SUSTAINABLE FINANCE FOR CREDIT INSTITUTIONS

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LOOKING FURTHER

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PERSPECTIVES OF SUSTAINABLE FINANCE

G20 INSIGHTS

G20 GERMANY 2017
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[…] *For a 2^{o}C compatible pathway, the G20 countries face an enormous investment. The investment required in infrastructure for energy, transport, potable water supply and sanitation, as well as telecommunications over the next 15 years is estimated to be around US$ 80–90 trillion. Flows will need to be redirected from brown investments into sustainable investments. A scale-up of green investments will not only mitigate climate change, it will also foster economic growth and job creation. However, public spending will not suffice to finance the green transformation. The majority of investment must come from the private sector. It is therefore important to align the financial system – banking, capital markets and insurance – with sustainable development*. […]

PERSPECTIVES OF SUSTAINABLE FINANCE

G20 INSIGHTS

G20 GERMANY 2017
THINK 20 DIALOGUE

[…] *Moreover, it is important that the financial sector prepares itself for risk related to climate change and other environmental hazards. Three types of climate-related risk have been identified: (i) physical risk, i.e., the risk of economic and financial losses due to climate-related hazards; (ii) transition risk, i.e., the risk of financial losses related to regulatory and economic adjustments in a transition to a low-carbon economy; and (iii) liability risk, i.e., the risk that liability insurance providers have to cover claims related to losses arising from physical or transition risk from climate change.*[…]

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PERSPECTIVES OF SUSTAINABLE FINANCE

- Meeting agreed upon objectives in Paris Agreement of 2015 will have implications for any individual and any business, **for instance pricing of energy consumption** from “brown” and not “green” production plants. This will have exacerbating effects on costs for anybody, including credit institutions;
- Credit institutions will particularly be exposed to **transition risk**, for instance in respect of revaluation of assets and collateral and the potential constraints in the performance of obligations and debt service by counterparties that merged too late to the green environment;
- **Microprudential concerns** include information asymmetry, maturity mismatches between long-term green investments and the relatively short-term time horizons of savers, and, inadequate analytical capacity, particular for smaller institutions;
- **Reputational effect of the profile of the bank**, in particularly expectations of retail customers about the alignment of the banks’ objectives and strategy with climate change constraints. This is a broader issue, and also covers for corporate social responsibility, diversity policy and responsiveness to the perceptions of society at large.

PART TWO

THE EUROPEAN COMMISSION ACTION PLAN ON SUSTAINABLE FINANCE

EUROPEAN COMMISSION

Brussels, 8.3.2018
COM(2018) 97 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

ACTION PLAN ON SUSTAINABLE FINANCE 8 MARCH 2018 (I)

Background

> Involvement of the financial sector will boost efforts to reduce the EU's ecological footprint
> Following up on the Paris Agreement of 2015 and the UN 2030 Agenda for Sustainable Development, private sector investments of EUR 180 million are required to meet the EU's 2030 climate targets

Goals

> Reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth
> Manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues
> Foster transparency and long-termism in financial and economic activity

EUROPEAN COMMISSION

Brussels, 8.3.2018
COM(2018) 97 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

ACTION PLAN ON SUSTAINABLE FINANCE 8 MARCH 2018 (II)

Action points

1. Establishing an EU classification system for sustainable activities (taxonomy)
2. Creating standards and labels for green financial products
3. Fostering investment in sustainable projects
4. Incorporating sustainability when providing financial advice
5. Developing sustainability benchmarks
6. Better integrating sustainability in ratings and market research
7. Clarifying duties of institutional investors and asset managers
8. Incorporating sustainability in prudential requirements
9. Strengthening sustainability disclosure and accounting rule-making
10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

PART THREE

EC LEGISLATIVE PROPOSALS ON SUSTAINABLE FINANCE THAT WILL IMPACT THE BANKING SECTOR

IMPACT ON THE BANKING SECTOR (I)

AMENDMENTS TO EXISTING REGULATIONS

Sustainability considerations in financial advice

> An amendment to a MiFID II Delegated Regulation has been proposed to take into account sustainability preferences in the suitability assessment (24 May 2018)

Standards and labels for green financial products

> The European Commission may adopt a Prospectus Regulation delegated act that specifies the content of the prospectus for green bond issuances (Q2 2019)

Sustainability in prudential requirements

> The European Commission will explore the feasability of including climate and environmental factors in risk management policies and the potential calibration of capital requirements in CRD/CRR

EUROPEAN COMMISSION

Brussels, 24.5.2018
COM(2018) 353 final

2018/0178 (COD)

