FRDO-CFDD SEMINAR OF 5 OCTOBER 2018: HOW TO DEFINE "GREEN" FOR FINANCING THE TRANSITION TO A CARBON-NEUTRAL ECONOMY?

REPORT AND ISSUE ANALYSIS[1]

I. REPORT OF THE PRESENTATIONS

Jean-Luc FILIPPINI (European Investment Bank, EIB) explained how the EIB has been contributing to the development of a taxonomy for green bonds. In order to ensure the transparency of the use of the proceeds from these green bonds, such a taxonomy classifies the activities financed according to their contribution to an environmental objective. This makes for the verification of the corresponding investments impacts, which is needed both for the accountability of the emitters and for the confidence of the investors.

The universal taxonomy of the EIB aims at listing activities eligible to "green" finance, i.e. specific activities selected on the basis of indicators (target values to which these activities contribute), screening criteria and screening metrics. It is called "universal" because it has the ambition to create a global comparability of the measurements that are used, and to serve as a common translation device ("Rosetta stone") for green finance, in accordance with the Joint White Paper of the EIB and the China Green Finance Committee (CGFC) of November 2017.

Maarten VLEESCHHOUWER (DG FISMA, European Commission) presented the EU Commission's proposals for a framework to facilitate sustainable investment (the "taxonomy proposal") and for low-carbon and positive carbon impact benchmarks (the "benchmarks" proposal) of 24 May 2018. He made clear that the taxonomy proposal sets up a process to determine that given economic activities are environmentally sustainable. It is not a behavioural policy tool for obliging investors to invest in these activities, and it doesn't mean that those activities that are not on the list cannot be financed. The proposed regulation obliges financial market participants offering "green" financial products to disclose how and to what extent their products finance these activities. It also obliges Member States to align their national labels on the European taxonomy.

Maarten Vleeschhouwer emphasized the dynamic character of this taxonomy, insofar as it would be regularly reviewed in light of new scientific evidence, and insofar as the screening criteria and thresholds would be tightened over time in order to comply with the increasing ambition of the targets. The taxonomy would also be science-based and rest upon the expertise of environmental and industry experts from the real economy, technology neutral, and granular. It would build on existing market practices and aim at greening the brown sector by not limiting itself to zero carbon emitting technologies.

Concerning the benchmarks proposal, he said that the existing carbon and ESG benchmarks resulting from market initiatives are not necessarily used a lot by the investors who don't trust their underlying

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methodologies that much. Legal, as opposed to market-created benchmarks would strengthen their confidence and optimize the benchmarks potential to shift capitals towards climate-friendly activities. Both the low carbon benchmark and the positive carbon impact benchmark will consist of minimum requirements (criteria to be used for selecting the assets and for weighting them) and leave room for benchmark providers to add additional features into these benchmarks. Finally, the proposal includes a transparency requirement for ESG benchmark providers, who will have to disclose with minimum contents requirements how the methodology that they use works and reflects ESG factors.

Annica COCHU (Adelphi) outlined the broader context of the various approaches for defining "green" in the context of green finance. A taxonomy that lays out exactly what is green (in) and what is not (out) in a binary manner, is only one option. A taxonomy can be universal and standard-neutral (e.g. the EIB taxonomy), and serve as a basis for a narrower EU-specific taxonomy. Another option is to develop a rating methodology, i.e. a methodology that assesses how much an activity contributes to environmental goals (performance assessment) and the scope of which could therefore be quite broad, not excluding anything per se. Process criteria can also be established. Such criteria don't describe what is green, but tell the investor how to engage with the companies that he invests in, and how to address environmental matters in order to make sure that his investment actually has an effect on the environmental performance of the company. They can be used for shareholder activism for example. Finally, a conceptual definition of green can be used. This is about specifying the environmental objectives to which green finance should contribute, and also about making reference to the importance of complying with minimum ESG standards. A conceptual definition can also be useful when it comes to activities with different shades of green, by specifying that the longer an asset lasts, the more sustainable it needs to be from the beginning, in order to contribute to the desired objectives.

According to Annica Cochu, the EU taxonomy proposal and the EU benchmarks proposal reflect these different approaches. For example, the six environmental objectives and the minimum safeguards of the taxonomy proposal (art.5 and art.13) are conceptual definitions. The benchmarks proposal reflects the rating methodology, because the benchmarks depend on the carbon impact and performance of the investee companies. The disclosure obligation of the taxonomy proposal (art.4) is an example of a process criterion.

