
16 July 2020

EBA Response to European Commission's Consultation on the Renewed Sustainable Finance Strategy

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):

- 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;
- ✓ 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? [BOX, 2000 characters]
- Do not know.

SECTION II: QUESTIONS TARGETED AT EXPERTS

“The following section asks further technical and strategic questions on the future of sustainable finance, for which a certain degree of financial or sustainability-related expertise may be useful. This section is therefore primarily addressed 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?

Quantifying the economic losses of not acting now to mainstream sustainability can be a hard endeavour. Notwithstanding the methodological and data challenges that exist, some simpler, clearly defined and standardised metrics (with the necessary caveats) would support the gradual but firm integration of sustainability into financial decision-making, hence avoiding that ‘the perfect becomes the enemy of the good’.

Having said that, the first challenge relates to the promotion of internationally consistent disclosures that support the identification, assessment and measurement of sustainability risks. Combined with the further development of commonly-agreed standards, metrics and taxonomies (see Q.14 and Q.82), such disclosures would support the availability of higher-quality comparable data.

Second, the impact of environmental risks (e.g. second-order effects, ‘tail risks’, multiple equilibria) is difficult to capture using standard risk management techniques and currently available historical data. Scenario analyses are a very important tool to better understand the potential consequences of the climate-change transition. Having common frameworks for the design of climate-related scenarios (e.g. assumptions, drivers of the transition and its distribution across time, geography, sector, etc.) would contribute to lowering costs of ongoing individual efforts, while fostering the comparability of results, therefore better grasping the systemic risks stemming from environmental threats. Public institutions could play a leading role in developing such frameworks.

Thirdly, there is relatively strong competition for multi-disciplinary sustainable finance skills (e.g. financial, legal, environmentalist). Finally, further international cooperation to promote regulatory convergence at international level would help preventing potential negative spill-overs from policy fragmentation and limit arbitrage opportunities (see also Q.77).

Regarding opportunities, the earlier institutions start considering how sustainability may impact their business, the higher their chances to build know-how, engage with clients and increase or at least maintain their customer base. In addition, by generating a stable long-term value in many cases, sustainable investments provide opportunities for the banking sector to prosper and tackle the crucial issue of stranded assets – i.e., the need for banks to shift their investments away from certain assets in the long run. Finally, given its key role in financial intermediation, the European banking sector is well-placed to support the re-allocation of capital needed to reach the Paris Agreement goals. By doing so, banks will enhance their corporate and social responsibility, contributing to the achievement of a common global goal and align their business with the

prevailing policy environment. An important opportunity for mainstreaming sustainable finance can be how the recovery after the COVID-19 crisis is managed.

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?

On top of the challenges mentioned in Question 6, there are some policy/regulatory factors hindering the development of sustainable finance and the integration of ESG risks in financial decision-making. Many of these factors are reviewed in the EBA's 'Report on undue short-term pressure from the financial sector on corporations' (2019), whose main conclusion is that, despite the limited concrete evidence of short-termism, which could be labelled as 'undue', there is room and a desire to promote long-term approaches and the integration of ESG risks into the institutions' financial decision-making.

The current financial and strategic planning horizons of EU banks may not be sufficiently tailored to the integration of long-term challenges -such as the transition to a sustainable economy. Based on the available information, these time horizons seem to be mostly around 3-5 years, reflecting inter alia (i) profitability pressures and shareholders' interest, (ii) accounting rules and (iii) supervisory requirements (e.g., SREP framework, ICAAP, funding plans, supervisory stress tests etc.) and (iv) longer-term uncertainty (e.g. difficulties in pricing long-term loans, uncertainty about the availability of long-term funding, etc.).

A framework for enhanced and standardised disclosures of ESG-related information, by both corporations and banks, would have several advantages, including the potential to lengthen time horizons for decision-making processes. Policy actions should focus on setting principles or requirements ensuring comparability, relevance and reliability of disclosures, while striking the right balance between EU efforts and the international dimension of financial markets on one side and between larger and smaller companies capacity (proportionality principle). Specific actions could include amending the Non-Financial Reporting Directive (NFRD) (see reply to question 14).

Moreover, sustainability considerations could be further integrated in directives and regulations applicable to the banking sector (e.g. CRD and CRR). For instance, having more specific sustainability related governance provisions would also support building sufficient ESG expertise inside the regulated entities, which is currently lacking in many cases. In this respect, the different mandates that have been extended to EBA - inter alia under the CRR (Article 434a, Article 449a and Article 501c), the CRD (Article 98(8)), the IFD (Article 35) and the Regulation for ESG disclosures for financial services - will be instrumental to support the full incorporation of ESG risks by the banking sector (see Q.88 and Q.102).

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?

- Yes, institutional investors
- Yes, credit institutions
- ✓ Yes, both
- No
- Do not know

[N.B. The draft RTS on ESG Disclosures, Article 10 “References to international standards”, requests to “include a description of the adherence of the financial market participant to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement, including at least forward-looking climate scenarios”.]

Question 13: In your opinion, which, if any, further actions would you like to see at international, EU, or Member State level to enable the financing of the sustainability transition? Please identify actions *aside from* the areas for future work identified in the targeted questions below (remainder of Section II), as well as the existing actions implemented as part of the European Commission’s 2018 Action Plan on Financing Sustainable Growth.

A principal challenge to scaling up environmentally sustainable investments and delivering on the objectives of the Paris Agreement relates to the profound structural, socio-economic changes that will be required in the global economy. The gradual alignment of customers and investors’ preferences towards sustainable products and activities may fail to adequately address the distributional effects associated with the transition towards a green economy. Environmental (physical and transition) risks and adaptation and mitigation measures are most likely to impact low-income economies, which may struggle to reduce carbon emissions, with potential negative spill-overs on other countries. Poorly coordinated national responses can exacerbate the distributional effects associated with climate change and calls for the strengthening of international coordination mechanisms.

From a different perspective, the EBA’s ‘Report on undue short-term pressure from the financial sector on corporations’ includes a number of more specific, non-regulatory actions, at EU or Member State level, that could help to enhance data availability and information flows as well as the awareness of long-term sustainability challenges. For instance, structured platforms or networks for exchanges between a range of stakeholders, including banks and corporates, could be developed at the EU and/or national levels. Such dedicated structures should help in sharing expertise (e.g. on the financial relevance of ESG factors in general and for specific sectors), facilitating information flows (e.g. on the financial instruments that could incentivise corporates to shift towards the adoption of sustainable business models) and raising awareness (e.g. on the benefits of long-term thinking/actions and the costs of short-termism). While the banks’ role in performing a neutral (un-biased) risk assessments of sustainable investments should not be

hampered, such structures would contribute to a better understanding across sectors of the long-term risks that could affect the robustness of corporates' business models.

Similarly, in order to facilitate information flows across sectors and improve the availability of data, the Commission could consider (i) promoting initiatives from the private sector that would aim to facilitate data access and comparability (e.g. industry associations' benchmarks), (ii) improving the communication channels between the public and private sectors in order to facilitate the dissemination of information, especially on the public regulatory roadmaps and long-term governmental policies, for example related to the implementation of the Paris Agreement. These actions would also facilitate long-term risk analysis (e.g. use of common transition scenarios) and support longer term strategic thinking and decision-making.

Additionally, we see as important to integrate ESG impact assessments as an integral part of policymaking at the EU level and Member States level. Such an assessment could guide policy makers in evaluating potential environmental impacts (and social impacts) of their policies. For instance, based on the EBA Regulation the EBA shall in its activities take into account the integration of environmental, social and governance related factors. Having specific responsibility to conduct the ESG impact assessment of all relevant public policy makers would support public policies becoming more sustainability oriented.

1. Strengthening the foundations for sustainable finance

"In order to enable the scale-up of sustainable investments, it is crucial to have sufficient and reliable information from financial and non-financial companies on their climate, environmental and social risks and impacts. To this end, companies also need to consider long-term horizons. Similarly, investors and companies need access to reliable climate-related and environmental data and information on social risks, in order to make sound business and investment decisions. Labelling tools, among other measures, can provide clarity and confidence to investors and issuers, which contributes to increasing sustainable investments. In this context, the full deployment of innovative digital solutions requires data to be available in open access and in standardised formats."

