# EACB Comments
# EU Commission High Level Expert Group
# Interim Report on Sustainable Finance

## General comments

- The members of the EACB welcome the opportunity to comment on the Commission interim report on Sustainable Finance.
- As local and regional banks, co-operatives 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 a long term relationships with members, clients and the communities they belong to. They reinvest significant portions of their available profits back into the community by financing social and cultural projects.
- However the current complexity and continuous motion of the regulatory framework is heavily impacting the local co-operative banks. 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 local 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.*
- As 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. Co-operative banks shall be closely involved.

## Answers to the on-line 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*".



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Q.1 *From your constituency's point of view, what is the most important issue that needs to be addressed to move towards sustainable finance? (sustainable finance being understood as improving the contribution of finance to long-term sustainable and inclusive growth, as well as strengthening financial stability by considering material environmental, social and governance factors).*

Policy makers need to act with new tools and strong political signals to unlock our economies from fossil fuels. Priorities areas are:

- Developing a common taxonomy for sustainable assets with minimum
- standards.
- The creation of market opportunities (private capital in public projects)
- Awareness raising and investors culture towards sustainable finance

At the same time, 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.

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.

Q.2 *What do you think such an EU taxonomy for sustainable assets and financial products should include?*

The EU taxonomy could be an important building block. Some very first steps have been taken in PRIIPs. Having said that it should be noted that there are currently no universal predefined standards on what constitutes "green" or "sustainable". For establishing an EU taxonomy for sustainable assets and financial products, all relevant parameters should be carefully assessed and the EU should aim at the wider principles, rather than focus on details. Moreover as sustainable finance is very young and rapidly developing, the principles of proportionality and flexibility should be applied, in particular in current market situation.

We would therefore welcome a step-by-step approach . Initially it might be useful to allow for different shades of green in the classification system. For example the HLEG could consider differentiated classification for real-estate and renewable energy.

Classifications may be based on the EUROSIF definition for sustainable investments (see last EUROSIF report), reaching beyond the issue of climate change.

Q.3 *What considerations should the EU keep in mind when establishing a European* *standard and label for green bonds and other sustainable assets? How can the EU ensure high quality standards and labels that avoid misuse/green-washing?*

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

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.

Finally the independent assessment, always keeping the flexibility and proportionality principles in mind, is an important factor.

Q.4 *What key services do you think an entity like "Sustainable Infrastructure Europe" should provide, more specifically in terms of advisory services and connecting public authorities with private investors?*

Today European Investment Advisory Hub (EIAH) of the EIB already offers extensive information possibilities for regional authorities and other public authorities when structuring and developing infrastructure projects. Establishing of similar authority is not useful. There should rather be an expansion of EAIH and especially services in European regions shall be extended. EAIH shall focus on bigger and cross-border projects.

In general deal flow and information on existing projects – help in creating a history that can be used to further develop sustainable investing. In addition, it could be envisaged to introduce the function of platform for a secondary market thus increasing the liquidity.

Q.5 *It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement?*

- ***Yes***
- *No*
- *Don't know/no opinion/not relevant*

Q. 5.1 *If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to resolve or attenuate this conflict?*

Despite answering "yes' above, we wish to emphasize that co-operative banks gear their business model towards a perspective that is more focussed on long-term value and on member/customer use. 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 in the financial sector it is important to address regulatory mechanisms that minimize speculative effects on the environment. It is necessary to promote the coupling, in terms of responsibility, between the financing period, the repayment period and the impact time on the environment of the financed activities and projects.

More in general there are reasons to believe that the banking system will support the energy challenge.

Q.6 *What key levers do you think the EU could use to best align the investment and analyst community with 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).

Other options to price carbon are: Pigovian taxes and subsidies; trading emission rights through market mechanisms and auctions; implicit pricing through regulations and standards that incentivizes shifts towards new, less carbon-intensive technologies. There could also be implicit pricing through reputation and exposure, by creating processes for disclosing climate-related financial assets and financed projects.

