reflect that investors will need indicators that help them invest sustainably. They will also want to see the detail as there will be nuances to what they or their fund can or cannot get involved with. Providing specific information on the green credentials of the bonds and requiring assurance over this would undoubtedly provide investors with more consistent and comparable information thereby ensuring confidence in each instrument and acting as a strong control against greenwashing.

The risks of (a) greenwashing and (b) that the judgment applied could vary between instruments, should be addressed through bespoke assured disclosures in the prospectus. To boost their rate of success at raising funds, issuers will need to engage closely with investors so that they understand what information investors need to see.

One of the aims of the GBS and GBF is to help develop the market for green bonds and we make the following observations:

- The EU needs a strategy that ensures the supply of green projects and assets to be financed as, at present, there is not a developed market. Given the momentum behind the sustainable finance strategy, the provision of projects and assets should not be delayed.
- Over time, disclosures of specific information should educate and inform the market – potential investors and future issuers – and build foundations for a steady issuance of green bonds.
- In conventional capital markets (including the EU prospectus regime) those investing in bonds do so on the basis of information on risk and reward, so these details must be provided alongside the specific information on the green bonds. Investors need to be able to assess the extent to which a bond is aligned to their ESG mandates – and how that impacts their cost of capital.

Question 26: In those cases where a prospectus has to be published, to what extent do you agree with the following statement: "Issuers that adopt the EU GBS should include a link to that standard in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus"

Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree)

1

If necessary, please specify the reasons for your answer

To ensure confidence in each instrument it is important that disclosures are made in the prospectus and that assurance is given of these to ensure they are reliable. The risks of greenwashing and that judgment applied could vary between instruments will provide an opportunity for a wide range of interpretation with negative consequences for consistency and comparability. This can be mitigated through bespoke, assured disclosures in the prospectus that will:

- focus the issuers' efforts on providing relevant information on the extent to which specific objectives have been contributed to; and
- enable investors to assess the extent to which their capital has contribute towards those objectives.

Linking information to the standard makes it easier for investors not to follow through the flow information (and compliance with the standard) and, ultimately, with their own investment mandate.

As the market develops and matures, the regime for EU Green Bonds and its disclosure requirements will need to be reviewed and, if necessary and subject to public consultation, adapted.

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).

4

If necessary, please explain.

While there is a plethora of standards already guiding market participants, sustainability is a much wider term than "green". Meeting those pre-determined sustainability linked targets will require very different set of actions, conditions and metrics than green bonds, therefore investors will need different set of standards to enable assessment and comparison. This will be particularly relevant during the aftermath of the COVID-19 pandemic when there will inevitably be a reassessment of investment principles.

Question 31: Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators?

Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).

5

If necessary, please explain.

The EU Taxonomy will likely become one of the overarching set of tools that will help investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy. The fewer tools there are, the easier it will be for investors to be able to assess and control their activities.

Question 33: The Climate Benchmarks Regulation creates two types of EU climate benchmarks - 'EU Climate Transition' and 'EU Paris-aligned' - aimed at investors with climate-conscious investment strategies. The regulation also requires the Commission to assess the feasibility of a broader 'ESG benchmark'. Should the EU take action to create an ESG benchmark?

Yes

If yes, please explain what the key elements of such a benchmark should be.

Based on anecdotal evidence, it seems that the impact of the pandemic is leading financial services firms to pivot slightly to the "S" of ESG. There seems to be a lot more consideration given to investments with the social considerations in mind. A more generic focus on sustainability / ESG risks seems to be more readily connected to internal risk management and decision making.

Question 34: Beyond the possible standards and labels mentioned above (for bonds, retail investment products, investment funds for professional investors, loans and mortgages, benchmarks), do you see the need for any other kinds of standards or labels for sustainable finance?

No

If yes, what should they cover thematically and for what types of financial products? [box max. 2000 characters]

We consider that there already a lot of competing standards and labels. Users lose focus and find it more difficult to decide which ones they want to and need to comply with.

1.6 Corporate governance, long-termism and investor engagement

Question 40: In your view, should there be a mandatory share of variable remuneration linked to non-financial performance for corporates and financial institutions?