1.1 Company reporting and transparency

Question 14: In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

- ~~Yes/No/Do not know.~~
- If yes, please explain how it should be structured and what type of ESG information should feature therein.

One of the recommendations to the European Commission in 'EBA report on undue short-term pressure from the financial sector on corporations' (December 2019) is to improve the information flows in this field. We are of the view that the EU should take action to support the development of a common, publicly accessible, cost-free environmental data space for companies' ESG

information. This is important to disseminate information and to build relationships between banks and corporates in relation to the materialisation of ESG risks in financial returns and the overall financial framework in the long-run.

More specifically, the EU should play an active role setting up a centralised database at the EU level on environmental data. It could account for the EFTG project ESG data mainly from non-financial statements but also could be used for financial purposes. Such a database could combine existing environmental statistical data already collected at national level with centralised ESG information from companies, including data reported under the NFRD.

The EBA has already encouraged institutions to act proactively in incorporating the ESG considerations into their business strategies, risk management, internal controls and decision-making processes, and encouraged them to disclose ESG information. While this would raise awareness amongst the clients of these institutions, a further EU-wide action is needed in order to facilitate corporates' efforts to evolve so to manage the ESG risks that may affect their business models in the future.

The EU can publish for example a guidance or a blueprint to allow such data initiatives to harmonise at Member State level and if needed set up an EU-wide platform for this purpose. Such an EU-wide centralised database can be built on the current industry experience and practices, e.g. industry associations' benchmarks, and leverage on existing public sector bodies such as the Eurostat. The database would include environmental data that could be used for financial purposes. This database should be transparent in its' methodology to enable clear understanding of the ESG results, facilitate improving performance in this field and recognised by the public as relevant and objective. It should retain the flexibility to utilise additional indices or other relevant information if needed.

By leveraging on shared efforts to set up a common data base for environmental data it would be a unique opportunity to include other ESG key metrics in order to facilitate the implementation of regulatory guidelines to integrate ESG profiles into sustainable finance practices in Europe.

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?

- ~~Yes/No/do not know.~~
- If yes, what is in your view the most important area (please provide details, if necessary):
- Impairment and depreciation rules. [BOX, 2000 characters]
- Provision rules. [BOX, 2000 characters]
- Contingent liabilities. [BOX, 2000 characters]

- Other, please specify. [BOX, 2000 characters]
- The EBA report on undue short-term pressure from the financial sector on corporations (December 2019) refers to industry criticism of the current accounting standards, as encouraging a prioritisation of short-term objectives rather than the long-term orientation needed for the management of climate and environmental risk.
- However, the new accounting standards have been introduced to address certain shortcomings in financial stability such as ‘too little too late’. They have been designed also to attenuate the reliance on short-term considerations. Credit institutions should consider a wide range of information when applying ECL accounting models (past, current information and future projections).
- The EBA report (and relevant studies mentioned in the report) found no evidence to suggest that the fair value measurement and ECL measurement approach under IFRS would result in distortions of the investment process triggering undue short-term pressures in financial markets. There is no evidence yet on the consequences of the implementation of IFRS 9 on long-term investment practices, yet it is important to continue assessing its impact and monitor its implementation.
- In addition, the IASB has confirmed that IFRS Standards (implicitly) cover climate change risks and other emerging risks (if material and relevant for the financial statements) in “IFRS Standards and climate-related disclosures” (November 2019).

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 European level
- Yes, at a national level
- No
- Do not know
- If necessary, please explain the reasons for your answer [BOX 2000 characters]

The third party verification is a central element of the transparency, of the integrity and of the credibility of the EU GBS label. Therefore, we consider it essential that the third party verifiers are subject to a dedicated EU accreditation and supervisory framework (e.g. performed by ESMA) and

based on a harmonised regime comparable, for example, to the regime applicable to the supervision of the credit rating agencies.

In addition, an EU regime for third party verifiers would avoid market fragmentation in terms of regulation and supervision. It would provide greater clarity to both verifiers and issuers (especially for those operating on a cross border basis). It would also ensure a fair competition across the different segment of the market, which is fragmented into four types of actors (audit companies, non-financial rating agencies, traditional credit rating agencies and other certification bodies) that are currently subject to different regulatory and supervisory regime.

However, when defining the EU accreditation and supervisory regime for third party verifiers of EU green bonds, the Commission should ensure that it is not overly complex to avoid potentially high costs (e.g. compliance fees) that might result in a barrier of entry for small providers and in a high level of concentration in the market.

Question 23: Should any action the Commission takes on verifiers of EU Green Bonds be linked to any potential future action to regulate the market for third-party service providers on sustainability data, ratings and research?

- Yes / ~~No~~ / ~~Do not know~~
- If necessary, please specify the reasons for your answer

Although the assessment performed by third party providers in the context of the EU green bonds differ from the assessment made with regard to ESG data and ESG rating (the latter being, by construction, less specific and targeted), the two types of assessment are likely to be performed by the same entities and to rely, to a certain extent, on the same tools and methodologies.

The market for third party providers of sustainability tools is expanding very quickly and in a disorderly manner, especially given the high level of competition in ESG rating. Several studies also highlighted that the correlation between the ESG ratings of a given company may be very low from one rating provider to another. Such an environment is very confusing for investors or other users of these ratings. Against this background, we consider that the measures to be defined for the EU green bonds certifiers in terms of due diligence processes, transparency, conflict of interest and market abuses would be also relevant for the third party service providers of sustainability tools.

Question 24: The EU GBS as recommended by the TEG is intended for any type of issuer: listed or non-listed, public or private, European or international. Do you envisage any issues for non- European issuers to follow the proposed standard by the TEG?

- Yes/ ~~No~~ / ~~Do not know~~
- If necessary, please specify the reasons for your answer [BOX 2000 characters]

We welcome the broad scope of application recommended by the TEG. A wider geographical scope is necessary to make the EU GBS attractive and competitive in the international bond market.

We do not see any major issues for international issuers to follow the proposed standards; however, it is unclear how the taxonomy and the use of proceeds will apply in an international context. For instance, where a non-EU institution issues the bond and the proceeds are used outside the EU, it may be challenging to verify the due allocation of the proceeds and to assess their environmental impact.

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)
- 4
- If necessary, please specify the reasons for your answer [BOX, 2000 characters]

The inclusion in the prospectus of a standardised and legally binding information regarding the use of the proceeds will certainly increase the consistency and the comparability of the green bonds instruments. It will also help reduce the risk of green washing, as issuers will not be able to market the bonds as green and neglect the EU GBS rules without facing legal impediments. A clear legal basis under the Prospectus Regulation will ensure that the bonds remain green during the life of the transaction and will require issuers to communicate this information regularly to investors.

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 [BOX]

We consider that such specification will not suffice to ensure the protection of investors. The main purpose of the prospectus is to gather in a single, standardised and legally binding document all the information needed by the investors so that i) they are fully and easily aware of the characteristics of the product, and ii) they can make a clear and well documented comparison between existing instruments in the market. These overarching principles embedded in the prospectus are essential to avoid asymmetry of information and to ensure a well-functioning of the market. The green feature of the bond is a fundamental component of the product. Therefore, it should be included in the prospectus in a form that is legally binding such as an incorporation by reference pursuant to Article 19 of the Prospectus Regulation to include key information disclosed by issuers that voluntarily adopt the EU-GBS.

Question 29: Should the EU establish a label for investment funds (e.g. ESG funds or green funds aimed at professional investors)?

- Yes/No/Do not know
- If necessary, please explain your answer [BOX, 2000 characters]

To date, ESG funds and green funds marketed across Europe are very diverse (due to various legal structures) and not always sufficiently clear on their ESG criteria.

As a result, a label could be beneficial to improve transparency and market discipline, to strengthen the confidence of investors into the ESG quality of the funds' portfolio and to avoid green washing. Such a label would be particularly relevant for institutional investors willing to expand their green investments but that are often limited due to i) a very prescriptive investment mandate from their members/ stakeholders often linked to capitalisation market index as benchmark and ii) a strong preference for standardised products.

