Sustainable finance – ensure stability and usability

Summary

In May 2018, the EU Commission published four legislative proposals. The common goal of these extensive detailed regulations is to systematically integrate sustainability issues into the investment process.

On 18 June 2019, the Technical Expert Group on Sustainable Finance (TEG) published its reports on taxonomy, green bonds and benchmarks. Although the taxonomy has not yet been finalised, the technical review criteria for 67 activities in eight sectors that contribute to reducing climate change has already been presented in the report on the EU taxonomy[1] along with case studies for investors preparing for the taxonomy. The TEG's recommendations should help the EU Commission with the development of the delegated legal acts.

The fpmi believes that a stable, sustainable finance and insurance sector in Europe is essential and unquestionable – as is a climate protection commitment from companies in the real economy and financial sector. National and Europe-wide initiatives must always be viewed in the context of international competition. Just as climate change is global, today's economy is also organised and interconnected on a global scale. As a result, the fpmi appeals to members of the European Parliament, representatives in the Directorates General of the EU Commission and members of national governments in the EU Council of Ministers not to go it alone and place an excessive burden on European companies and/or entire industry sectors in terms of worldwide competition. The fpmi also proposes the use of tried-and-tested economic and monetary policy instruments such as public lending by development banks in order to achieve Europe's sustainability goals. These tools are proven and should be expanded.

While the fpmi welcomes political efforts to create an even more sustainable finance industry, it notes that the sector is already mobilising private investment for sustainable purposes such as climate and environmental protection or providing financing for infrastructure projects.[2] With regard to the specific draft legislation planned, the fpmi asks that the following **principles** be taken into account when discussing new regulations:

1. **Europe-wide fundamental principles and minimum standards with regard to environmentally sustainable economic activity and its standardised classification system ("taxonomy") should be developed in close cooperation with the real economy and financial sector.** Otherwise, the international competitiveness of numerous sectors could be undermined over the long term. This means that every step towards an appropriate system

---

[1] TEG report on EU taxonomy, downloadable from https://ec.europa.eu/info/files/190618-sustainable-finance-teg-report-taxonomy_en.

[2] This is evident in the market for "green" bonds, which reached a total volume of USD 155 billion in 2017 (Green Bond Highlights 2017, Climate Bonds Initiative, January 2018). The EU Commission calculated an annual funding gap of EUR 175-290 billion to reach the EU's 2030 targets, while the TEG report (Footnote 1) calculated an annual funding gap of EUR 90-628 billion – taking into account hypothetical regulatory measures, e.g. promoting renewable energy, increasing the building renovation rate and ecodesign standards. The larger the gap, the higher the proportion of loan financing required to close the gap compared to bond financing (approx. 75% loans with a EUR 90 billion gap, approx. 93% loans with a EUR 628 billion gap).

This is a summary of the key statements.
The full position paper is downloadable from www.fpmi.de.

must be carefully coordinated with the affected parties and tested in transitional and trial periods. An appropriate level of manageability should take priority when designing the taxonomy.

2. **Sustainability targets must not counteract stability goals in the financial sector.** A one-sided preference for "green" investments and/or discrimination against "brown" investments could lead to flawed risk management incentives and misallocations on the capital markets and could therefore compromise financial stability.
3. **The Environmental, Social and Governance (ESG) Criteria used by the EU Commission must be considered together and as a whole.** The EU Commission's current focus on environmental aspects should be expanded soon to include the other two criteria in order to ensure a general overview and accommodate the complexity of the economy.

If these three principles are taken into account, the fpmi believes that this will lead to the following **specific requirements** that should comply with European legislation:

1. **Introducing a generally applicable "green supporting factor" is unsuitable** for adequate risk assessment and management. As a result, flat discount rates for "sustainable risk assets" to reduce the capital requirements for banks should not be provided in either the standard (KSA) or ratings-based (AIRB) approach. In the case of insurance companies, this kind of flat-rate relief would lead to non-risk-based allocation of capital. Individual risk must always remain the benchmark for capital requirements. The principle of proportionality must be maintained when designing new requirements for management and the disclosure of sustainability risks. The scope and level of detail of new regulations must correspond to the size and risk profile of small and medium-sized credit institutions. These institutions should not be burdened by excessive bureaucracy.
2. **Client advisory services must not be overloaded with regulatory requirements**. Obligating banks, insurance companies and financial advisers to enquire about sustainability targets in client meetings is not recommended. Consultations must not be overburdened further with formal, substantive requirements; instead, they should be freed from bureaucracy. In fact, the focus should be on providing advice based on the client's actual interests (e.g. public services).
3. **An undifferentiated expansion of the requirements for disclosing the climatic factors of non-financial corporations will lead to excessive bureaucracy.** For the real economy and smaller companies in particular, the costs of this must not result in competitive disadvantages on an international level. National gold-plating, e.g. via the CSR Guidelines Implementation Act (*CSR-Richtlinie-Umsetzungsgesetz*), should be ruled out. Appropriate disclosure only makes sense if sustainability issues are essential to the commercial success of the company. Guaranteeing a generous timescale for implementing the disclosure obligation is extremely important for all companies. In light of this, the financial industry also relies on relevant information to meet future risk management requirements and enable it to support sustainable capital allocation.
4. **Existing remuneration rules for the variable salary components of senior management at banks and insurance companies take the issue of sustainability into account by incentivising positive long-term business development.** For many companies, ESG criteria are already part of their long-term corporate strategy. Rather than adding value,

integrating ESG criteria into existing remuneration rules would water down remuneration policies and their risk relevance.

5. **The taxonomy should be designed in a lean and flexible way** to ensure that small and medium-sized businesses in particular can use it without a great deal of bureaucracy; on the other hand, it must be clear enough to effectively prevent “greenwashing”. It must also take into account companies’ individual sustainability strategies and transformation paths as well as sustainability-based strategies along the value chain.
6. **This taxonomy, with quantified criteria for determining the sustainability of a company’s business activities and investments, is of such fundamental importance that it must be defined by European lawmakers.** Its development must not be left entirely to the EU Commission in ancillary legislation.