Yes

If yes, please indicate what share.

Such a measure would forward-thinking about the long-term sustainability of corporates and financial institutions. However, it must be made clear that a mandatory share is only a minimum. For some member states, corporates, financial institutions and executives a greater share of variable remuneration will be necessary or preferable. Remuneration committees should have the discretion to place even greater emphasis on directors' non-financial performance if they wish to do so. In the UK, the average percentage of variable pay determined from non-financial measures across the FTSE 350 is 30 percent. For this reason we suggest that the EU considers a mandatory minimum of 20-25 percent. We believe this percentage strikes the right balance as anything under 15 percent may not affect behaviours and shareholders may be concerned by anything over 30 percent.

Question 41: Do you think that a defined set of EU companies should be required to include carbon emission reductions, where applicable, in their lists of ESG factors affecting directors' variable remuneration?

Yes

Carbon emissions reductions should be taken into consideration in respect of the remuneration of directors of companies operating in fossil fuels and other carbon intensive industries, e.g. real estate and cement production. The factors affecting directors' variable remuneration should include intensity emissions reduction targets and absolute emissions reduction targets.

Question 42: Beyond the Shareholder Rights Directive II, do you think that EU action would be necessary to further enhance long-term engagement between investors and their investee companies?

Do not know.

If yes, what action should be taken? Please explain or provide appropriate examples.

We believe current engagement trends in member states need assessing first. If this assessment leads to the conclusion that further EU action is needed, recent developments in investor engagement in the UK may be informative. For instance, the recently revised UK Stewardship Code sets higher expectations around long-term quality engagements, including more detailed reporting expectations. Code signatories must report on their activities and outcomes. This is intended to replace the previous focus on high-level policies. We also point to the world's first register tracking shareholder dissent published by the Investment Association.

Question 43: Do you think voting frameworks across the EU should be further harmonised at EU level to facilitate shareholder engagement and votes on ESG issues?

No

Question 44: Do you think that EU action is necessary to allow investors to vote on a company's environmental and social strategies or performance?

No

If yes, please explain.

In the UK investors can express any dissatisfaction with ESG in their voting decisions on the annual report and accounts, and directors' elections and remuneration. A separate vote for ESG may reduce investors' influence if fewer consequences arise from a negative ESG vote than from other negative votes on other issues.

Question 45: Do you think that passive index investing, if it does not take into account ESG factors, could have an impact on the interests of long-term shareholders?

Yes

If yes, in your view, what do you think this impact is, do you think that the EU should address it and how?

Although index investing has increased, at the moment companies are still actively engaging with their active and long-term shareholders This will be reinforced by the recent changes to the Shareholder Rights Directive.

Many passive investment houses are already active stewards of their clients' assets and have significant influence over market-level practices. Passive investors can drive improved levels of disclosures, and this should inform the buy and sell decision of active managers.
Despite these positive trends, passive index investing could have impact on the interests of long-term shareholders.

Question 46: Due regard for a range of 'stakeholder interests', such as the interests of employees, customers, etc., has long been a social expectation vis-a-vis companies. In recent years, the number of such interests have expanded to include issues such as human rights violations, environmental pollution and climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?

Yes, a more holistic approach should favour the maximisation of social, environmental, as well as economic/financial performance.
Yes, as these issues are relevant to the financial performance of the company in the long term.
While we agree that companies and directors should take these interests into account we do not see the need for new EU law, in addition to the Non-Financial Reporting Directive (NFRD). Member states need the flexibility to take their own approaches to anything that goes beyond the NFRD.
By way of example, there has been UK legislation in this area for over a decade. Section 172 of the Companies Act (2006) requires directors to 'have regard to' stakeholders' interests. The stakeholders listed in this legislation include; the company's employees; suppliers; customers; the community; and the environment. This so-called 'enlightened shareholder value' has been consolidated by the recently revised UK Corporate Governance Code, which refers to stakeholder engagement and participation, and by new reporting requirements.
COVID-19 has underlined the importance of all stakeholders but particularly employees. Many member states require companies to have an employee director. In the UK, the value of employee directors has been formally acknowledged for the first time in the revised Corporate Governance Code. However, employee directors are voluntary rather than compulsory.