However, we do not see at the moment a pressing need to develop a label for professional investors given the adoption of the new disclosure framework, we also consider that such a label for professionals should be developed once the label for retail investors is fully in place and experience is develop in this area.

- If yes, regarding green funds aimed at professional investors, should this be in the context of the EU Ecolabel?

Given that an Ecolabel is under development for retail financial products, we see merit in assessing whether the label for professional investors could set under the similar framework. Although green financial products for professional investors may significantly differ from the ones addressed to retail investors, (e.g. in terms of complexity, risk profile and due diligence requirement) we consider that the proposed framework for retail clients can constitute a good starting point.

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).
- 3 (neither agree nor disagree)
- If necessary, please explain. [BOX, 2000 characters]

Sustainability-linked bonds are still emerging products. It is too early at this stage to assess the extent to which they may become a useful complement to the well-established 'use of proceeds'

approach, although in principle these bonds could offer strong incentives to the issuers to improve transparency and to enhance global sustainable business behaviour.

We would recommend that the Commission waits for the market to gain further knowledge and understanding on the risks and opportunities attached to these instruments and see how the market is growing, before it decides on the opportunity to produce an EU standard for these new types of bonds. Several market analysts and associations are currently analysing the development of these bonds. Based on the outcome of these analyses, the market may issue guiding principles and market standards as it did for green bonds. These could constitute an interesting starting point for the Commission.

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. [BOX, 2000 characters]

Should an EU standard for sustainability-linked bonds be developed, EBA would recommend the Commission to align it, to the greatest extent possible, with the EU taxonomy and to use the relevant KPIs. This alignment is necessary to guarantee the consistency of the EU framework for sustainable finance and to ensure an even level playing between the EU green funding instruments.

Question 32: Several initiatives are currently ongoing in relation to energy-efficient mortgages¹ and green loans more broadly. Should the EU develop standards or labels for these types of products?

- ~~Yes/No/Do not know.~~
- If yes, please select all that apply:
 - a broad standard or label for sustainable mortgages and loans (including social and environmental considerations);
 - ✓ a standard or label for green (environmental and climate) mortgages and loans;
 - ✓ a narrow standard or label only for energy-efficient mortgages and loans for the renovation of a residential immovable property;
 - other: please specify what type of standard or label on sustainability in the loan market you would like to see [BOX, 2000 characters]

¹ See for instance the work of the EFIG (Energy Efficiency Financial Institutions Group set by the EC and the United Nations Environment Program Finance Initiative or UNEP FI) on the financial performance of energy efficiency loans or the energy [efficient mortgages initiatives](#).

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/No/Do not know.~~
- If no, please explain the reasons for your answer, if necessary. [BOX, 2000 characters]
- If yes, please explain what the key elements of such a benchmark should be. [BOX max. 2000 characters]

The setting of an EU ESG benchmark requires evaluation of environmental, social and governance profiles which entails more technical assessment, compared to that implied by the climate benchmarks. Although it is very challenging to incorporate all the components of the ESG factors into a single benchmark that would be meaningful for all EU investors, we deem this expansion as necessary. There is a market demand for broad investable and reliable EU ESG benchmarks to serve as the foundation for ESG products and to allow investors to construct a comprehensive ESG strategy for asset allocation.

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?

- ~~Yes/No/Do not know.~~
- If yes, what should they cover thematically and for what types of financial products? [box max. 2000 characters]

Green covered bonds

Covered bonds in general have been an efficient source of long-term funding for EU real estate assets and public infrastructures due to their specific features and regulatory regime that make them attractive to investors and issuers.

In that context, green covered bonds could be useful instruments to scale up green finance. Although, the market is relatively small in the broader context of the covered bond market, its growth could be significant due to a number of factors comprising:

- banks focusing increasingly on green lending,
- market initiatives aimed at improving transparency and disclosure around green assets including energy efficiency mortgages and;

- the potential expansion of the covered bond framework to new asset classes as part of the recently adopted EU Covered Bond Directive.

However, sustainable finance has not been reflected yet in the EU covered bond framework. For example, the directive does not specifically refer to green assets or the green use of the proceeds. In addition, the EU GBS might be too generic to capture for the specific features of the EU green covered bonds. For example, the EU GBS allows all type of institutions to issue EU green bonds (including non-EU bodies), while the issuance of EU covered bonds is restricted to credit institutions subject to EU regulation and supervision.

Therefore, a specific framework for green covered bonds could be desirable:

- to clarify the interaction between the EU GBS and the EU covered bonds directive;
- to specify the definition of the EU green covered bonds: There is no single definition of green covered bonds. This term is currently used in the market for instruments i) collateralised by green eligible covered bonds assets or ii) which proceeds are allocated to invest in green assets; or iii) where condition i) and ii) are both met. Such clarification is necessary as the EU GBS has focused on an use of proceed approach.
- to create potentially a label for green covered bonds backed by standardised energy efficiency mortgages and which proceeds are used to generate new green assets. We would expect such label to stimulate green loan origination of EU credit institutions and to incentive the more risk avert investors to enter into the green market.

Building on the EBA's experience in the development of the EU framework for covered bonds, the EBA stands ready to contribute to the potential framework for green covered bonds.

Standardised EU infrastructure bonds

Following the call for advice of the Commission to the EBA on the European Secured Note, the EBA made a detailed analysis on the relevance of an EU instrument to fund infrastructure projects (Link). The assessment concluded that there could be a business need in Europe to create a new distinct class of funding instrument in the form of an EU standardised infrastructure bond, whose structure would be similar to an off-balance sheet single recourse instrument. In particular, a standardised infrastructure bond secured by EU infrastructure loans transferred and segregated into an SPE, and offering EU credit institutions some degree of capital relief through risk transfer, might be suitable and should be considered by the European Commission.

The EBA considers that this work could be relevant for the funding of green infrastructures in Europe especially in these specific circumstances where public authorities are getting more and more financially constrained. As advised in the EBA report on the European Secured Note, the EBA would invite the Commission to continue the work and to issue another call for advice for the EBA to specify further the potential framework for this standardised instrument, taking into account, in particular, the EU Commission New Green Deal.

1.5 Capital markets infrastructure

Question 35: Do you think the existing capital market infrastructure sufficiently supports the issuance and liquidity of sustainable securities?

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).
- **3 (neither agree nor disagree)**
- For scores of 1 and 2, please list the main problems you see (maximum three). [BOX, 2000 characters].

Markets infrastructures are not fully suited to allow access to small market players. While this issue is not specific to sustainable finance, it is very pressing in that segment because the transition to a low carbon economy needs the involvement of all the economic actors. SMEs and retail clients are also the ones currently facing the largest green funding need.

Access of small market players to funding via capital markets is not easy to facilitate due to the costs of entry. This is why we deem necessary that the EU sustainable finance framework also allows for a good functioning of banking intermediation through for example green securitisations (see Q.54-56) and green covered bonds (see Q.34), which could provide an efficient indirect way to SMEs and retail clients to access funding for their green projects.

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/No/Do not know.**
- If yes, please indicate what share. [box 2000 characters]

The CRD and the EBA Guidelines on sound remuneration policies and practices specify clear principles on remuneration policies for staff whose professional activities have a material impact on the institution's risk profile to reflect sound and effective risk management. In particular, remuneration policies should be aligned with the long-term interests, business strategy, objectives and values of the institution. Hence, institutions that have adopted sustainability objectives should apply remuneration policies that are consistent with such objectives.

The proportion of variable remuneration is limited for these categories of staff, with a maximum ratio of variable to fixed remuneration of 100% (or 200% with shareholders' approval, where implemented by the Member State) under directive 2013/36/EU. The amount of fixed remuneration must be sufficiently high to ensure that the reduction of the variable remuneration down to zero would be possible. Staff should not be dependent on the variable remuneration award, as this might create incentives for short-term-oriented excessive risk-taking, including the mis-selling of products.

However, variable remuneration can provide for positive incentives on staff members to pursue the goals of the institution, while enabling them to share in its success. It is also an element of cost flexibility for institutions. Provided that the long-term interests of the institution are taken into account and there is no incentive to assume inappropriate or excessive risks, an appropriate level of variable remuneration can benefit all stakeholders of an institution.