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on the establishment of a framework to facilitate sustainable investment

(Text with EEA relevance)

{SEC(2018) 257 final} - {SWD(2018) 264 final} - {SWD(2018) 265 final}

EU TAXONOMY FOR SUSTAINABLE ACTIVITIES, PROPOSAL FOR A REGULATION

Proposal for a regulation on the establishment of a framework to facilitate sustainable investment, 24 May 2018

> A framework is proposed to gradually create a unified classification system ('taxonomy') that sets out criteria to determine whether an economic activity is ‘environmentally sustainable’
> The taxonomy will serve as the foundation of the entire sustainable finance initiative, providing it with a common language applicable to its different areas
> The taxonomy applies to financial products and corporate bonds (but not to sovereign bonds)
> The main body of these rules will not apply until six months after the entering into force of the relevant Delegated Acts (between July 2020 and December 2022)

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EUROPEAN COMMISSION

Brussels, 24.5.2018
COM(2018) 355 final

2018/0180 (COD)

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

(Text with EEA relevance)

{SEC(2018) 257 final} - {SWD(2018) 264 final} - {SWD(2018) 265 final}

LOW-CARBON AND POSITIVE CARBON IMPACT BENCHMARKS, AMENDMENT TO THE BENCHMARKS REGULATION

Proposal for a Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive impact benchmarks, 24 May 2018

- New categories are proposed for low-carbon and positive-carbon impact benchmarks to measure a company's footprint and an investment portfolio's carbon footprint.
- These benchmarks will provide a tool for investors to compare the environmental performance of their investment.
- This Regulation increases transparency and counters ‘greenwashing’ of investments


EUROPEAN COMMISSION

Brussels, XXX
[…](2018) XXX draft

COMMISSION DELEGATED REGULATION (EU) …/…

of XXX

amending Regulation (EU) 2017/565 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

AMENDMENT TO DELEGATED REGULATION UNDER MIFID II

Draft Commission Delegated Regulation on organisational requirements and operating conditions for investment firms, 24 May 2018

- Economic, social and good governance (ESG) factors, including sustainability preferences will be included in the suitability test
- Investment firms will be obliged to ask clients about their ESG preferences and ensure that financial products offered are suited to these preferences
- ESG considerations must be included in the description of financial instruments and in financial advice relating to financial instruments

AMENDMENT TO THE CRD/CRR FRAMEWORK

The Commission will explore the feasability of the amendment of the CRD/CRR framework to include climate and environmental factors in risk management policies and the potential calibration of capital requirements (no date announced)

- Capital requirements would include factors that reflect sustainability risks associated with assets held by financial institutions
- Capital buffers may be lowered for ‘green’ exposures
- Changes to prudential requirements would be progressively phased in, concurring with the development of the taxonomy framework

PART FOUR

SUSTAINABLE FINANCE IN THE DUTCH BANKING SECTOR

POSITION OF THE DUTCH CENTRAL BANK
THE ENERGY TRANSITION AS A RISK FOR FINANCIAL STABILITY

- ✓ In the view of the Dutch Central Bank, a volatile implementation of the 2015 Paris Agreement may constitute a risk for financial instability.
- ✓ The Dutch Central Bank urges Government not to stall the implementation of climate policies, in order to prevent the need for sudden and disruptive measures.
- ✓ Financial institutions are urged to incorporate measures mitigating climate risks in their risk management.
- ✓ Four scenarios for a disruptive energy transition have been identified:

Policy shock
An abrupt and significant price increase for CO2 emissions leads to a devaluation of carbon-intensive assets.

Technology shock
Advancements in green energy technology lead to a devaluation of carbon-intensive assets.

Double shock
A combination of the risks outlined above.

Confidence shock
A loss of confidence caused by ongoing uncertainty about climate policy.

POSITION OF THE DUTCH CENTRAL BANK

PRUDENTIAL REQUIREMENTS AND SUSTAINABLE FINANCE

- ✓ In the view of the Dutch Central Bank, lowering capital buffers for ‘green’ exposures could only be allowed when evidence shows that such exposures carry lower risk.

- ✓ As a member of the Central Banks and Supervisors Network for Greening the Financial System (NGFS), the Dutch Central Bank is currently involved in research on the risks associated with ‘green’ exposures versus ‘brown’ exposures. The Dutch Central Bank’s position on lowering capital buffers for ‘green’ exposures will depend on the outcome of this research.

- ✓ The Dutch Central Bank questions the effectiveness of a green supporting factor in the framework for prudential requirements as a means to boost green lending.