Mireille MARTINI (Finance Watch, TEG Sustainable Finance - Taxonomy) gave further insights on the organization of the Taxonomy sub group of the Technical Expert Group on Sustainable finance and on the mandate of this group to define technical screening criteria for activities that "contribute substantially" to one of the six environmental objectives defined, while "not significantly harming" one of the five other ones. She made clear that the taxonomy would be based on the NACE classification system that is in use at the EU level, in particular by Eurostat, but with possible additions in case NACE codes are not available. The NACE is a standard classification of economic activities and the interest of using it is that it includes equivalence systems with domestic and transnational systems (correspondence metrics) and is already widely used across the financial sector. She also underlined that the taxonomy is not supposed to constrain the investors, but to provide them with clarity and to help them trust issues by avoiding greenwashing.

The work of the TEG plays a crucial role from three points of view. Firstly, it gives visibility to the sustainable finance issue in the financial community. This is very important because sustainable finance is still too much of a niche, it needs to mainstream and this is what the European Commission is looking for. Secondly, it matters to harmonize the activities financed through sustainable finance because we need to measure this financing in order to be able to evaluate investment gaps. Thirdly, through the way the TEG process has been set up, it is a very open one that consults stakeholders, widely calls for experts, and clusters the existing best practices. Knowing what is working is crucial for moving forward. We should not put down what has been done and do something else.

Asdin EL HABBASSI (BUSINESSEUROPE) presented the position of BUSINESSEUROPE regarding the taxonomy proposal. They support the main objective of the Action Plan on Sustainable finance to create a level playing field for so-called "green" financial products and to further mobilize investments in the EU to achieve sustainable growth. The action taken should accommodate the needs of both the financial market and of the real economy and not approach them separately as they are deeply intertwined.

For BUSINESSEUROPE, the taxonomy proposal raises some critical points in terms of scope, methodology and process. Regarding the scope, they recognize fear that it could be used in the future to prescribe market actors what to invest in. In their view, the link between the taxonomy and other EU legislations must be strictly defined in the proposal to avoid future ill-conceived initiatives and unintended negative impact. They also ask that the proposal does not lead to additional bureaucratic burden and ensures that SMEs and midcaps are not disadvantaged through additional direct or indirect reporting obligations. As far as the methodology is concerned, the taxonomy should harmonize existing standards rather than setting new criteria, and bring added value. Rigid and very detail prescriptions must be avoided; a kind of flexibility is essential. Finally, BUSINESSEUROPE raises the concern that the mandate given to the Commission to fix the taxonomy through delegated acts might bypass a proper impact assessment of the delegated acts which will include highly political decisions that could have a significant impact on many economic actors. Furthermore, they criticize the fact that the manufacturing industry is underrepresented within the TEG.

Maarten VLEESCHHOUWER clarified that the Commission has clearly committed that they would do impact assessments on the delegated acts before adopting them, and that they're asking the TEG to already take the possible environmental, economic or financial impacts of the proposed screening criteria into account as well. He added that the Commission is also very much in line with the fact that the taxonomy should be a translation device from existing sustainability policies and best practices.

Ariane MEUNIER (FPS Finance, International and European Financial Affairs - IEFA) is the coordinator of the Belgian Task force "BE Sustainable Finance" which has been mandated to launch a global reflection on sustainable finance and to perform technical preparation work on the different legislative proposals of the Commission. She developed how the task force is composed and how the political issues are dealt with. She highlighted that the issue of sustainable finance had links with thematic items addressed in a large number of European groups (such as financial stability, financial markets, the financing of the external action of the EU, etc.). IEFA works for the coherence of Belgium's positions in these different groups, which is very important for the credibility of Belgian representatives. Coherence also matters in terms of the contents of the principles that are defended: they should not harm other principles (fiscal stability of our States, financial stability, good governance and minimum criteria in terms of social and human rights). This is particularly challenging in the context of global financial markets. The objective is that European standards can work on international financial markets while complying with EU climate and ESG policies.

She developed the need for consistency of the investments needed to implement these policies with Belgium's fiscal constraints. The European semester is one instrument for this. The EIB and the national promotional banks have a very important role as well. The reporting of non-financial information is another essential element to implement the SDGs because the financing of projects also requires a good risk analysis based on a sufficient level of information. Banks behavior is also a point of attention. Shadow banking to some extent, and tax avoidance, clearly stand in the way of concrete action for the SDGs.