Pursuant to the CRD, in order to ensure that the risk-adjusted performance is appropriately reflected in the variable remuneration, institutions need to measure risks and performance and use a mix of different qualitative and quantitative (e.g., including, where relevant, ESG) criteria for their measurement to ensure that overall the assessment outcome is appropriate and weaknesses of single criteria are counterbalanced (for example in case of ESG, criteria should not encourage potential green washing). The criteria must be set by institutions (based on their characteristics, business model, activities performed and risks taken by staff members, etc.) and might include also ESG factors.

In addition, the remuneration assessment should be set in a multi-year framework to ensure that the assessment process is based on longer term performance, and that the actual payment of performance-based components of remuneration is spread over a period that takes account of the underlying business cycle of the institution and its business risks.

Building on the above, we would recommend that financial institutions consider sustainability indicators when taking into account the long-term interests of the institution in the design of their remuneration policies and its application.

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

“Increased opportunities need to be provided to citizens, financial institutions and corporates in order to enable them to have a positive impact on sustainability. Citizens can be mobilised by providing them with opportunities to invest their pensions and savings sustainably or by using digital tools to empower them to make their communities, their homes and their businesses more resilient. Financial institutions and corporates can increase their contribution to sustainability if the right policy signals and incentives are in place. Furthermore, international cooperation and the use of sustainable finance tools and frameworks in developing countries can help build a truly global response to the climate and environmental crisis. As part of the European Green Deal, the Commission has launched a European Climate Pact to bring together regions, local communities, civil society, businesses and schools in the fight against climate change, incentivising behavioural change from the level of the individual to the largest multinational, and to launch a new wave of actions. A [Consultation on the European Climate Pact](#) is open until 27 May 2020 in order to better identify the areas where the Commission could support and highlight pledges as well as set up fora to work together on climate action (including possibly on sustainable finance).”

2.1 Mobilising retail investors and citizens

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. **[4]**
 - 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]
 - 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]
 - Directly, through targeted campaigns. [1-5]
 - As part of a wider effort to raise the financial literacy of EU citizens. **[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. **[5]**
 - Promote the inclusion of sustainability and sustainable finance in the curricula of students, in particular future finance professionals. **[4]**
 - Other, please explain.[box max. 2000 characters]

Increased literacy and transparency about the environmental and social impact of financial activities considerations is key. It would not only help financial consumers/investors to improve their understanding about the financial risks and opportunities on which they may incur -hence helping them to make informed choices-, it would also foster corporate and societal awareness and behavioural changes, as needed to achieve sustainable goals.

Regarding finance professionals, given the significant role they play providing advice for the allocation of capital in the economy, integrating sustainable finance in their curricula and training programmes seems warranted. A sustainable finance curricula for finance professionals is also needed to ensure that institutions can hire necessary human capital/expertise to be able to adequately integrate sustainability considerations into their business strategies, risk management frameworks, stress testing and disclosures.

As for citizens, raising sustainable finance awareness and knowledge would help them to understand better the purpose of their investments and the risks intrinsic across the lifetime of the specific financial product. Understanding the sustainability features of financial products is not a

trivial task, particularly for retail investors. Investors/consumers are likely to lack understanding of the implications of these relatively new set of risks, whose impact is not immediate but occurs over a relatively long time. Hence, like with any other characteristics of financial products, investors should have access to high-quality information on the sustainability features of their investments, provided at the appropriate time and via suitable means.

Regarding education, modules or targeted campaigns to promote sustainable finance literacy could be considered in the curriculum for secondary education, complemented with targeted campaigns. Sustainable finance could also become part of standard training curricula for financial professionals. Member States' competences for education should be, however, respected.

2.2 Better understanding the impact of sustainable finance on sustainability factors

Question 52: In your view, is it important to better measure the impact of financial products on sustainability factors?

- Please express your view by using a scale of 1 (not important at all) to 5 (very important).
- 4
- For scores of 4 to 5, what actions should the EU take in your view? [BOX max. 2000 characters]

Assessing the potential impact of financial products on environmental and climate-related factors, in terms of timing, magnitude and potential socio-economic repercussions, is very challenging.

Notwithstanding these difficulties, there are several reasons to support a better measurement of the contribution of financial products to the achievement of sustainability objectives. First, it would support a more accurate pricing of financial products (e.g., based on the expected value of current and future returns), hence improving customer protection and reducing legal risks. Second, it would allow investors and savers to distinguish between financial products, supporting a more efficient allocation of capital in the economy and the achievement of sustainability goals. Third, a more explicit link between products and sustainability goals would increase the general awareness (through improved transparency) among investors and market players. Fourth, a better understanding of the impact of financial products on sustainability objectives would enable the banking industry to identify those financial activities with a higher exposure to ESG risks, hence contributing to a better assessment of the overall risks and opportunities faced by the institution. Finally, in order to support sustainable economic growth and financial stability, estimates on the contribution of financial services to the achievement of sustainable goals should become available, just as for any other production sectors.

Question 53: Do you think that all financial products / instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities?

- ~~Yes/No/Do not know.~~
- If no, please explain what you would consider to be the most impactful products/instruments to reallocate capital in this way. [box max. 2000 characters]

In the context of the EU banking framework, green bonds have a bigger capacity to fund sustainable projects than shares. Within the regulatory framework, own funds are necessarily raised for general purposes. They should be also available to absorb any type of losses as they arise (going concern capital) or in case of insolvency (gone concern capital). Therefore, the ring fencing concept usually attached to green issuances is not compatible with the fundamental definition of own funds provided in the CRR.

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. [box, max. 2000 characters]

For many years, the development of the green securitisation market has been limited by the lack of available green assets; but there is now a critical mass of green assets to make green securitisation possible, especially in Europe where many jurisdictions have committed to departing from petrol transportation and to providing significant public support to mortgage energy efficiency upgrades.

Green securitisation could have a primary role to play in financing green projects because it:

- Improves funding access to green projects: A large number of green loans (e.g. rooftop solar photovoltaic, energy efficiency upgrades, electric/hybrid vehicles) are of a relatively small scale to access the capital market. Securitisation enables these small green assets to be aggregated and to have a better access to capital and funding.
- Increases the ability to originate green loans by credit institutions: Green securitisation allows credit institutions to free up capital and incentivise them to expand their green lending business. In this regard, credit institutions have a key role to play in increasing funding allocated to sustainable projects given their unique position in facilitating capital flows through their lending, investment and advisory roles. Within banks also resides the technical underwriting expertise that is critical to assessing the risk and opportunities attached to green assets, especially during the transition phase.

- Expands the pool of investors in green projects. Green securitisation offers an opportunity of investment to certain players that cannot originate directly green exposures. In addition, compared to green bonds issued in the form of unsecured senior notes, green securitisation provides through the tranching of the bond a broader spectrum of risk/return profile thereby expanding the universe of interested investors.

In addition, the EU securitisation market is able to adapt swiftly to the new requirements defined in the EU green bond standard (GBS):

The new securitisation framework already sets out high disclosure standards including information related to energy efficiency of the underlying assets in RMBS and auto ABS.

Market participants in the securitisation market are already familiar with third party verifier and due diligence requirements. Issuers also have high levels of knowledge and experience in monitoring asset pools and managing cash flows. Therefore, they are able to provide the requisite level of monitoring, transparency and disclosure that green securitisation needs.

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?

- ~~Yes/No/Do not know.~~
- If yes, please list the barriers you see (maximum three). [BOX max. 2000 characters]

Market limitations:

Similar to other green products, green securitisation faces a range of limitations affecting both the supply and the demand including:

- Challenging identification of green assets. Entities willing to originate green securitisation often have difficulties in defining and identifying green assets within their balance sheet. Since climate issues are relatively new for most issuers, the internal reporting processes and information systems have not been designed yet to fully track green assets.
- No clear pricing advantage of issuing [securitisation] green bonds versus conventional bonds. With the exception of the ring fencing of the proceeds and/ or the green feature of the underlying assets, green securitisation have the same financial characteristics of conventional securitisation issued by the same issuers and having the same structural features. As a result, similarly to green bond in general, there is at the moment no green premium attached to green securitisations in the primary market.
- Lack of clear understanding of the structural features: As green products are relatively new, the investors have not built yet full knowledge and understanding of the risk/ return characteristics of these products. Green investments typically include less matured

technologies where the related risks and opportunities are more difficult to assess due to the lack of historical evidence on the performance.