Question 47: Do you think that an EU framework for supply chain due diligence related to human rights and environmental issues should be developed to ensure a harmonised level-playing field, given the uneven development of national due diligence initiatives?

Do not know
The UN Guiding Principles on Business and Human Rights (the GPs) and the OECD Guidelines on Multinational Enterprises (the Guidelines) provide a solid foundation for a level-playing field. These instruments are high-level, they cover due diligence and there are remedies for non-compliance.

Question 48: Do you think that such a supply chain due diligence requirement should apply to all companies, including small and medium sized companies?

Yes
If yes, please select your preferred option:

Only large companies in general, and SMEs in the most risky economic sectors sustainability-wise
If necessary, please explain the reasons for your answer.

Our answer acknowledges the greater resources which are available to large companies and their role in leading best practice, i.e., it is the procurement practices of large companies which often sets minimum standards.
We suggest a risk-based approach towards preventing human rights and environmental violations, i.e., in order to effectively prevent harm the riskiest SMEs must fall into scope regardless of their size or resources. The UN's GPs 14 and 15 strike the same balance. The OECD also takes a risk-based approach, e.g., the Guidelines have been complemented by due diligence guidance for higher risk sectors such as extractives.
A risk-based approach takes cost and practicality of compliance into account. It is impossible to be precise as to which SMEs should be subject to new requirements without knowing whether the

requirements will be very detailed and onerous or high-level. An important factor will be whether SMEs can rely upon what they are told by intermediaries or whether SMEs must conduct all due diligence directly themselves.

2. Increasing opportunities for citizens, financial institutions and corporates to enhance sustainability

2.1 Mobilising retail investors and citizens

Question 49: In order to ensure that retail investors are asked about their sustainability preferences in a simple, adequate and sufficiently granular way, would detailed guidance for financial advisers be useful when they ask questions to retail investors seeking financial advice?

Yes

If necessary, please provide an explanation of your answer.

Question 50: Do you think that retail investors should be systematically offered sustainable investment products as one of the default options, when the provider has them available, at a comparable cost and if those products meet the suitability test?

Yes

Question 51: Should the EU support the development of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals?

Please reply using a scale of 1 (completely disagree) to 5 (fully agree)

4

If you agree (for scores of 4 to 5), please choose what particular action should be prioritised:

- Integrate sustainable finance literacy in the training requirements of finance professionals. [1-5]
- Stimulate cooperation between Member States to integrate sustainable finance as part of existing subjects in citizens' education at school, possibly in the context of a wider effort to raise awareness about climate action and sustainability. [1-5]

4

- Beyond school education, stimulate cooperation between Member States to ensure that there are sufficient initiatives to educate citizens to reduce their environmental footprint also through their investment decisions. [1-5]

4

- Directly, through targeted campaigns. [1-5]
- As part of a wider effort to raise the financial literacy of EU citizens. [1-5]
- As part of a wider effort to raise the knowledge citizens have of their rights as consumers, investors, and active members of their communities. [1-5]
- Promote the inclusion of sustainability and sustainable finance in the curricula of students, in particular future finance professionals. [1-5]

4

- Other, please explain.

ICAEW recently joined with other leading financial professional bodies to launch a Green Finance Education Charter. Signatories have committed to integrating green finance and sustainability into core curricula, new qualifications and the continuing professional development of members – and will report annually on progress made in mainstreaming the principles and practice of green and sustainable finance.

2.3 Green securitisation

Question 54: Do you think that green securitisation has a role to play to increase the capital allocated to sustainable projects and activities?

Please express your view by using a scale of 1 (not important at all) to 5 (very important).

4

If necessary, please explain your answer.

The principles of securitisation are sound. Green securitisation would lead to an increase in the capital allocated to sustainable projects and activities. However, as shown by the 2008-9 financial crisis, the regulatory framework and prudential treatment have to be robust while also providing necessary incentives.