Q.7 *How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?*

We agree with the position of the HLEG that banks have an important role for green infrastructure finance. We support the position of HLEG on project finance, in particular that stability in financial regulation is necessary and an important precondition for increasing banks' engagements in sustainable projects. We should bear in mind that the primary goal of real economy is to develop economically feasible and at the same time sustainable projects. Banks have a supporting role.

Moreover, we suggest to build and leverage on what is there already: i.e. the existing DFIs (Development Finance Institutions). As semi-public institutions they are well positioned and can be more flexible on market returns.

The creation of public-private funds aimed at sustainable investments is crucial; public-private partnerships can align with the objectives of social cohesion. The ultimate objective shall be to foster new climate change technologies, towards an economy with a smaller carbon footprint.

We also suggest creating a banking-insurance working group to develop green insurance offerings to secure financing for the transition.

Q.8 *What are some of the most effective ways to encourage credit rating agencies to take into consideration ESG factors and/or long-term risk factors?*
*Please choose 1 option from the list below*

- *Create a European credit rating agency designed to track long-term sustainability risks*
- ***Require all credit rating agencies to disclose whether and how they consider TCFD-related information in***
- ***their credit ratings***
- *Require all credit rating agencies to include ESG factors as part of their rating*
- *All of the above*
- *Other?*

Q.8.1 *Please specify what other ways you would deem most effective in encouraging credit rating agencies to take into consideration ESG and/or long-term risk factors.*

In general, we would agree with the second option: require all credit rating agencies to disclose whether and how they consider TCFD-related information in their credit ratings. Indeed ESG factor become increasingly important. In the 2015 update of its Annual Study of Intangible Asset Market Value, Ocean Tomo has revealed that intangible asset value of the S&P 500 has an increase of eighty percentage points over forty years. It should however be avoided an approach with strict regulatory specifications that could threaten existing and accepted rating agencies.

Moreover the credit rating procedures development should remain proportionate and flexible and not be based on too strict specifications of the risk factors to be considered. They should take into account co-operative banks specificities and their distinct business model.

Q.9 *What would be the best way to involve banks more strongly on sustainability, particularly through long-term lending and project finance?*

- Increasing the market knowledge and trust on green bonds and other sustainable instruments and thereby increasing investor demand.
- Lowering barriers to entry for issuers through creating clear, common and comparable European Standard utilising as far as possible the current market practice created by ICMA.
- Encouraging banks to sign sustainability commitments, such as Equator Principles on project financing.
- Increase the efforts regarding energy efficiency and renewable energies.
- 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.

Moreover as mentioned in the interim report (Pag. 31-33), the treatment of specialised lending and long term financing is not conducive for a growth of investment in this area. Although not addressed in the report, 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 way 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.

Q.10 *What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?*

Establishing metrics to demonstrate the effects of environmental performance on the financial performance of assets. Adjustment of SOLV to allow for long term investments

Q.11 *What do you think should be the priority when mobilising private capital for 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.

Q.12 *Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?*

*Disclosure/reporting:* banks already provide extensive information to stakeholders (both financial and non). As per CRR they are subject to specific financial reporting (FINRE,COREP). DIR 2014/95/EU establishes the framework for sustainability reporting. It would be too early to add elements of sustainability reporting into accounting standards before having assessed the existing non-financial reporting framework (currently implemented). If necessary, targeted adjustment may be considered in NFRD. A proportionate approach is necessary. No expansion of disclosure shall be addressed in Pillar III.

*Changes to capital charges factors: capital requirement reductions are relevant incentives to sustainable financing. I*n 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.

EACB is opposed to a further generalised elaboration of *the Fiduciary duty as described in the report*. Relevant provisions are already included in different pieces of legislation such as MiFID (II), UCITS, AIFMD, Solvency II and IORP II .

Position ESAs on sustainability: an extension of the mandate should be carefully assessed ESAs could focus on establishing guidelines that facilitate setting the framework (i.e. classification).

Q.13 *In your view, is there any other area that the expert group should cover in their work?*

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.

**About EACB**

The European Association of Co-operative Banks (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 27 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.050 locally operating banks and 58.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 81 million members and 749.000 employees and have a total average market share of about 20%.

For further details, please visit www.eacb.coop

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