Brenda VAN TENDELOO (National Bank of Belgium - NBB) gave a comprehensive presentation on the risks related to climate change and energy transition for the financial stability. Physical risks stem from the damage provoked by weather-related events and transition risks arise from disruptions in the transition to a low carbon economy. Although physical risks are more visible, transition risks may be more important for the financial sector insofar as political actions are taken regardless of whether and to what extent the physical risks materialize. The features of these risks show that there is a very important need for an early and gradual transition. Physical risks are all the more important as political action is delayed. Drastic measures generating abrupt changes are then required but they have a stronger impact on the economy as a whole and on the financial sector.

She presented the various possible channels through which physical risks and transition risks could affect the soundness of individual financial institutions and the stability of the financial system. Both types of risks are drivers of traditional risks: credit risk, market risk, operational risk, business risk (including missed opportunities or "lagging behind" for transition risks), liquidity risk, reputation and legal risk, and underwriting risk. The supervisory community and the financial institutions are more and more aware that these risks have to be taken into account, but this does thus not necessarily mean that a new risk category has to be created. Although identifying and quantifying climate-change related risks remains very difficult, there seems to be an upward trend in economic and financial losses due to climate change and this trend is expected to increase.

The NBB has carried out a detailed analysis of the exposure of insurers and banks to these risks in Belgium. Physical risks are expected to mainly impact insurers on their liability side. Years with extreme meteorological events typically come with higher combined ratios for the non-life insurance sector. Reinsurance can act as a buffer, however this could cause a systemic risk because of the interconnectedness between Belgian insurers and European reinsurers. Physical risks on the asset side of both insurance companies and banks seem limited insofar as their portfolios are little exposed to the risks of vulnerable countries. However, this analysis doesn't take the important discrepancies in physical risks between regions within a country into account (lack of granularity). Transition risks for banks and insurance companies are proportional to their corporate loans, bonds and equities in energy intensive sectors (Banks: 30%; insurance companies: 23%).

Prudential regulators and supervisors have an important role in that context. Supervisory requirements would be established following a waterfall structure:

1) Reporting and disclosure: Prudential regulators and supervisors could enhance reporting and disclosure, thereby addressing the current lack of high quality and sufficiently granular data and information. Reporting and disclosure is also necessary for non-financial firms!
   For this to happen a common taxonomy is needed (EU Commission proposal).
2) Risk assessment: Climate-related risks could be included in the supervisory risk assessments and the institutions supervised could also be required to include them in their own risk assessments (ERA: Environmental Risk Analysis). Potential tailored capital add-on (Basel pillar 2)
3) Only in a final step a green supporting factor and a brown penalizing factor could be introduced if and to the extent that they reflect a risk differential supported by evidence (Basel pillar 1). However, the improvement of the green market infrastructure (taxonomy, disclosure) should be preferred to green supporting factors for supporting green finance.

There are Important points of attention in setting supervisory requirements. Prudential regulation needs to remain risk-based. Although it should not hamper other measures designed to incentivize sustainability, its role is not to stimulate sustainable behavior. Maintaining a sound financial sector is crucial for the support of the transition towards a more sustainable economy. Prudential requirements also require a clear taxonomy (what is green/sustainable?)

Brenda VAN TENDELOO closed her presentation by sketching out the NBB short term action plan, which includes a survey on climate-related risks and practices in the Belgian financial sector (banks and insurers). She highlighted that the NBB intends to raise awareness with their questionnaire and also, to the extent possible, close the data and information gap.

Veerle DE SCHRYVER (Financial Services and Markets Authority – FSMA) reported that investors and asset managers are asking for a better understanding of sustainability-related issues in order to ensure that capital is allocated according to the preferences of their clients or beneficiaries. The lack of transparency resulting from limited access to relevant information and from insufficient comparability of this information, is an important obstacle for investors and consumers who want to put money or invest in sustainable activities, or simply understand sustainability risks. Therefore, sustainability is on the agenda of the FSMA for 2018 and 2019. The FSMA monitors both financial actors and financial products.

As far as financial actors are concerned, the FSMA controls the reporting of non-financial information by listed companies (art.119 §2 of the Belgian Companies code). A questionnaire has been sent to the Belgian institutions for occupational retirement regarding, among others, the consideration of climate change risks in their risk management and the integration of ESG criteria in their investment policies (2d pillar). A distinct questionnaire is going to be sent to Belgian retirement savings funds (3d pillar). Veerle DE SCHRYVER added that the results of these surveys would be made public under an aggregated form. She also said that for a number of institutions the quality of the information produced could be improved.