Question 55: Do the existing EU securitisation market and regulatory frameworks, including prudential treatment, create any barriers for securitising 'green assets' and increasing growth in their secondary market?

Do not know.

Question 56: Do you see the need for a dedicated regulatory and prudential framework for 'green securitisation'?

No

If yes, what regulatory and/or prudential measures should the dedicated framework contain and how would they interact with the existing general rules for all securitisations and specific rule for STS securitisations?

2.7 The use of sustainable finance tools and frameworks by public authorities

Question 70: In your view, is the EU Taxonomy, as currently set out in the report of the Technical Expert Group on Sustainable Finance, suitable for use by the public sector, for example in order to classify and report on green expenditures?

Yes - please explain which public authority could use it, how and for what purposes. [Box max. 2000 characters]
Yes, but only partially - please explain which public authority could use it, how and for what purposes, as well as the changes what would be required to make it fit for purpose. [Box max. 2000 characters]
No - please explain why you consider that it is not suitable for use by public authorities, and how those reasons could be best addressed in your view. [Box max. 2000 characters]
Do not know.

The EU Taxonomy sets out performance thresholds to help companies, project promoters and issuers accessing green financing to improve their environmental performance, as well as to help to identify which activities are already environmentally friendly. We consider that public sector bodies could also aim to use it where relevant.

Question 73: Should public issuers, including Member States, be expected to make use of a future EU Green Bond Standard for their green bond issuances, including the issuance of sovereign green bonds in case they decide to issue this kind of debt?

Yes

2.9 EU Investment protection framework

Question 75: Do you consider that the investment protection framework has an impact on decisions to engage in cross-border sustainable investment? Please choose one of the following:

Investment protection is a factor that can have a decisive impact on cross-border investments decisions and can result in cancellation of planned or withdrawal of existing investments.

3. Reducing and managing climate and environmental risks

3.1 Identifying exposures to harmful activities and assets and disincentivising environmentally harmful investments

Question 82: In particular, do you think that existing actions need to be complemented by 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, in line with the review clause of the political agreement on the Taxonomy Regulation?

Yes

If yes, what would be the purpose of such a brown taxonomy? (select all that apply)

o Help supervisors to identify and manage climate and environmental risks.
o Create new prudential tools, such as for exposures to carbon-intensive industries.
x Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.
x Identify and stop environmentally harmful subsidies.
o Other, please specify.

Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

Yes

If yes, what should be the purpose of such a taxonomy? Please specify.

It is highly unlikely that the transition to the low carbon economy could happen in an immediate switch from brown to green economic activities. It will have to be a gradual process over several years and covered by activities that lie in between the two ends of the spectrum. Giving investors transitional choices will enable them to choose the better / less bad options, rather than having to make binary choices.

3.2 Financial stability risk

Question 84: Climate change will impact financial stability through two main channels: physical risks, related to damages from climate-related events, and transition risks, related to the effect of mitigation strategies, especially if these are adopted late and abruptly. In addition, second-order effects (for instance the impact of climate change on real estate prices) can further weaken the whole financial system. What are in your view the most important channels through which climate change will affect your industry? Please provide links to quantitative analysis when available.

Physical risks, please specify if necessary
Transition risks, please specify if necessary
Second-order effects, please specify if necessary
Other, please specify
For the financial services industry transition risks will be the ones that have a significant impact first. Regulatory expectations, investor pressure, market sentiment changes will force banks and asset managers (and insurers through the assets side of their balance sheet) to seriously consider the impacts on their portfolios. This will be closely followed by physical risks, including

the consequence impact on the cost of insurance and the likelihood that some assets will become uninsurable.

Question 85: What key actions taken in your industry do you consider to be relevant and impactful to enhance the management of climate and environment related risks?

Please identify a maximum of three actions taken in your industry

For the financial services industry considerations are two-fold. Banks and insurers need to manage the risk related to both their own and their customers' activity.
The Climate Financial Risk Forum set up in the UK by the PRA and the FCA aims to build capacity and share best practice across financial regulators and industry to advance the sector's responses to the financial risks from climate change. Membership is drawn from a wide range of industry participants, to ensure the perspective of a broad range of firms is represented.
Such forums can help banks, insurers and investment managers to assess, mitigate and manage their relevant risks.
Other practical and relevant actions include sharing scenario analysis information, the establishment of a database of relevant climate change related information and clear guidance on disclosure requirements. Such measures would enable industry participants to gain consistent and comparable information on the risks these organisations face.

