EACB POLICY PAPER

"Towards a Sustainable Finance Framework in EU: the views of Co-operative Banks"

November 2017

- As local and regional banks – with 58.000 branches and 209 million clients across the EU - ***co-operative banks play a key role in financing the energy transition***, by promoting within their networks the distribution of investment or savings products in favour of sustainable development; through their expertise in project financing in accompanying energy transition; through their green financing geared to SMEs and energy efficiency financing of private and public buildings. Some co-operative banks are leaders in green bonds.
- Beyond that, co-operative banks ***are engaged in long-term relationships with their members, their private and corporate clients and the communities where they reside.*** They reinvest significant portions of their available profits back into the community by supporting social and cultural projects. Thus they contribute to sustainable financing.
- However, the current complexity and continuous motion of the regulatory framework is ***heavily affecting the local co-operative banks and their capacity to finance the real economy***.
- Additionally, there is a risk that ***regulation will lead to a less diverse banking environment*** that would undermine the sustainability and stability of the financial framework in Europe [1]. Those are key issues to address in the debate on sustainable finance.
- This is why from a co-operative, retail and locally focused institutions' point of view, we think that it is important to highlight the fact that "sustainable" finance is already being carried out in Europe through banks' balance sheets, mostly putting deposits at work for the benefit of the real economy.
- In this light, we suggest that at ***European and international level a greater emphasis is put on the retail side of green financing by promoting tools and policy measures that are conducive of regional green growth via SMEs, households and local actors***.
- Since the EU Commission's HLEG is mainly composed of experts in asset management and insurance sector but no retail bankers, a priority shall be to correct this deficit by integrating the local financing dimension in the final recommendations and in the further steps undertaken by the European Institutions. Co-operative banks shall be closely involved.

The paragraphs below provide a summary of the EACB reply to the High Level Expert Group on Sustainable Finance interim report and questionnaire.

[1] Snapshot of European Cooperative Banking 2017, Tilburg Universtiy, Eindhoven University of Technology, Tias. "*it cannot be excluded that regulatory forces are pushing banks is same direction or prompt them to make similar choices*".

PRIORITIES TO MOVE TO A MORE SUSTAINABLE AND INCLUSIVE GROWTH, STRENGTHEN THE FINANCIAL SYSTEM

The sustainable integration of productive activities and the availability of capital in the territory are crucial in moving towards a more sustainable economy. Thus, the role of decentralized banks (aimed at territorial development and the financing of local production systems), is at the core of climate change policies.

More in general (co-operative) banks already play an important role in stimulating investment and creating jobs by lending to businesses. They provide a range of sustainable financial products and services to underpin the sustainable development of the local economy, climate financing and the switch to renewable energy.

At the same time, enterprises from real economy shall be encouraged by policy makers to initiate green investments and projects with ecological and/or social benefits, being also economically sound. However enterprises need a favourable and calculable policy framework.

Instead, long-term funding is hindered by several regulations, which should be checked against fitness. Overregulation of the banking industry, risks undermining the shift towards sustainable economy.

Among the proposal put forward in the interim report of the HLEG on Sustainable Finance, the **EACB particularly supports**:

- Developing a common taxonomy for sustainable assets (with minimum standards) including retail banking dimension.
- Promotion of low-carbon market for retail banking activity with adapted commercial tools. This according to the cooperative difference which creates growth and jobs as it finances SMEs, the engine of growth in the EU (see § on social dimensions).
- A stable legislative and regulatory framework, especially for key parameters such as environmental policy, taxation and prudential requirements.
- A legislative framework that is conducive of diversity of business model of financial institutions to create an ecosystem able to cater for different needs and longer-term approaches.

LONG-TERM VISION AND DIVERSITY AS PART OF SUSTAINABLE FINANCE

Co-operative banks gear their business model towards a perspective that is more focussed on long-term value and on member/customer needs. This being the case, we would like to point out that the decisive element for a long-term policy of financial institutions is a stable political, legislative and regulatory framework. Especially for sustainable finance the stability of fundamental parameters in terms of environmental policy, taxation, prudential requirements is essential. A lack of stability of such factors could lead to think short-term and avoid any long-term engagements.