In terms of control of financial products, the FSMA intervenes in the context of the procedures set up under the Markets in Financial Instruments Directive (MiFID 2) to ensure that adequate financial products reach the corresponding target market. This includes the preferences and needs of their clients/beneficiaries, for example for “green” or “ethical” investments. The FSMA is also responsible for controlling the information being made available to the public concerning the marketed products. In this context, the FSMA asks for certain information to be provided in the documents that are subject to its approval (pre-contractual and contractual documents): a warning if the money is not specifically and directly allocated to activities complying with sustainability criteria (for structured products), the selection method applied, the company in charge of the ESG assessment, etc. According to the FSMA, a product cannot be called “sustainable” if its investor is not really exposed to assets that comply with sustainability criteria. This may be uncertain for structured products: in order to consider that the underlying funds comply with sustainability criteria, minimum requirements must be met (use of “filters” reducing the investment universe, of an independent rating entity, etc.).

Anne LECLERCQ (Belgian Debt Agency) reported on the Belgian Debt Agency’s experience of the issuance of the green bond of 26 February 2018. She situated the green OLO within the issuance of Belgium, the green bond market, and the total bond market. She outlined the process of this bond, from political traction and feasibility study to impact reporting.

The green OLO has several benefits: it underlines the Belgian commitment towards a more environmental friendly economy, catalyzes other sovereign issuances and should incentivize other Belgian public or private issuers. Notwithstanding the scarcity of green assets in the bond market, there was only limited price traction: investors are happy to invest in green assets but they don’t want to pay for “green”. From a debt manager point of view, one issue that still needs attention is that the process is very cumbersome for a small amount of financing.

According to Anne LECLERCQ, Further questions to be discussed are the creation of separate bonds to finance other ESG objectives and a green rating of sovereign and private issuers in order to stimulate additionality and decrease the total cost of their issuance.

Pierre-Emmanuel NOEL (European Investment Bank – EIB) recalled that the EIB had invented the green bond with their “climate awareness bond” in 2007. That’s why it is deeply involved in the development of the EU taxonomy. In terms of financial volume, EIB financing in Belgium is about 2 billion of which 25% is climate-related. In addition to its lending activity, the EIB also acts as advisor to the public authorities on different matters relating to investing and sometimes on green investing, and provides grants for example in ELENA agreements. In Belgium, the EIB has been at the forefront of financing the transition (offshore wind, smart cities, inland water ways, etc.).

EIB teams are composed of engineers and environmental specialists who assess the carbon impact of all the projects financed by the EIB as part of its duty of due diligence. For issuing a green bond, the EIB bundles different projects that meet the requirements of its taxonomy. But the EIB doesn’t have the resources to screen every SME that it finances. In that case, for the sake of consistency, the EIB says that its SME financing is zero climate.

Pierre-Emmanuel NOEL concluded his presentation by making reference to the first "sustainability awareness bond" that the EIB launched in September 2018.

II. ISSUE ANALYSIS

A – ISSUES RELATED TO THE TAXONOMY PROPOSAL AND TO THE BENCHMARKS PROPOSAL

1. Activity level vs. company level

- The taxonomy is economic activity based. Financial products (equities and bonds) are not only activity based but also company based. How can the taxonomies then apply ? (seminar participant from a Belgian bank and Annica Cochu)
- Quid companies that have both green and brown activities? (Brenda Van Tendeloo)
- We can use thresholds for funds. For example, in the French TEEC label, 50% of an equity fund has to go to companies where 75% or more of the revenues come from taxonomy activities (notion of gradation) (Maarten Vleeschhouwer)
- "This proposal provides the basis to establish the environmental sustainability of economic activities, rather than that of companies or assets … However, the uniform criteria for environmentally sustainable activities will permit to determine the degree of environmental sustainability of a given company, for the purposes of investment …Those companies that perform several activities and only some of them are environmentally sustainable, may have different degrees of environmental sustainability, that can be determined, for instance, based on the proportion of turnover that originates from sustainable activities as compared to other activities" (Taxonomy proposal, explanatory memorandum p.12).
- It is easy to say that an activity is sustainable or not sustainable, but if you move to company level, things become much more complicated because obviously a company has 10 or more activities and the relative share of each of these activities is very hard to get. The "degree of sustainability" of a company is to me something which is very hard to put in practice (Pieterjan Debergh)

