



2018/2007(INI)

2.2.2018

DRAFT REPORT

on sustainable finance
(2018/2007(INI))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

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The European Parliament,

- having regard to the G20 commitment to sustainable growth under the German presidency from 1 December 2016 to 30 November 2017, with particular reference to the statement: ‘we will continue to use all policy tools – monetary, fiscal and structural – individually and collectively to achieve our goal of strong, sustainable, balanced and inclusive growth, while enhancing economic and financial resilience’,
- having regard to the Commission’s commitment to sustainable investment in this regard in the Capital Markets Union (CMU) plan and specifically the findings of the High-Level Expert Group (HLEG) on Sustainable Finance,
- having regard to the HLEG interim report of July 2017 entitled ‘Financing a Sustainable European Economy’, which outlines the tension between short-term profit seeking behaviour and the need for long-term investment in order to meet the environmental, social and governance (ESG) targets, and in particular to point 5 on the financial system and policy framework risks succumbing to the ‘tragedy of the horizon’ on page 16¹,
- having regard to page 14 of the HLEG interim report, which states that Europe’s investors have a combined exposure to carbon-intensive sectors of roughly 45 % and that less than 1 % of global institutional investors are green infrastructure assets,
- having regard to the fact that prudential frameworks, in particular Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), and accounting rules for investors discourage a long-term approach, and that prudential rules require a level of capital proportional to the level of risk over a one-year horizon and only take financial risk into consideration for the calculation of capital requirements,
- having regard to Article 173 of French Law No 2015-992 of 17 August 2015 on Energy Transition for Green Growth,
- having regard to both the speech of 22 September 2016 by Mark Carney, Governor of the Bank of England and Chair of the Financial Stability Board, and the Carbon Trackers Initiative report of 2015, with particular reference to the fact that the combined market capitalisation of the top four US coal producers had fallen by over 99 % since the end of 2010,
- having regard to page 9 of the E3G discussion paper of May 2016 entitled ‘Clean Energy Lift Off – Capitalising Europe’s Energy Union’, with particular reference to the fact that from 2008 to 2013 the top 20 energy utilities in Europe saw over half of their

EUR 1 trillion market value wiped out,

- having regard to Carbon Tracker Initiative reports of 2015 and 2016 which indicate that another USD 1.1 to USD 2 trillion fossil fuel capex is at risk of stranding, with USD 500 billion in the Chinese power sector alone,
- having regard to the OECD Responsible Business Conduct for Institutional Investors guidelines of 2017, in particular page 13, which states that ‘investors, even those with minority shareholdings, may be directly linked to adverse impacts caused or contributed to by investee companies as a result of their ownership in, or management of, shares in the company causing or contributing to certain social or environmental impacts’,
- having regard to the OECD paper of 2017 entitled ‘Responsible Business Conduct for Institutional Investors: Key Considerations for Due Diligence under the OECD Guidelines for Multinational Enterprises’,
- having regard to Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (Non-Financial Reporting Directive – NFRD)¹, and in particular Articles 19 and 19(a) and Recitals 3, 6, 6(a) and 6(b) thereof,
- having regard to Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (the Shareholders Rights Directive)²,
- having regard to Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (the IORPs Directive)³,
- having regard to Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC⁴,
- having regard to Article 8(4) of Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (the PRIIPs Regulation)⁵, which states that when a packaged retail and insurance-based investment product (PRIIP) has a demonstrated environmental or social objective, the manufacturer has to demonstrate to the potential retail investor and wider stakeholders how those objectives are met throughout the investment process,
- having regard to Regulation (EU) 2017/2402 of the European Parliament and of the

¹ OJ L 330, 15.11.2014, p. 1.

² OJ L 132, 20.5.2017, p. 1.

³ OJ L 354, 23.12.2016, p. 37.

⁴ OJ L 182, 29.6.2013, p. 19.

⁵ OJ L 352, 9.12.2014, p. 1.

Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (the STS Regulation)¹,

- having regard to the suggestion from Triodos Bank of ‘model mandates’ which contain the requirement of full integration of environmental, social and governance factors in investment decisions, active engagement and voting on these issues, the choice of sustainable benchmarks, less frequent but more meaningful reporting by asset managers and a long-term oriented fee and pay structure,
- having regard to the British Government’s reinterpretation of fiduciary duty, which weakens the link to maximum returns and allows for ethical and environmental issues to be considered,
- having regard to China’s dominance in the issuance of green bonds and to the need for a European definition of a green bond that includes social as well as ecological criteria,
- having regard to the Principles for Positive Impact Finance developed by the United Nations Environment Programme Finance Initiative (UNEP FI),
- having regard to the UNEP Inquiry into the Design of a Sustainable Financial System,
- having regard to the Climate Bonds Initiative report of 2017, which shows how bonds are being used to transition to a low-carbon global economy,
- having regard to the UNEP Inquiry report of 2016 which finds that several national financial regulators are already performing or preparing sustainability assessments and such initiatives should be rapidly mainstreamed at EU level, and with reference to the point that such analyses should build on standardised climate scenarios, including one in which a rise in global temperatures is kept well below 2 °C,
- having regard to the recommendation in the HLEG interim report of July 2017 that the Commission should conduct a sustainability test on all financial legislative proposals,
- having regard to the Commission communication on the midterm review of the CMU action plan and its clear statement that: ‘The Commission supports alignment of private investments with climate, resource-efficiency and other environmental objectives, both through policy measures and public investment’ (COM(2017)0029),
- having regard to the Bundesbank report of April 2017 and the Bank of England Quarterly Bulletin of 2014 Q4, which state that most money in circulation is created by the private banking sector when banks make loans,
- having regard to Article 2(1)(c) of the Paris Agreement on the need to make ‘finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development’,
- having regard to the Financial Stability Board report of June 2017 entitled

¹ OJ L 347, 28.12.2017, p. 35.

‘Recommendations of the Task Force on Climate-related Financial Disclosure’,

- having regard to the work by the European Systemic Risk Board (ESRB) on the risks of stranded assets,
 - having regard to the European Court of Auditors Special Report No 31 of 2016, which found that, despite the EU making a political commitment under the current budgetary period 2014-2020 to spend one euro in every five (20 %) on climate-related purposes, it was not on track to meet that commitment, since current programming would account for only around 18 %,
 - having regard to the Bankwatch Network briefing of May 2017 which found that in 16 EU Member States European Investment Bank (EIB) support for climate action did not reach even the level of 20 % and that climate action investment in 2016 was predominantly located in the EU’s stronger economies, with 70 % of European Fund for Strategic Investments (EFSI) support for renewable energy being concentrated in Belgium, while 80 % of energy efficiency investment through the EFSI was allocated to France, Finland and Germany,
 - having regard to Rule 52 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs (A8-0000/2018),
- A. whereas the power of finance can and should be used to facilitate the transition to a sustainable economy in the EU which extends beyond the climate transition into other areas of ecological crisis;
- B. whereas the Paris Agreement requires a rapid transition that calls for urgent funding; whereas, according to the HLEG report of July 2017, the funding gap to deliver Europe’s decarbonisation efforts is almost EUR 180 billion, excluding other sustainable development goals;

The role of finance in facilitating the transition to a sustainable economy: risks and opportunities

1. Stresses the potential of a faster green transition as an opportunity for orienting capital markets towards long-term, innovative and efficient investments; notes that environmental, social and governance (ESG) benefits and risks are not reflected in prices and that this provides a market advantage to unsustainable and short-termist geared finance; stresses that a political and regulatory framework to govern sustainable finance is overdue;
2. Stresses that the financial sector as a whole and its core function of allocating capital to benefit society should be governed by the values of equity and sustainability; emphasises in that respect the instrumental role of economic, fiscal and monetary policy in fostering sustainable finance by facilitating capital allocation to decarbonised and resource-efficient economic activities which are able to reduce the current need for future resources and thereby capable of meeting EU sustainability goals; insists that a substantial price for greenhouse gas emissions is a key component of a functioning and

efficient environmental and social market economy;

3. Emphasises the massive systemic risks that stranded carbon assets represent to financial stability; stresses the need for the identification and mandatory reporting of these assets as essential to the orderly transition to climate-positive investments; calls for the introduction of ‘carbon stress tests’ for banks and other financial intermediaries to determine the risks related to such stranded assets;
4. Calls on the Member States, in coordination with the Commission and the EIB, to evaluate their national and collective public investment needs to ensure that the EU is on track to meet its climate change goals within the next five years;

Putting ESG factors at the heart of EU financial decision-making and establishing an EU sustainability taxonomy