Moreover, the raising complexity of the regulatory and supervisory framework poses challenges to locally operating co-operative banks, undermining their capacity to drive sustainable growth.

Furthermore, the financial sector, regulation is too often designed following a one-size-fits all approach with one single set of rules that may lead to uniformity rather than foster diversity in banking at the detriment of financial stability, but also sustainable growth. This is why it is important that the regulatory framework takes into account the diversity of banking models in Europe. The co-operative banks difference in terms of ownership structure, organisational settings, risk profiles and economic and social role should not be undermined.

INCENTIVES TO INTEGRATE LONG-TERM SUSTAINABILITY CONSIDERATIONS IN THE REAL ECONOMY

In general, co-operative banks are based on relationship lending to private customers and enterprises that is naturally long-term orientated. Their success depends strongly on the economic, ecological and social wellbeing of their operating area. This naturally leads intermediation by banks to more likely meet economic and social sustainability requirements.

Beside this, in the field of climate change, a key lever is the "price" to act as an incentive to reduce a negative externality such as GHGs. The price needs to reflect what we already know about the medium to long-term additional costs of climate change. In theory, such a "shadow price" incorporating the social cost of carbon (SCC) would be enough to reduce emissions and should be used in economic and financial calculations, in particular in the cost-benefit analysis of investment projects, to take into account these negative externalities (i.e. congestion, pollution, toxic emissions).

BEST WAY TO INVOLVE BANKS MORE STRONGLY ON SUSTAINABILITY, PARTICULARLY THROUGH LONG-TERM LENDING AND PROJECT FINANCE

The EACB Members consider the followings to be priorities:

- Increasing the market knowledge on climate change economic sectors distinguishing corporate and retail dimension. This will permit to measure retail banking contribution
- Lowering barriers to entry for issuers through creating clear, common and comparable European Standards utilising as far as possible the current market practice (ICMA).
- Encouraging banks to sign sustainability commitments, such as Equator Principles on project financing.
- Continue to support insurance and reinsurance to maintain the same level of insurance coverage for customer in physical risk (tourism, agricultural, real estate).
- Increase the efforts to facilitate retail financing on regional energy efficiency and renewable energies markets.
- Help in the effort to adjust the global rules on liquidity and solvability (creation secondary markets).
- Capital requirement reductions are also relevant incentives to longer-term sustainable financing: in particular, we support green adjustments correlated to lower risk such as the EeMAP initiative that relates to green mortgages. We encourage the HLEG to advance in such direction. In general, we invite the EU to assess the risk, based on market practice data, to ensure the alignment of capital allocation with the credit risk perspective.
- Moreover, treatment of specialised lending and long-term financing is not conducive for a growth of investment in this area. One of the key factors that may impact the flow of funds towards project finance/structured finance deals and long term lending is the direction of the credit risk reforms currently being finalised at Basel. The Basel

proposal to replace internal models for specialised lending with the risk weights of the SA (which depending on the final package would also floor the IRB banks) or the slotting approach is too restrictive and would not be risk sensitive enough for this bespoke type of financing. In that context the calibration was overly punitive compared to the low loss rates observed.

The social dimensions of sustainable development

Sustainable finance should also include social aims. In particular, we believe that employment, social inclusion and affordable housing should be priorities. As it is the case with environmental issues, an accurate but simple (and with some degree of flexibility) taxonomy has to be developed.

The role of retail banks (and particularly that of co-operative banks) is in our view key to advance in the European social agenda by channelling finance to the real economy. Concerning employment, European statistics acknowledge the role of local SMEs as key actor in job creation. The local (co-operative) banks – as financing partners - are accompanying them. Integrating those sectors, that are the engines of territorial and regional development and link climate and social dimension, also means integrating the expertise and recommendations of co-operative banks in the HLEG.

Green Bonds

The green bond market has developed dynamically in recent years, also supported by green bond principles introduced and updated by ICMA. EU standards could accelerate such development as long as there are not too strict guidelines/frameworks and that will focus on minimum reporting obligations. Keeping the flexibility and proportionality principles in mind, is an important factor.