2. Capital markets but also bank credit

- The scope of the Commission's proposal is limited because it is made under the Capital Markets Union. The financing of the EU economy is 80% bank credit but only 20% capital markets.
- EIB's work is intertwined with the "Green Bonds Principles" (ICMA) and those inspired the "Green Loan Principles" of March 2018. Of course it is not a copy-paste but indeed the idea is that the taxonomy might serve the full spectrum of finance to the economy. The green bond market is still a niche, a specialized market, even if it is expanding. We want to scale it up but we also want to face the urgency of financing (closing the investment gap of EUR 180 million a year). Greening the economy is a walk on two legs, capital markets and bank financing. The taxonomy must not be restricted to capital markets (Jean-Luc Filippini).
- Banks are also very important players. Bank credit, nor only investors and market players, play an important role (Tom Van den Berghe)

3. **Transition taxonomy vs. "gold standard"**

-The taxonomy should help brown sectors becoming more green. But how far should it go in creating and supporting this transition? Will it be possible for example to classify investments into more sustainable activities of brown industries as sustainable investments? Will the do-no-harm principle or the technical assessment criteria be sufficient to address such controversies, to create the necessary trust and to avoid greenwashing, which is the main concern of the industry at the moment? And, if yes, if such activities would be possible, if it would be allowed for example to call a filter for a clean coal plant "sustainable", will this be good, or not? Will this trigger broader changes by addressing also those that are considered brown, or will this dilute the signal behind the taxonomy, increasing the policy risk for investors, because of changes that need to be expected in the taxonomy in the future? Overall this debate is quite prompt to instrumentalization, so it depends on who speaks. So it will be crucial that the TEG and the sustainable finance platform work towards neutrality on this matter (Annica Cochu)

- Maybe green**<u>er</u>** should be supported, making progress BUT consider potentialrisks of products not turning out to be as green as initially expected (**greenwashing**) … (Brenda Van Tendeloo)

4. **Green finance vs. sustainable finance**

-Sustainable finance is something else than green finance. Just transition and socially sustainable finance is also a key issue in Europe (Nadine Gouzée).

- It is essential that this EU initiative leads to mobilization of investments in support of economic and ESG goals and I was happy that the question was brought up because we always switch from sustainable to green. We would prefer to have a holistic sustainability approach which means also considering economical, and social and governance aspects (Asdin El Habbassi)

- The taxonomy should be designed according to a holistic approach. If something is sustainable in terms of climate it doesn't automatically mean that it is sustainable in terms of environmental and other factors. This should be kept in mind to avoid undermining the overall objective (Asdin El Habbassi)

- Issue of what is sustainable and what is green, confusion between green growth and sustainable growth. Sustainable growth is desperately needed and not understood at all. Lack of perception of what a holistic approach can be in terms of activities. The Commission comes with a project that is called "sustainable growth" but that is only on "green growth" actually. Their only answer is that social issues can wait, they come later. But in the EU social issues are terribly pressing! (Nadine Gouzée)

- Clarity is important on this issue. Personal comment: There are people who believe that GDP growth can be decoupled from emissions and there are people who think that in order for emissions to decrease, GDP should decrease. It's a big question (Mireille Martini, personal comment)

- The TEG is going to work first on climate sustainability: technical screening criteria for the first two objectives: adaptation and mitigation. Then later it is going to work on environmental sustainability: under this regulation, this means the four other environmental objectives. But the first work has envisaged minimum social standards. It is a wrong view to believe that the social issue is postponed to five years. The delegated act cannot deliver something that is climate-friendly but completely independent from the social issue (Mireille Martini).

5. **FEBELFIN quality standard**

-Art.3 of the taxonomy proposal (criteria for environmentally sustainable activities) sets up that the activity is carried out in accordance with the minimum safeguards laid down in Article 13 refers to the 8 fundamental conventions identified in the ILO declaration on Fundamental Rights and Principles at Work. The FEBELFIN standard will make the safeguards a little bit broader (inclusion of Tobacco, coal). We are trying to make some bottom line (Tom Van den Berghe)

6. **Need to reflect the taxonomy into the ratings**

-The taxonomy is clearly relevant to define what is being financed, but certain questions still need to be clarified: Which additional mechanisms might be required? A rating system is potentially interesting but further research would also be required for example on how to use the taxonomy for such a rating (Annica Cochu)

- Link between the taxonomy and the benchmarks proposal: The Commission had initially considered a link, but the Regulatory scrutiny board (RSB) told that it was premature and that the possible consequences of adding the taxonomy as a feature of the benchmarks couldn't be overseen. Therefore, there is no link so far between the benchmarks proposal and the taxonomy proposal (Maarten Vleeschhouwer).