- Lack of liquidity of the green finance market. Since green markets are still small and nascent in many countries, investors may refrain from investing in green bonds as they are perceived as less liquid than other instruments, especially when they are issued by new issuers.

Regulatory limitations (applicable to the securitisation market in general)

The new securitisation regulation has addressed many of the risks attached to securitisation, including prohibiting re-securitisation, imposed strict risk-retention requirements, improved transparency and risk management, enhanced underwriting policies, due diligence and reduced procyclicality. It has also created a new specific framework for STS transactions by virtue of which a transaction can be labelled as STS and give investors assurance that it meets certain minimum quality criteria. As a result, the EU securitisation market has become a more reliable and safer environment than before to support the growth of securitisations.

However, the EU securitisation issuance in the last 10 years has been significantly below its peak issuance in 2008 whilst, by contrast, the U.S. securitisation market has largely recovered to close to pre-crisis levels.

Although there is a variety of factors that contribute to subduing securitisation issuance, regulation poses certain challenges for the securitisation market in general due to, for instance:

- The remaining legal uncertainties with regard to the full implementation of the level 2 measures.
- The Lack of supervisory convergence, in particular in the supervisory assessments of significant risk transfer (SRT).
- The disadvantage of regulatory treatment of senior STS securitisation bonds compared to other funding products such as covered bonds.

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

- ~~Yes/No/Do not know.~~
- 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? [box max. 2000 characters]

EU policymakers and regulators have made it a priority within the CMU to support the revival of the securitisation market to unlock funding to EU businesses and households. The main pieces necessary to that revival have now been finalised by the ESAs. As a result, a second stage of the development of the CMU could be considered as part of an overarching EU strategy to meet climate targets.

Sustainable finance has not been reflected into the new securitisation regulation. For example, the STS framework does not specifically refer to green assets. Although there is a requirement for sponsors and originators to disclose the environmental efficiency of the underlying assets in RMBS and auto loan ABS designed to receive preferential capital treatment under the STS regime, the STS regulation does not make energy efficiency a condition of STS. The eligibility criteria for green securitisation come as an add-on to the eligibility criteria STS recognition.

Therefore, there would be a merit to investigate whether a specific framework for green securitisation would be needed in order i) to assess the extent to which the specificities of green securitisations are sufficiently captured within the EU GBS, ii) to clarify the interaction between the securitisation regulation and the EU GBS and iii) to determine whether a deviation from the existing securitisation framework would be appropriate. The EBA could contribute with technical work on these issues in a similar manner as for the STS framework.

A green securitisation framework could in particular:

- Clarify the definition of green securitisation: There is no single agreed definition on what constitutes a green securitisation. This term is currently used for securitisation i) collateralised by green assets or ii) the proceeds of which are allocated to invest in green assets; or iii) where the originator uses freed-up capital or leverage from a capital relief or synthetic securitisation to invest in green projects. Such clarification is necessary as the EU GBS has adopted a broad 'use of proceeds approach'.
- Elaborate on the specific disclosure and reporting requirements for green securitisations: The EU GBS requires the publication of a 'green bond framework' that includes data related to the issuer's strategy to align with environmental objectives, the use of proceeds and an impact reporting. The extent to which how such framework would fit in the existing securitisation disclosure framework needs to be clarified.
- Assess the merit of a label for high quality green securitisations: A green EU securitisation label, similar to what has been developed for STS securitisation, could be key in ensuring transparency for market participants in the green securitisation market. This label would also support further standardisation that is essential to strengthen investor demand especially for ABS in new green asset classes which risk profile is not always well understood. In this regard, the EBA stands ready to provide technical analysis to determine whether such a green securitisation label should be built upon the existing STS label or whether it should be kept separately.
- Investigate an appropriate prudential treatment taking into the account the risk profile of green exposures. EU policymakers and regulators could assess the merit of a differentiated prudential treatment for green securitisation compared to non-green securitisation based on the existence of a credit risk differential. For this purpose it would be essential to take into account the outcome of the analysis performed by the EBA under article 501 of the CRR that would determine whether a dedicated prudential treatment for exposures

associated with ESG objectives would be justified. The EBA stands ready to investigate the issue with a dedicated mandate on green securitisation.

2.4 Digital sustainable finance

Question 57: Do you think EU policy action is needed to maximise the potential of digital tools for integrating sustainability into the financial sector?

- ~~Yes/No/Do not know~~
- If yes, what kind of action should the EU take and are there any existing initiatives that you would like the European Commission to consider? Please list a maximum of three actions and a maximum of three existing initiatives. [BOX max. 2000 characters]

Digital finance has gained importance and is driving developments in the banking sector. Yet, a holistic approach bringing together sustainability objectives and digitalisation, while ensuring a sound and stable banking sector as well as an inclusive society, is lacking.

Mobilising and allocating the huge amounts of financial resources required to achieve sustainability objectives pose an enormous burden but offers significant opportunities as well. To be able to capitalize on the latter, developing digital platforms/tools is important, for instance:

- Integrating statistical and economic data that take into account ESG-factors, with sufficient level of granularity and clear definitions, available for public, private and institutional investors to be able to discriminate across, e.g., regions/countries, economic and financial activities, when deciding on funding projects that are in line with SDG and the Paris Agreement;
- Incorporating in the review of the NFRD freely accessible and reliable sources of machine-readable information/templates for market participants across the Single Market;

From a different angle, public intervention is also warranted to contain the potential risks that may come along with the use of financial technologies (see reply to Q.58). The EBA provided more details in its response to the A new digital finance strategy for Europe / FinTech action plan.

Question 58: Do you consider that public authorities, including the EU and Member States should support the development of digital finance solutions that can help consumers and retail investors to better channel their money to finance the transition?

- ~~Yes/No/Do not know.~~
- If yes, please explain what actions would be relevant from your perspective and which public authority would be best-positioned to deliver it. Please list a maximum of three actions [BOX max. 2000 characters]

EBA has highlighted in different publications the potential risks and uncertainties that may come along with the use of financial technologies (see 'EBA report on the prudential risks and opportunities arising for institutions from Fintech' (2018)). To that end the concept of technological neutrality applies equally to the use of digital finance to manage the transition and public authorities should monitor technological developments to ensure they are not inadvertently impeded by existing regulatory approaches.

Even though digitalisation offers new chances for European citizens, it is important to ensure that these new technologies embrace the society as a whole, and that they do not exacerbate the existing structural inequalities in society and/or market concentration in the products and services markets. In the context of climate-risks, the impact of both physical and transition risks is likely to be unevenly distributed affecting more severely low-income regions and households. It would be important to avoid that these impacts are amplified by that of digitalisation.

At the same time some technologies can be resource intensive and some consideration to green labelling could be considered for key technologies.

More generally, from a prudential perspective, legal and conduct risk could be adversely affected, alongside reputation risk, particularly in the event of consumer protection issues such as lack of information transparency, unethical behaviour/discrimination, etc. In this regard, at European level, further harmonisation of consumer protection rules across the EU would contribute to enhancing cross-border sustainable investments, supporting competition and eventually the development and supply of 'green' products (as highlighted in the EBA Report on report identifying potential impediments to the cross-border provision of banking and payment services in the EU (2019). The EBA provided more details in its response to the A new digital finance strategy for Europe / FinTech action plan.

2.6 Incentives to scale up sustainable investments

Question 66: In your view, does the EU financial system face market barriers and inefficiencies that prevent the uptake of sustainable investments?

- Please express your view on the current market functioning by using a scale of 1 (not well functioning at all) to 5 (functioning very well).
- 3
- Please specify your answer. [BOX max. 2000 characters]

Three market barriers constitute, in our view, major impediments to the uptake of sustainable investments:

- The uncertainty on the economics long-term value of sustainable investments,
- The actual (or perceived) insufficient return on the risks and costs associated to sustainable investments,

- The insufficient volume of available sustainable projects to reflect investors' needs.

Question 67: In your view, to what extent would potential public incentives for issuers and lenders boost the market for sustainable investments?