5. Calls on the Commission to lead a multi-stakeholder process to establish by the end of 2019 a robust and credible green taxonomy, including a ‘Green Finance Mark’, through a legislative initiative;
6. Recommends that this taxonomy include three levels:
 1. a minimum standard aligned with the Paris Agreement and the do-no-harm principle in accordance with ESG risk analysis;
 2. an intermediate level identifying activities that are demonstrably achieving a ‘Positive Impact’ as defined by the UNEP FI;
 3. a level including activities that can accelerate a positive transformation and support ecological regeneration;
7. Welcomes the recent inclusion of sustainability issues in the PRIIPs and STS Regulations, as well as in Shareholders Rights Directive and the NFRD; applauds the inclusion in the IORPs Directive of recognition of stranded assets; asks for the transversal integration of sustainable finance criteria in all legislation related to the financial sector;
8. Asks the Commission to adopt a regulatory strategy aimed *inter alia* at measuring sustainability risks within the framework of capital adequacy rules; stresses that capital adequacy rules must be based on and fully reflect demonstrated risks; aims to initiate an EU pilot project within the next annual budget to begin developing methodological benchmarks for that purpose;
9. Emphasises that disclosure is a critical enabling condition for sustainable finance; applauds the work of the Taskforce on Climate-related Financial Disclosure (TCFD) and calls on the Commission and the Council to explicitly endorse its recommendations; urges the Commission to include mandatory disclosure in the framework of the revision of the Accounting Directive and the NFRD;
10. Insists that fiduciary duty should be extended to encompass a mandatory ‘two-way’ integration process whereby asset managers are obliged to consider ESG factors and

clients are asked about their timeframe and sustainability preferences;

11. Calls on the European Supervisory Authorities (ESAs) to develop guidelines for model contracts between asset owners and asset managers, which would clearly incorporate the transmission of the beneficiary interest as well as clear expectations as regards the identification and integration of ESG risks on behalf of the asset manager;
12. Asks that stewardship form an integral part of the legal duties of investors to be reflected through disclosure of major holdings, engagement activities, the use of proxy advisers and the use of passive investment vehicles;
13. Notes the lack of a robust, reliable and uniform definition for reporting in the framework of the NFRD and the need to define the most strategic ESG metrics for each sector or sub-sector; calls on the Commission to create EU-wide multi-stakeholder groups to establish a list of metrics covering the most significant sustainability risks as part of a pilot project on this matter;
14. Notes the urgent need for a uniform standard for green bonds; insists that such green bonds should include periodic reporting on the environmental impacts of the underlying assets; underlines that green bonds should also respect negative criteria and must not include any form of fossil fuel asset, nuclear power or investment in aviation infrastructure;
15. Notes that existing credit-rating agencies do not integrate the influence of disruptive ESG trends in issuers' future credit-worthiness; calls for clear EU standards and supervision regarding the integration of ESG factors in ratings for all credit-rating agencies operating in the EU; calls for the establishment of an accreditation process for a 'Green Finance Mark' by certifying agents supervised by the European Securities and Markets Authority (ESMA);
16. Calls on the Commission to establish a legally binding labelling system for personal bank accounts, investment funds, insurance, and financial products indicating their level of conformity with the Paris Agreement and ESG goals;
17. Intends to further clarify the mandate of the ESAs so that it includes ESG risks; calls on ESMA to update its 'suitability' guidelines to include ESG issues and on the three ESAs to introduce a monitoring system to assess material ESG risks beginning in 2018 and with a forward-looking climate scenario analysis; favours the extension of the ESAs' mandate to include checking portfolio alignment with the Paris Agreement and to ensure consistency with the TCFD recommendations;
18. Notes that the EIB has a mixed record on climate action; insists that the EIB should only agree to future lending that is compatible with a 1.5 °C climate limit;
19. Calls on the ECB to redesign its purchase programmes in order to rebalance and align its portfolio with an investment policy that is consistent with the Paris Agreement and ESG goals; underlines that such redesign may act as a pilot for establishing a future sustainability taxonomy;

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20. Instructs its President to forward this resolution to the Council and the Commission.

EXPLANATORY STATEMENT

Introduction

The vast majority of investment and lending is not compatible with internationally agreed climate objectives or environmental, social and corporate governance criteria. The Paris Agreement has provided a new impetus to decarbonise our economy and yet the Parliament does not yet have a common understanding on how the financial system can be reformed in a way that accelerates rather than deterring this transition. It has been estimated by the Commission that realising the Sustainable Development Goals will require annual investments in sustainable infrastructure worth 4.7-6.7 trillion Euros¹.