- General application of one taxonomy. The taxonomy should be used everywhere. I heard this morning that the benchmarks would not follow the taxonomy. This is quite strange for us (Tom Van den Berghe)

7. **Need to define "brown" activities**

- We welcome the work done by the European Commission but we would actually even go further and we would also want to have a taxonomy for what are the brown sectors and what is risky investments (Brenda Van Tendeloo)

- If the evidence is there, there could be interest for the brown penalizing factor. Significant step forward of the NBB (Frank Vanaerschot)

-How could we finance the brown sector's decarbonization ? Decarbonizing a sector focuses on carbon emissions and specific technologies. For example, a technology to decarbonize cement could be in the taxonomy (if it would really decarbonize it). The benchmarks are more at company level and portfolio level. It will be quite challenging to only take these activities; it will be calculated at a more macro-level (Maarten Vleeschhouwer)

8. **Niche vs. mainstream**

<u>Overall consideration</u>

Process criteria could have an effect on greening the economy by raising awareness especially by companies that need further greening, through either active and intended exchange such as through signaling and shareholder activism, or through unintended exchange where for example ESG rating agencies request information to build/to assess the performance of the company, thereby causing the company to reflect on this topic. So we think that process criteria are definitely worth further consideration. This would also be applicable to untargeted financing or general financing which is not purpose-specific. But essentially the impact on greening the transformation would depend on the uptake of such criteria by investors: would a label provide sufficient incentive for them to actually use such criteria, or not?

A rating methodology would also be applicable to the wider investment universe and would trigger action of the company to improve their rating but several aspects are still to be clarified. So would an EU-wide rating methodology on environmental sustainability hamper market initiatives? And how feasible and how easily could this be used? Would it lead to maybe over-generalization, also between the different asset classes? (Annica Cochu).

<u>Taxonomy proposal</u>

- What is the dream world for the taxonomy: a mainstream tool that will be used by the large part of the financial world or just a minor tool for those who want to be the best in class for climate change (a niche) ? (Participant from a Belgian bank)

-This taxonomy alone will not be a silver bullet. It is gonna be a list for investors – retail or institutional: clarity that they know that their investment is green and contributes to the 6 environmental objectives. There's a huge demand for this clarity: it will attract more financing and improve financing conditions but you really have to see the taxonomy as a part of the overarching Action Plan (10 major actions). The taxonomy is one of the steps but we need all of the steps to make sustainable finance more mainstream. Of course the taxonomy will only be on the green, not on how you manage ESG risks for example. We need to look at the whole picture of what we've announced and what we want to implement. That Action Plan when implemented fully will make the financial sector a lot more sustainable (Maarten Vleeschhouwer)

<u>Benchmarks proposal</u>

-Stakeholders said that we should have stricter disclosure requirements on all benchmark providers, not only on ESG benchmark providers. The Commission has chosen to limit the disclosure requirements to ESG benchmarks but this is a controversial issue (Maarten Vleeschhouwer).

9. Stranded assets - Grandfathering

- Need for impact assessment for addressing issues such as stranded assets (Mireille Martini)

- Secretariat: Stranded assets are a risk for financial stability and the financial regulators have a role to prevent that risk. Can the national bank also consider options to mitigate the financial impact of stranded assets?

- Brenda Van Tendeloo: We would want the transition to be as smoothly as possible. When we have abrupt changes this is where real risks come above. The regulator plays a very important role here: decisions are taken quite fast but we need to make sure that the impact is not too big. And for the rest we need to make sure that banks are considering these risks. Banks may not be reducing their exposures immediately but maybe think in the long term that maybe they should reduce their exposures to these asset classes that could become stranded.

10. Issues for the TEG

a. The life cycle dimension

   -There are some doubts whether the proposed taxonomy enables to assess the types of the whole value chain, e.g. life cycle analysis (Asdin El Habbassi).