In general, new European Standards for green/social/sustainability bonds should widely be based on existing ICMA Green/Social Bond Principles and Sustainability Bond guidelines, since they serve as current market practice. Any new European standard should recognise and acknowledge the outstanding green/social/sustainability bonds issued before its launching.

A European Green Bond Label, such as the existing European Covered Bond (ECBC) Label, is welcome if it relies on European standards based on ICMA principles. Moreover, the ECBC definition of "Sustainable Covered Bonds" could be adapted to include any bond type and extended to loan portfolios.

EU official labels may create credibility and standards for investors and market participants. This is why it is important to broaden the current discussion on various ESG labels, currently used in the EU Member States.

Co-operative banks are key player in green bonds issuing in certain countries. In Germany, DZ BANK has been active in green bonds market segment since 2013. It is one of the ten leading syndicate banks operating in this segment. The fact that sustainability is a major aspect of the cooperative principle and culture is proving to be an advantage. Beside DZ BANK in Germany, also Crédit Agricole in France and Rabobank in the Netherland, are in the list of market leaders in this segment.

ENERGY EFFICIENCY

Buildings account for 40% of the EU's energy consumption, 36% of its CO2 emissions and 55% of its electricity consumption. This makes emissions and energy savings in this sector vital to meeting the EU's climate and energy targets. The stock of buildings in the EU is relatively old, thus consuming more energy than new buildings. The rate at which new buildings either replace this old stock, or expand the total stock, is low (about 1% a year).

This implies that if the energy consumption of buildings is to be reduced the renovation of existing buildings is key. Moreover renovation leads, among other, to higher property values, lower energy bills, hedging of energy price with particular relevance in peri-urban and rural households.

Therefore, energy efficient mortgage loans are a critical financial instrument to redirect private capital into energy efficiency investments, lowering carbon emissions and transposing the EU's energy efficiency policy into tangible results contributing to the challenges posed by the COP21 agreement.

Co-operative banks in various EU countries contribute substantially to finance energy efficiency for properties.

In Spain, Group Cooperativo Cajamar has financed in 2016 about 5.000 transactions for a total amount of 600 million €. In Austria, the regional banks of the RBI have contributed with 411 million €. In the Netherlands, Rabobank contributed with 50 million € in 2016. In France, Crédit Mutuel has financed 5.400 projects for a total amount of 100 million €; Crédit Agricole's regional banks finance home energy renovations in 2016, over 104,000 offers had been made totalling over 2.1 billion €. The German cooperative banks had a high market share (more than 30%) in offering promotional housing loans of KfW regarding energy efficiency in 2016.

Groupe BPCE was the first pilot bank to sign an agreement with the European Commission in 2012 to organize the financing of the energy transition in the territories. As of December 31, 2015, 2.8 million € in grants were allocated to partner communities, including 255 k € already committed. Households benefited from 2.8 million € in loans from participating Banques Populaires and Caisses d'Epargne, allowing a total final investment of 29.9 million € and an energy saving of 56.68 GWh/year.

Notes:

- For more information and data on the ***"The co-operative banks engagement to green and sustainable finance"*** download the on-line brochure on the EACB website.
- *A webpage dedicated to sustainable initiatives of co-operative banks can be found on the EACB website*
- *The EACB Comments on EU Commission High Level Expert Group Interim Report on Sustainable Finance are also on-line on the EACB website*

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About EACB

The European Association of Co-operative Banks (EACB) represents, promotes and defends the common interests of its 28 member institutions and of cooperative banks, with regard to banking as well as to co-operative legislation.

Founded in 1970, today the EACB is a leading professional lobbying association in the European banking industry. Co-operative banks play a major role in the financial and economic system.

They contribute widely to stability thanks to their anti-cyclical behaviour, they are driver of local and social growth with 3,135 locally operating banks and 58,000 outlets, they serve 209 million customers, mainly consumers, SMEs and communities.

Europe's co-operative banks represent 80.5 million members and 742,000 employees and have an average market share of about 20%.

Downloadable on the EACB website

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