Question 86: Following the financial crisis, the EU has developed several macro-prudential instruments, in particular for the banking sector (CRR/CRDIV), which aim to address systemic risk in the financial system. Do you consider the current macro-prudential policy toolbox for the EU financial sector sufficient to identify and address potential systemic financial stability risks related to climate change?

Please express your view by using a scale of 1 (highly inadequate) to 5 (fully sufficient).

2

For scores of 1-2, what solution would you propose? Please list a maximum of three.

Currently macro-prudential instruments do not consider climate change (or any ESG) risks when regulating the financial services industry, particularly banking. Addressing financial stability risk by prescribing the amount of capital banks have to hold against different types of risks can be an effective tool to ensure that banks assess these risks sufficiently. Requiring regulatory capital to be held against specific climate change and ESG risk, could ultimately be a tool to safeguard banks and financial stability. However, there are important issues that would have to be considered before taking such a step. The assessment of climate change related financial risks is still in its infancy therefore the introduction of capital requirements for them would likely be met with some resistance. It would also be very important to ensure that capital requirements achieve their intended purpose, including that they promote the concrete climate change risk mitigating actions and not just temporary solutions.

Question 87: Beyond prudential regulation, do you consider that the EU should take further action to mobilise insurance companies to finance the transition and manage climate and environmental risks?

Do not know

If yes, please specify which actions would be relevant. [BOX max. 2000 characters]

Insurance companies could be the ultimate enablers of the transition by requiring their customers to make concentrated efforts to mitigate their climate change risks as a condition of providing insurance. This could however be counterproductive as a large part of the economy would probably be uninsurable.

Question 88: Do you consider that there is a need to incorporate ESG risks into prudential regulation in a more effective and faster manner, while ensuring a level-playing field?

Yes

If yes, is there any category of assets that could warrant a more risk-sensitive treatment? Are there any other prudential measures that could help promoting in a prudentially sound

way the role of the EU banking sector in funding the transition to a more sustainable economy?

Commercial lending should be paid particular attention when assessing risk sensitivity so as to ensure that not only banks but also their customers scale up efforts to support a faster transition.

Question 89: Beyond prudential regulation, do you consider that the EU should take further action to mobilise banks to finance the transition and manage climate-related and environmental risks?

Yes one or both

Please specify which action would be relevant

Banks are in a position to request their customers to scale up their efforts to support a faster transition, for example by extending credit conditional on customers' climate change related efforts. However, these requirements would have to be implemented gradually and proportionately so customers are able to keep their businesses viable while going through transition.

Question 90: Beyond the possible general measures referred to in section 1.6, would more specific actions related to banks' governance foster the integration, the measurement and mitigation of sustainability risks and impacts into banks' activities?

No

Question 91: Do you see merits in adapting rules on fiduciary duties, best interests of investors/the prudent person rule, risk management and internal structures and processes in sectorial rules to directly require them to consider and integrate adverse impacts of investment decisions on sustainability (negative externalities)?

Yes

If yes, what solution would you propose?

By requesting asset managers to follow rules as detailed above, investors would be able exercise their own judgement and exert influence in scaling up climate change related efforts. Making the double materiality the default position would inevitably go some way to promote such efforts.

Question 92: Should the EU explore options to improve ESG integration and reporting beyond what is currently required by the regulatory framework for pension providers?

Do not know

If yes, please specify what actions would be relevant in your view.

Outside of the corporate environment most people will only have their pension funds (as investors) where they can influence climate change related efforts. Therefore pension funds are in important area to provide opportunities for individuals to exercise their judgement and influence. Enhanced financial literacy and sustainability awareness will be important in enabling individuals to do this.