   - Is anything really green? Cfr. Solar panels taking into account entire life cycle, electric cars, .. (Brenda Van Tendeloo)

b. Policy lines

   -If you want to take care also of minimum social standards, you need to consider the origin of the components, how they have been extracted, etc.: the full carbon, environmental and social footprint must be considered. This means that basically some choices, some lines will have to be drawn (Jean-Luc Filippini)

c. Impact assessments and other considerations

   -Need for impact assessments for addressing issues such as stranded assets and liquidity of the financial market (Mireille Martini)

   -No unreasonable costs (Mireille Martini)

   - No discrimination of activities within one sector (Mireille Martini)

   - DG ENV of the EU Commission continues to work on environmental accounting (Thomas Verheye)

d. Forward-looking elements

   The criteria should maybe also reflect qualitative and future-forecast factors such as the development and innovation potential and not only determine the degree of sustainability based on the past investment like in the current approach (1sdin El Habbassi)

   What about forward looking elements, for example investments in innovation? (Pieterjan Debergh)

   The taxonomy is not at all in terms of new or old technologies but in terms of thresholds (for example for the transport sector: the emissions per km) (Maarten Vleeschhouwer)

e. Economic indicators

   Discussion on the NACE. The way the economic indicators are now constructed is not necessarily fully compatible with biodiversity and environmental protection challenges that we have ahead of us. To say it in simple terms, we don't know how much water we are using. The only water that is measured in the current economic system is the water that is paid for. We have an idea of how much water we are using because scientists are observing the soil, so they know how much the dam is going down, but the models don't say it because in our models anything that is free, that is not paid for, doesn't exist. So there is a huge issue of changing these codes. But this is not the work of the TEG and this was a personal comment (Mireille Martini)

f. Data availability

   The lower availability of information to evaluate sustainability, especially for SMEs, must not become a barrier for their economic activities to be classified as environmentally sustainable. Therefore, the screening criteria should take account of the lower data availability, especially for SMEs (Asdin El Habbassi)

g. <u>Baselines</u>

- Vincent van Steenberghe: For developing the taxonomy we have to measure reductions in greenhouse gasses. These reductions are measured on a baseline/reference level. Starting points can be very different from one country to another (e.g. measuring improvements in a country with a large gas power station). How do you plan to deal with such difficulties? Gradual implementation of the taxonomy? (Vincent van Steenberghe)

- Maarten Vleeschhouwer: That's one of the questions that the TEG will need to look into. We don't foresee that we have geographical differences in terms of the technical screening criteria but it is a very good question and people may disagree. It is definitely something that we need to look into more and consider more, but our initial thinking was that we should not have that (activities need to "contribute substantially" to the objectives). It doesn't mean that things that are outside of this list can't happen, cannot be financed.

EIB universal taxonomy: Once a primary indicator has been agreed upon preferably on a global basis, metrics can be adapted to local requirements and preferences (Jean-Luc Filippini)

-The EIB universal taxonomy is adaptable to different situations but at the end of the day the drawing line has to be made also by the policymaker (Jean-Luc Filippini)

B – CROSS-CUTTING ISSUES

1. The need for additional finance

- Investors are happy to invest into green assets but they don't want to pay for green (Anne Leclercq). New money is needed because there is an investment gap (180 billion a year up to 2030 for the EU climate and energy policy).

- Whether or not new investments would be sought depends on whether such investments bring a net benefit to the investor or borrower (e.g. in the form of increased investor base or better financing conditions (Annica Cochu).

- A "green rating" for states, possibly on the basis of the EU taxonomy, would stimulate the sovereigns' efforts towards additionality in order to improve their green rating. This would decrease the total cost of their issuance (Anne Leclercq).

- For companies, better financing conditions for a sustainable project can serve as an incentive to implement such a project (Annica Cochu).

- Example: Credit rating models such as the ING sustainable investment loan (Secretariat)

- Mixing public and private finance is one option for promoting additional financing. The EIB and the national promotional banks can play a role here (Ariane Meunier, Frank Vanaerschot).

- The European taxonomy will help shift existing investments towards sustainable activities but it will not attract more investments than that (Tom Van den Berghe).

2. The lack of available data, the cost of reporting and corporate disclosure

<u>On the importance of reporting</u>

-There is an overall demand for high quality and sufficiently granular data on the activities of companies and on their financing by the financial sector. Among other things, this is useful for:

- Assessing investment gaps (Mireille Martini)

- A more efficient allocation of capital through an improved pricing mechanism (Veerle De Schryver, Brenda Van Tendeloo)
- Risks and opportunities identification and management by individual enterprises and financial firms (Veerle De Schryver)
- A better monitoring and assessment of risks within financial institutions by supervisors (Brenda Van Tendeloo).