- Please express your view on the importance of financial incentives by using a scale of 1 (not effective at all) to 5 (very effective).
- 4
- In case you see a strong need for public incentives (scores of 4 to 5), which specific incentive(s) would support the issuance of which sustainable financial assets, in your view? Please rank their effectiveness using a scale of 1 (not effective at all) to 5 (very effective).

<u>Types of incentives</u>	<u>Bonds</u>	<u>Loans</u>	<u>Equity</u>	<u>Other</u>
Revenue-neutral subsidies for issuers (e.g. cost of green bonds verification)	<u>4</u>			
De-risking mechanisms such as guarantees and blended financing instruments at EU-level	<u>4</u>	<u>4</u>		
Technical Assistance				
Any other public sector incentives - Please specify in the box below. Enhance a forward-looking perspective, for example in calibration of prudential requirements and modelling approaches Evaluate risk characteristics of green products and adjust the prudential framework where risk based performance shows differentiation compare to non-green exposures.		<u>4</u> <u>4</u>		

Question 68: In your view, to what extent would potential incentives for investors (including retail investors) help create an attractive market for sustainable investments?

- Please express your view by using a scale of 1 (not effective at all) to 5 (very effective).
- 4
- For scores of 4 to 5, in case you see a strong need for incentives for investors, which specific incentive(s) would best support an increase in sustainable investments? [drop down menu]

- Revenue-neutral public sector incentives
- Adjusted prudential treatment
- Public guarantee or co-financing
- Other
- Please specify the reasons for your answer (provide if possible links to quantitative evidence) and the category of investor to whom it should be addressed (retail, professional, institutional, other).

The labelling of sustainable financial products as well as the use of simple and comparable metrics would constitute an important incentive for retail and professional investors to increase their demand of sustainable products. In this regard, we consider that i) the widening of the scope of EU ecolabel to a larger range of financial products and ii) the creation of a broad investable and reliable EU ESG benchmarks to serve as the foundation for ESG products are essential. Considerations could also be given to further standardisation and labelling for green covered bonds and green securitisation as a tool to support the origination and the funding of sustainable projects.

A duly calibrated risk based prudential treatment could also have a positive impact on the uptake of sustainable investments for credit institutions. As stated in 'the EBA Report on undue short-term pressure from the financial sector on corporations' (2019) using primarily historical data to assess future performances may not be a sufficient indicator, taking into account the likelihood of unprecedented disruptions e.g. caused by climate change. As a result, going forward, the need to enhance a forward-looking perspective for example in calibration of prudential requirements and modelling approaches should be investigated to ensure that there is no bias towards unsustainable financing.

A potential differentiated treatment should have to be risk-based and take into account any potential negative unintended consequences for financial stability. It should also include adequate credit and liquidity risks safeguards and be based on clear eligibility criteria.

The EBA is mandated under article 501c of the CRR to assess prudential treatment for assets associated substantially with environmental and/or social objectives.

As recommended by the TEG in the EU GBS report, we would invite the Commission to issue a call for advice to the EBA to assess the possibility to develop a segment of green bonds that would define the conditions to be met by the EU-GBS in order to assess the potential benefits from a differentiated prudential treatment, similar with what EBA did for covered bonds, European Secured Notes (ESN) and Simple, Transparent and Standardised (STS) securitisation. Such assessment would be, in our view, particularly relevant for green securitisation (see reply to Q.56), green covered bonds (see reply to Q.34) and green infrastructure bonds (see reply to Q.34).

Question 69: In your view, should the EU consider putting in place specific incentives that are aimed at facilitating access to finance for SMEs carrying out sustainable activities or those SMEs that wish to transition?

- ~~Yes/No/Do not know.~~
- If yes, what would be your main three suggestions for actions the EU should prioritise to address this issue? [box max. 2000 characters]

It is important to ensure that the EU funding framework is supportive of SMEs lending in general. In particular, the EBA sees a need for the Commission to clarify the EU legislative frameworks applicable to STS synthetics and NLP securitisation, which are of high relevance to SMEs lending. In addition, a follow up on the EBA recommendations to the Commission on the potential creation of a European Secured Note to fund SMEs loans in Europe might also be worth considering.

2.10 Promoting sustainable finance globally

Question 76: Do you think the current level of global coordination between public actors for sustainable finance is sufficient to promote sustainable finance globally as well as to ensure coherent frameworks and action to deliver on the Paris Agreement and/or the UN Sustainable Development Goals (SDGs)?

- Please express your view by using a scale of 1 (highly insufficient) to 5 (fully sufficient).
- 3

Strengthening the international coordination should be given priority in order to ensure an effective implementation of the Paris agreement and prevent regulatory fragmentation and arbitrage (see also replies to Q6 and Q13). Such coordination is equally important at governmental and financial regulation level. In the context of the financial regulation and supervision, coordination and development of global approach is very relevant for the fora such as FSB, BCBS. NGFS has done significant amount of work on which these policy making bodies could build.

Question 77: What can the Commission do to facilitate global coordination of the private sector (financial and non-financial) in order to deliver on the goals of the Paris Agreement and/or SDGs? Please list a maximum of three proposals.

Coordinating efforts to scale up sustainable finance and promote globally integrated markets would foster the ability of the financial sector to support the transformation. In this regard, the work of the EU International Platform on Sustainable Finance (IPSF) seems particularly relevant. By facilitating exchanges and coordinating efforts, in particular in the areas of taxonomies, disclosures, standards and labels, this Platform shall help to further align international approaches and facilitate the mobilisation and allocation of financial resources at a global level. Another example for scaling-up sustainable finance while promoting a level-playing field can be found in the area of trade

finance and export credits, where harmonisation of the ESG criteria for the activities to be guaranteed or insured could be enhanced. Moreover, from the prudential regulation perspective, continuous efforts are needed to promote consistency in the treatment of ESG risks by regulators and supervisors, including potential adjustments in the prudential regulation at global level.

3. Reducing and managing climate and environmental risks

“Climate and environmental risks, including relevant transition risks, and their possible negative social impacts, can have a disruptive impact on our economies and financial system, if not managed appropriately. Against this background, the three European supervisory authorities (ESAs) have each developed work plans on sustainable finance.⁹ Building, among others, on the ESAs’ activities further actions are envisaged to improve the management of climate and environmental risks by all actors in the financial system. In particular, the political agreement on the Taxonomy Regulation tasks the Commission with publishing a report on the provisions required for extending its requirements to activities that do significantly harm environmental sustainability (the so-called “brown taxonomy”).”

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/No/Do not know.~~
- If no, please explain why you disagree [BOX max. 2000 characters]
- If yes, what would be the purpose of such a brown taxonomy? (select all that apply)
- ✓ Help supervisors to identify and manage climate and environmental risks.
- ✓ Create new prudential tools, such as for exposures to carbon-intensive industries.
- ✓ Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.
- ✓ Identify and stop environmentally harmful subsidies.
- Other, please specify. [box max. 2000 characters]
- facilitate financial institutions’ assets classification from sustainability perspective for identification, assessment and management of related risks;

- assist the supervisors' assessment of institutions' assets classified from sustainability perspective ("brown" exposures);
- harmonize the selection process of economic sectors and institution's exposures captured under scenario analysis and stress testing exercises;
- facilitate consistency of disclosures and reporting by financial institutions. For example, a taxonomy of carbon-intensive activities would provide the basis for disclosing the share of carbon-related assets, in line with the Commission's Guidelines on climate-related information reporting;
- provide an immediate anchor for applying potential risk differentials between different types of assets to assess, if a specific prudential treatment would be justified.