3.4 Natural capital accounting or 'environmental footprint'

Question 98: Are there any specific existing initiatives (e.g. private, public or other) you suggest the Commission should consider when supporting more businesses and other stakeholders in implementing standardised natural capital accounting/environmental footprinting practices within the EU and internationally?

Yes

If yes, please list a maximum of three relevant initiatives.

1. The Natural Capital Protocol (https://naturalcapitalcoalition.org/natural-capital-protocol/), a decision making framework that enables organizations to identify, measure and value their direct and indirect impacts and dependencies on natural capital. The Protocol provides an internationally standardized framework for the identification, measurement, and valuation of

impacts and dependencies on natural capital in order to inform organizational decisions. The Protocol is accompanied with a set of sectoral guidances, including a supplement for the financial sector (https://naturalcapitalcoalition.org/finance/), and a Toolkit that is hosted by MIT-Shift (https://mitsloan.mit.edu/sustainability/shift), that brings together best available tools and metrics. Available guidance is constantly being updated and supplemented. For example, currently specific guidance for the agri-food sector is being developed by TEEB, UNEP and Capitals Coalition through the TEEBAgriFood-project, and additional guidance on biodiversity will be published by the Capitals Coalition in the summer of 2020.

2. The report Improving Nature’s Visibility in Financial Accounting (https://naturalcapitalcoalition.org/wp-content/uploads/2020/04/NatCap_VisFinAccount_final_20200428.pdf) describes and illustrates methods to integrate natural and other capitals into financial accounting. The methods discussed are offer novel improvements to current financial accounting approaches.
3. The Transparent Project, a collaboration of the Value Balancing Alliance, Capitals Coalition and WBCSD, aims to develop a set of environmental generally accepted accounting principles (E-GAAP) to enable a shift towards a more sustainable financial and economic system. Funded by the European Commission, this project will develop a standardized natural capital accounting and valuation methodology.

3.5 Improving resilience to adverse climate and environmental impacts

Question 99: In your opinion, should the European Commission take action to enhance the availability, usability and comparability of climate-related loss and physical risk data across the EU?

Yes

If yes, please select all that apply:

x Loss data, please explain why
x Physical risk data, please explain why

Question 100: Is there a role for the EU to promote more equal access to climate-related financial risk management mechanisms for businesses and citizens across the EU?

Yes

If yes, please indicate the degree to which you believe the following actions could be helpful, using a scale of 1 (not helpful at all) to 5 (very helpful) and substantiate your reasoning:

- Financial support to the development of more accurate climate physical risk models.

5

This would be beneficial to all if widely and freely shared. Physical risks are easier to understand and can help to illustrate the ultimate risks.

- Raise awareness about climate physical risk.

5

As above.

- Promote ex-ante “build back better” requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe.

5

Prevention is more expedient and potentially saves lives.

- Facilitate public-private partnerships to expand affordable and comprehensive insurance coverage.

3

Private businesses should be able to price their products appropriately. Public-private partnerships could enable the participation of currently excluded proportions of the population to participate.

- Reform EU post-disaster financial support

- Support the development of alternative financial products (e.g. catastrophe bonds) offering protection/hedging against financial losses stemming from climate- or environment-related events.

4

Possibly all innovation that aims to improve on the current situation is helpful.

- Advise Member States on their national natural disaster insurance and post disaster compensation and reconstruction frameworks.
- Regulate by setting minimum performance features for national climate-related disaster financial management schemes.
- Create a European climate-related disaster risk transfer mechanism.
- Other, please specify.

Question 101: Specifically with regards to the insurability of climate-related risks, do you see a role for the EU in this area?

Do not know.

Question 102: In your view, should investors and / or credit institutions, when they provide financing, be required to carry out an assessment of the potential long-term environmental and climate risks on the project, economic activity, or other assets?

Yes

If yes, what action should the EU take? Please list a maximum of three actions.

Ultimately investors and credit institutions / insurers will have the power to encourage their customers to scale up their efforts in mitigating climate change related risks. Making the provision of credit and / or insurance conditional on these efforts (whether it is required by EU or national standard setters and regulators) will provide the incentives that businesses might need to do so.