- The NBB plans to send a survey on climate-related risks by banks and insurers. One of the objectives is to close the data and information gap but the NBB is totally aware that for the time being, probably a lot of institutions don't have much information regarding these risks (Brenda Van Tendeloo).

- The results of this survey will be reported in the NBB financial stability report. The NBB sees this survey as a tool for raising awareness and also for identifying "out liars", not in terms of specific institutions, but in terms of specific actions that might be taken. Green finance and transition risks are project-based and activity-related more than sector-based (Hans Dewachter).

- One of the reasons for sending such a survey is that green finance and climate-related risks are very much "orthogonal" to the reporting schedules and schemes that banks and insurance companies are basically delivering (Hans Dewachter)

- The FSMA carries out surveys on the integration of ESG by the pension funds (see above p.5).

- The FSMA is in charge of the application of Art.119 §2 of the Belgian Companies code (transposes the EU NFRD). Companies active in the field of ESG have to include information on ESG issues in their management reports from 2018 onwards. These reports are public. The sanction for companies not doing so would be the publication of the information required (Veerle De Schryver).

<u>On the cost of reporting</u>

- The EIB finances SMEs but says that this financing is "zero climate" because they don't have the resources to scan every SME's activities (Pierre-Emmanuel Noel).

- EU taxonomy proposal should not lead to any direct or indirect additional reporting duties, nor disproportionate cost increases as companies already disclose a wide range of information in the scope of their financial put SMEs and midcaps at a disadvantage insofar as they would have additional reporting duties. Due to their limited capacities these companies already have less reporting duties (SMEs and midcaps up to 3000 employees). Any additional cost should be avoided. Moreover, the lower availability of information to evaluate sustainability by SMEs must not prevent their economic activities to be classified as environmentally sustainable (Asdin El Habbassi).

- The idea of the EU Commission is obviously not to burden SMEs with huge reporting requirements. This would be disproportionate. But it is addressed by the text of the taxonomy proposal (explanatory memorandum p.8, rectitals pars (9) and (29) and Art.15 para 2(b)) (Mireille Martini).

- For SMEs, a part of the reporting could be required not at the level of the company itself but at the level of the “donneur d’ordre” of the purchaser, somewhere else in the supply chain (Mireille Martini).

3. **The need for economic policy measures**

-On a national level it can be said that a simple definition of green is probably not going to trigger the wider economy to uptake such a definition and to work towards it, but what is actually needed is a clear policy signal to be provided through measures that address the real economy but also the financial sector, e.g. to maybe establish labels such as for example the Febelfin sustainability standards for advising retail investors (Annica Cochu)

- The role of the financial sector will always be limited. There should be more investments, but ultimately we need real economy policies from governments for the transition of the industries (Maarten Vleeschhouwer)

- The financial sector can never be a substitute for real economic policies in the different sectors. It cannot be the financial sector alone that will make us go to the Paris Agreement. It plays a major role and we want to enlarge that role but it doesn’t come in place of the ETS etc. One of the big elephants in the room is of course carbon pricing (Jean-Luc Filippini).

4. **Asset managers (structured products or “funds of funds”)**

-We think that you do not have to have a 100% investment in sustainable funds in order to be a “sustainable fund of funds”. A share of 80% would be enough for the FSMA. But there are probably 2 levels: 1) The documentation of the fund clearly shows that it is meant to be sustainable, 2) If it is not clear from the investment policy of the fund itself then you have to go through and look what is really happening on the basis of the portfolio of the underlying funds. But this is the approach of the FSMA. I would prefer to have a European vision on this. We are also contributing to the work of ESMA (Veerle De Schryver)

5. **Savings accounts**

-Most of the money is on savings accounts and we don’t see many sustainable savings accounts yet. So I think there is also a job to do for developing sustainable savings accounts. I know that there has been a restriction on the number of savings accounts that banks can have, but I think we really need sustainable savings accounts as well (Sebastien Mortier)

- The legislation should change on this point (savings accounts) (Veerle De Schryver)

- We have in Belgium EUR 260 bn on savings accounts. That money will not be activated by the taxonomy (Tom Van den Berghe).