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/No/Do not know.~~
- If yes, what should be the purpose of such a taxonomy? Please specify. [BOX max. 2000 characters]

The completion of the EU taxonomy to all economic activities and the gradual development of more granular criteria for other sustainability objectives beyond climate change will be key for the practical implementation of the EU taxonomy and, hence, for the publication of wider, more comparable disclosures and for application in risk management tools. Such complete taxonomies would enable also more granular prudential monitoring and calibration of monitoring metrics. A better understanding of the links between environmental and social objectives (also in light of COVID-19 impact on financial sector), supported by relevant datasets, seems warranted too. With regards to the brown taxonomy covered in question 82, it is important to ensure that it will not lead into a binary outcome, and that the set criteria in brown taxonomy will reflect future technological improvements impacting pollution level of some economic activities. Completion of a granular EU taxonomy for all economic activities and all sustainability objectives will require appropriate time and expertise. Considering that financial institutions and prudential supervisor need to evaluate their assets and liabilities from sustainability perspective as part of the risk management and supervision, it might be advisable to consider additional tools available to support consistent classification of assets and liabilities before the full taxonomy is available. In the context of the EBA mandate under Article 98 of the CRDV, the EBA will explore issues related to risk management and supervision of ESG risks.

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 [BOX max. 2000 characters] – add definition;
- Transition risks, please specify if necessary [BOX max. 2000 characters] –add definition;
- Second-order effects, please specify if necessary [BOX max. 2000 characters] – add examples/ check report / unemployment (NPLs), migration (real estate would go down, higher labour costs)/ declines in productivity (e.g. due to health impacts of polluted environments);

In the context of the mandate extended to EBA under Article 98 of the CRDV, the EBA will prepare a report to the Commission (to be submitted by June 2021) that makes, inter alia, a proposal for the definition of ESG risks, including physical risks and transitions risks. In this report, the EBA will elaborate more detailed analysis of the transmission channels and financial stability risks relevant for the banking sector.

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 [BOX max. 2000 characters]

Based on a market survey conducted by the EBA in May-June 2019, banks are making progress in considering and determining the materiality of ESG factors. Although most EU banks have not yet identified key performance indicators / balance sheet targets and need to enhance and refine their internal risk review process, there seems to be a gradual trend towards a greater recognition of ESG risks.

The EBA published an Action plan on sustainable finance in 2019, where the EBA highlights some key policy messages on the topic of sustainable finance to provide institutions on the EBA's high-level policy direction and expectations about ESG risks. These expectations emphasise three areas where institutions are encouraged to consider taking steps, (strategy and risk management, disclosure, and scenario analysis), before the EU legal framework is formally updated and the EBA regulatory mandates delivered.

The EBA encourages institutions to act proactively in incorporating ESG considerations into their business strategy and risk management, while highlighting that proactive strategies and forward-looking approaches that aim to build resilient and sustainable business models in the long-term, should be understood, if appropriately designed, as tools mitigating the potential impact of environmental and social risks.

In the short-term, EBA has encouraged disclosure (with necessarily caveats) of some key metrics, notably a Green Assets Ratio (GAR), to facilitate institutions' move towards full disclosure based on

the upcoming EBA technical standards: (i) volume of financial assets funding sustainable economic activities contributing substantially to climate mitigation and/or adaptation; (ii) volume of collaterals related to assets or activities in climate change mitigating sectors; (iii) total amount of the fixed income portfolios invested in green bonds.

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).
- 3 (neither agree nor disagree)
- For scores of 1-2, what solution would you propose? Please list a maximum of three. [BOX max 2000 characters]

This question would require some additional analysis and, in this context, the EBA would like to refer to the review of the macro prudential toolbox according to article 513 of the CRR. The EBA would contribute to this macroprudential review which can also provide a good opportunity to consider whether the macroprudential toolbox is appropriate for addressing financial stability risks related to climate change.

Banking prudential framework

“In the context of the last CRR/D review, co-legislators agreed on three actions aiming at integrating ESG considerations into EU banking regulation: (i) a mandate for the EBA to assess and possibly issue guidelines regarding the inclusion of ESG risks in the supervisory review and evaluation process (SREP) (Article 98(8) CRD); (ii) a requirement for large, listed institutions to disclose ESG risks (Article 449a CRR) (note that some banks are also in the scope of the NFRD); and (iii) a mandate for the EBA to assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with sustainability objectives would be justified (Article 501c CRR). Because the work on ESG risks was at its initial stages, co-legislators agreed on a gradual approach to tackling those risks. However, given the new objectives under the European Green Deal, it can be argued that the efforts in this area need to be scaled up in order to support a faster transition to a sustainable economy and increase the resilience of physical assets to climate and environmental risks. Integrating sustainability considerations in banks’ business models requires a change in culture which their governance structure needs to effectively reflect and support.”

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/No/Do not know.
- 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? [box max. 2000 characters]

As stated in the EBA 'Report on undue short-term pressure from the financial sector on corporations' (2019), the EBA recommends that the European Commission and EU legislators continue to have as a key regulatory priority a safe and stable financial system. This entails maintaining a robust regulatory framework and maintaining an evidence and risk based approach to banking prudential regulation, including when pursuing the objective of promoting sustainable finance. In this context, the EBA will assess –as part of the mandate extended under CRR (Article 501c) – whether or not a dedicated prudential treatment of exposures that is related to assets or activities associated substantially with environmental and/or social objectives would be justified. Any potential change in the regulatory treatment should be based on robust evidence that confirms the lower riskiness, *ceteris paribus*, of sustainable investments noting also the need for a dynamic analysis that doesn't rely solely on historical data in light of the changing risks and policy environment associated with climate change.

In the same report the EBA recommended to integrate further sustainability considerations in directives and regulations applicable to the banking sector (e.g. CRD and CRR), in particular those related to the provisions on governance and risk management. These provisions should be extended by the introduction of requirements to implement long-term sustainable business strategies, and the incorporation of environmental, social and governance risks, including climate-related risks, into the requirements on risk management. Such provision would contribute to a deeper understanding of the long-term potential impact of climate change and ESG factors more generally.

In this regard, the EBA is aware that the calibration of prudential requirements, which are primarily based on historical data, may not be a sufficient means for the assessment of future changes, including unprecedented changes. As a result, going forward, the need to enhance a dynamic forward-looking perspective for example in the calibration of prudential requirements and modelling approaches should be considered to ensure that there is no bias towards unsustainable financing, as part of the work of incorporating ESG factors and risks in the banking prudential regulation. Note that, in this respect, the EBA Guidelines on loan origination and monitoring also provide that institutions should incorporate climate-related and ESG risks in their credit risk policies and procedures, for the purposes of loan origination and monitoring.

The EBA is of the view that robust corporate governance arrangements that support a sound management of risk and a sound risk culture at all levels of the institution as well as an effective oversight by the management body are key for the implementation of strategies that take greater account of short-medium and long-term sustainability risks and sustainability objectives. The new provisions introduced into the CRD have strengthened the requirements for the institutions' internal governance as well as the mandates for competent authorities to monitor the adequacy of such arrangements, taking into account the nature, scale and complexity of institutions' activities.

Moreover, for the purpose of managing ESG risks, the EBA has been extended a mandate under Article 98 CRDV and is expected to come up with a proposal on how to best incorporate ESG risks into the business strategy and process and the risk management frameworks (see also answer Q.102).

The EBA would like to stress that the work mandated to the EBA in the Art. 501c CRR and Art. 98 CRD will provide significantly deeper technical analysis for the prudential treatment of assets linked with sustainability objectives. In this context, it would be the EBA's strong preference to deliver on these mandates before the Commission's publication of specific legislative proposals.

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 [BOX max. 2000 characters]
- ~~No.~~
- ~~Do not know.~~

Credit institutions have a key role to play in increasing funding allocated to sustainable projects given their unique position in facilitating capital flows through their lending, investment and advisory roles. The following measures would, in EBA's view, be particularly relevant to further mobilise banks to finance green projects:

- Ensure a well-functioning of the green securitisation market (as described in Q.56)
- Ensure a well-functioning of the EU green covered bonds market (as described in Q.34)
- Develop a standardised EU funding instrument for EU infrastructure (as described in Q.34)
- Originate large scale EU bankable pipelines for sustainable projects (as described in Q.60)
- Calibrate solutions for smaller local banks which are better fit for streamlining funding for SMEs (in particular in agriculture which is particularly threatened by physical and transition risks, e.g. draught).

3.3 Credit rating agencies

Question 95: How would you assess the transparency of the integration of ESG factors into credit ratings by CRAs?