At the very same time we see abundant capital seeking a profitable investment opportunity. The key to solving the riddle of sustainable finance is to creating an information and incentive framework so that this capital flows in the direction of the investments necessary to ensure a rapid and just ecological transition for our European economies and societies. This would allow Europe to maintain its leading position in tackling climate change and reinforce that the EU is driven by strong values while giving European businesses a competitive advantage.

The Current Status Quo

The urgent need to respond to the threat from climate change has led to innovation in the field of sustainable finance in different EU member states. The French law of disclosure; German leadership in the field of public investment in the energy transition; the Bank of England's timely action in encompassing the threat to financial stability from stranded assets; the Swedish FSA's ambitious agenda to integrate sustainability into its daily work; and the consideration of the threat to pensions and insurance from the tragedy of the horizon by the Netherlands. The aim of the European Parliament should be to take the best from this innovation across our Union and to combine it into minimum standards for all, guiding investment to ensure a just and rapid transition towards a sustainable economy and society.

Between 60 and 80 per cent of the coal, oil and gas reserves of publicly listed companies are 'unburnable' if the world is to have a chance of keeping global warming well below 2°C and as closely as possible to 1,5°C as agreed at the COP21 in Paris. This means in practice that a very substantial source of global systemic risk - in the form of what has been called 'the carbon bubble' - is currently embedded within EU and global financial markets. This means that, in practice, the business model of the 'carbon economy' as a whole depends on rent extraction and ultimately of implicit subsidies as the costs associated with these risks are pushed forward to the future whereas current market players benefit from a present call on future resources.

Climate change is merely the most pressing of the multiple and interconnected ecological crises threatening the future of humanity. Further examples include the exhaustion of water supplies and pollution of the water-table; deforestation and loss of habitats; soil degradation

¹ Financing Sustainability, Issue 25, 8 June 2017:
https://ec.europa.eu/epsc/sites/epsc/files/strategic_note_issue_25.pdf

and the threat to food supplies; weakening of the nitrogen and phosphorous cycles; ocean acidification; ozone depletion. So far sustainable finance and the risk to financial sustainability from stranded assets has encompassed only climate risks and this is the main focus of this report. This is only a first step and future work on sustainable finance needs to include consideration of the wider ecological crisis and we welcome the attention paid to the risks posed by intensive farming in the HLEG final report.

The Rapporteur's proposal

As pointed out by central banks (BoE, Bundesbank¹), most money in circulation is created by the private banking sector, when banks make loans. This grants immense power to the banking sector in deciding the allocation of money in the economy, even before it is taxed or saved. This power is currently being concentrated by an oligopolistic banking sector, which naturally pursues for the most part a profit-seeking agenda, to the detriment of environmental and social goals. While market deficiencies should be corrected by introducing market mechanisms such as climate-risk disclosures, we should also rebalance this extensive power by empowering a more decentralized and resilient banking system, in parallel with a strong public banking network in Europe.

Where this fails, or is too slow, the role of public financial institutions and governments is essential. Given the current pace of the development of green finance and clean energy investments, the objectives of the Paris agreement are unlikely to be reached without additional efforts. We cannot afford to wait for the private sector to shift its investment profile towards practices that are compatible with the 2° trajectory. This underlines the urgent need for more ambitious and decisive action by public authorities to accelerate the speed of investment, in particular in green infrastructure and to address the misallocation of capital away from sustainable and long-term value creation.

Public authorities should have the confidence to take a stronger role in financing the green transition and to show leadership to the private sector to scale up the necessary investment capacity for the energy transition. A synergistic relationship between Member States, the EIB and the ECB's asset purchase programme could offer positive developments along these lines. We should also acknowledge the leading role played by cooperative and community finance in pioneering green investments.

We welcome the final report from the High Level Expert Group on Sustainable Finance and applaud its level of ambition. Our report lends political support to their recommendations and we thus seek to convey to the Commission and Council our firm belief that the citizens of the EU look to them to show global leadership in this area and to use the power of money to enable and accelerate the stabilisation of the climate and the protection of the global ecosystem for the sake of current and future generations.

¹ https://www.bundesbank.de/Redaktion/EN/Topics/2017/2017_04_25_how_money_is_created.html