- Please express your view by using a scale of 1 (not transparent at all) to 5 (very transparent).
- 3 (neither agree or disagree)

- If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

CRAs have made significant effort to increase transparency in their ESG risk assessment methodology, although some improvements could still be made with regard to the extent to which this assessment i) affects the credit worthiness of institutions and ii) is taken into consideration in the credit rating methodology.

The issue with regard to transparency is mostly driven by:

- Lack of reliable data. CRAs' ability to conduct robust and transparent analysis when it comes to ESG integration in credit ratings is dependent on the availability and quality of the data. However, public disclosures of ESG performance of institutions have been relatively scarce, leaving CRAs with large room for interpretation and subjectivity in their ESG assessment.
- Lack of visibility of ESG risks within the credit rating methodology. CRAs usually embed ESG risks within their assessment process as opposed to adding a specific ESG pillar. In that context, it is very difficult to isolate the effect of ESG factors from other factors. In addition, ESG considerations are rarely the main driver of credit outcomes. The financial profile of an issuer would typically constitute a more important part of the credit rating assessment.
- Uncertainty on the materiality of ESG risks. ESG factors are considered in credit ratings only if they are relevant and have a material effect on the probability of default. However, the impact of ESG risks is not always clear in terms of scale and timing (e.g. traditional credit risk variables would often materialise in a shorter time horizon compared to ESG risk). In addition, ESG considerations being relatively new risk indicators, CRAs are still developing knowledge and understanding on how they affect credit risk and credit ratings.

As a result, we expect transparency to increase as CRAs improve their methodology used to assess the correlation between ESG factors, credit risk and credit rating.

Question 96: How would you assess the effectiveness of the integration of ESG factors into credit ratings by CRAs?

- Please express your view by using a scale of 1 (very ineffective) to 5 (very effective).
- 3 (neither very ineffective nor effective)
- If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

The effectiveness of the integration of the ESG factors into credit ratings by CRAs is facing the same structural impediments as the ones identified in Q.95 in particular, with regard to the lack of data and the methodological uncertainties regarding the materiality of ESG risks.

In addition, there is some inconsistency in how CRAs are able to account for the consideration of each factor. CRAs are usually more familiar with the governance factor, which is already often considered as a valuable input variable to assess the performance of an entity through its business model and strategy. However, the environmental and social factors are not captured sufficiently within credit ratings yet, due to their complexity, holistic nature and lack of commonly agreed definition.

Question 97: Beyond the guidelines, in your opinion, should the EU take further actions in this area?

- ~~Yes/No/Do not know.~~
- If yes, please specify what kind of action you consider would address the identified problems. In particular should the EU consider regulatory intervention? [BOX max. 2000 characters]

We see merit in enhancing disclosures requirement for ESG products and to strengthen the regulatory framework for sustainability assessments, as included in the ESMA's Technical Advice to the Commission on sustainability considerations in the credit rating market. We also share ESMA's view regarding the interaction between credit risk assessments and sustainability assessments. Although complementary and interlinked, credit risk assessments and sustainability assessments have different purposes, they are subject to a different time horizon and they are also facing different methodological challenges.

In addition, given the critical role of credit ratings in the EU financial legislation and their mechanical use in the calculation of capital requirements of financial institutions, it is recommended to require credit ratings to incorporate sustainability assessment into credit ratings only when relevant from a credit risk point of view. Under the current legislation, CRAs are already required to incorporate all relevant factors in their credit rating methodologies. No legislative change is therefore needed in this regard.

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/No/Do not know.~~
- If yes, please select all that apply:
- ~~Loss data, please explain why [BOX max. 2000 characters]~~
- ~~Physical risk data, please explain why [BOX max. 2000 characters]~~

There are already some data providers on the impact of natural disasters, supplemented by numerous databases focusing on certain climate/environmental hazards and/or specific

sectors/regions across the globe, which are being used by the financial sector to drive their ESG strategies. The institutions' efforts to estimate the sensitivity of their portfolios to physical risks are very encouraging and could be complemented with policy action that contributes to a more accurate analysis and better understanding of the impacts of climate change. For instance:

The European Commission could play a bigger role in supporting the use of a common database for climate-related risks, with consistent criteria, definitions and common reporting and data management standards. This would enhance the comparability of the quantitative and qualitative metrics (e.g. development of scenario analysis, probabilities, value at risk) used by banks, alleviate the burden of multiple non-coordinated efforts by the banking sector and facilitate the work of supervisors.

On top of the above, it would be important to expand datasets to include the financial losses and hazards stemming from any other environmental disasters than just climate change.

Moreover, statistics on transition risks should be explored, e.g., by Eurostat, based on polls, sentiment barometers, etc. As an example, regular (e.g. monthly) indexes that provide estimates of market sentiment/perceptions/tolerance towards climate-change, preferences of the society to support the transition to a low-carbon economy and other sustainable goals would be very beneficial. They would allow institutions to monitor developments in social/market preferences, hence supporting the management of the risks in the transition and the definition of business strategy by the banking sector.

Finally, improved communication about the potential impact that the intended nationally measures to achieve sustainability goals may have on industries, sectors and services in each EU country, and for the EU as a whole, would facilitate ESG risk analysis and, more generally, support a better understanding within the financial and corporate sectors of the transition. In the same spirit, the NGFS has recommended that the appropriate public authorities share data of relevance to climate risk assessment and, whenever possible, make them publicly available in a data repository.

Financial management of physical risk

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/No/Do not know.~~
- 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 [4/5]. [BOX max. 2000 characters]
 - (see replies to Q.7 and Q.99 on the role of public institutions to support the development of scenario analysis and high-quality data sets)
 - ✓ Raise awareness about climate physical risk [4/5]. [BOX max. 2000 characters].

- (see replies to Q.51 on financial literacy)
- Promote ex-ante “build back better” requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe. [BOX max. 2000 characters].
- Facilitate public-private partnerships to expand affordable and comprehensive insurance coverage. [BOX max. 2000 characters].
- Reform EU post-disaster financial support. [BOX max. 2000 characters].
- Support the development of alternative financial products (e.g. catastrophe bonds) offering protection/hedging against financial losses stemming from climate- or environment-related events. [BOX max. 2000 characters]
- Advise Member States on their national natural disaster insurance and post disaster compensation and reconstruction frameworks. [BOX max. 2000 characters].
- Regulate by setting minimum performance features for national climate-related disaster financial management schemes. [BOX max. 2000 characters].
- Create a European climate-related disaster risk transfer mechanism. [BOX max. 2000 characters].
- Other, please specify. [BOX max. 2000 characters].

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/No/Do not know.~~
- If yes, what action should the EU take? Please list a maximum of three actions. [BOX max. 2000 characters]

The EBA already recommended in its ‘Report on undue short-term pressure from the financial sector on corporations’ (2019), to integrate further sustainability considerations in directives and regulations applicable to the banking sector (e.g. CRD and CRR), in particular those related to the provisions on governance and risk management. These provisions should be extended by the introduction of requirements to implement long-term sustainable business strategies, and the incorporation of environmental, social and governance risks, including climate-related risks, into the requirements on risk management. Such provision would contribute to an enhanced incorporation of the long-term potential impact of climate change and of ESG risks more generally into the institutions’ decision making. Following such strengthened provision, the EBA could incorporate further details in the relevant guidelines (e.g. EBA Guidelines on internal governance)

Based on the mandate to the EBA under Art. 98 CRD, the EBA will in more details recommend how to incorporate the ESG factors into the business strategies, governance and risk management

frameworks of institutions. This will contribute to a deeper understanding by financial institutions and supervisors of the long-term potential impact of ESG risks, which then could indirectly facilitate the financing of sustainable activities and the transition towards a sustainable economy.

Regarding new lending activities, the “EBA’s Guidelines on loan origination and monitoring” already state that institutions should incorporate ESG factors and associated risks on the financial conditions of borrowers. The EBA Guidelines also require institutions that originate –or plan to originate- environmentally sustainable credit facilities to develop, specific details of their environmentally sustainable lending policies and procedures, covering the granting and monitoring of such credit facilities, hence fully embedding them in the institution’s credit risk policies and procedures. Moreover, institutions should position their environmentally sustainable lending policies and procedures within their overall management framework, setting up qualitative and, when relevant, quantitative targets to support the achievement of the institution’s overall sustainability objectives.