Brussels, 16th July 2020

Key messages regarding the Sustainable Finance Strategy Consultation

The **European Association of Co-operative Banks** (EACB) represents, promotes and defends the common interests of its 27 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 2.800 locally operating banks and 51,500 outlets, they serve 209 million customers, mainly consumers, SMEs and communities. Europe's co-operative banks represent 84 million members and 713,000 employees and have an average market share in Europe of about 20%.

For further details, please visit www.eacb.coop

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

SECTION I: QUESTIONS ADDRESSED TO ALL STAKEHOLDERS ON HOW THE FINANCIAL SECTOR AND THE ECONOMY CAN BECOME MORE SUSTAINABLE

- From the perspective of our members, 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, **incremental additional actions** may be needed in targeted areas, but **existing actions implemented** under the Action Plan on Financing Sustainable Growth **should be the basis** .

- EACB also welcomes **measures that are compatible with a free market** like tightening **carbon trading schemes, pollution taxes** etc. that allow for transition and continuing innovation. Indeed, 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**.

- The **EU should, in our view, however refrain from establishing strategies for private investment but should provide incentives to stimulate the desired behaviours**. The current EU legislative framework (+ national standards) already provide the necessary tools for investors to influence companies' environmental strategies.

- We believe there should be an **incentivizing approach rather than a penalising approach**: penalising investments in environmentally harmful activities may be detrimental to companies that are on a transition path but carry on activities, which are still brown today, by preventing them access to investments they need to operate that transition. Investments in sustainable business activities should be incentivised instead of penalizing investments that are (probably) not in line with certain sustainability targets.

- It should be noted that EACB believes that more efforts and resources should be dedicated to **social challenges**, especially to contrast the **socio-economic consequences of green transition** and Covid-19 pandemic.

SECTION II: QUESTIONS TARGETED AT EXPERTS

- The EACB identifies **three main challenges** and **three main opportunities** for **mainstreaming sustainability in the financial sector** over the coming 10 years.

- The three main challenges appear to be i) **the complexity of the regulatory framework** and **the complexity of implementation** of the various and interconnected regulations (TR, SFDR, CRR/D) and other initiatives (ECB guidance, GL, Ecolabel) on sustainable finance. Consistency between all measures is crucial in this context; ii) **the availability, collection, processing, reliability of data reporting and accessibility** from the perspective of financial market participants and the **difficulty to provide such sustainability-data** from the perspective of companies; iii) **the lack of investor-awareness and acceptance** about the EUs sustainable framework.

- The three main opportunities appear to be: i) **to standardize data reporting**, and then **digitize data** reporting and access; ii) to make the European economy and financial markets more resilient **by focusing on sustainability and long-termism**, while making the EU the **main market for sustainable finance**; iii) to set **the right incentives to encourage sustainable investments**.

- It should be noted that there is a **lack of projects for green investments and lack of incentives** for all economic players, both public and private, to make their transition towards sustainability. We encourage **public authorities to lead by example** (EU public expenditure represents 45% of EU GDP, which shows the important potential of public investments in sustainability) and to develop public green projects and assets, which the financial sector will then finance.

- Concerning the data issues**, a clear and precise definition of climate, environmental and social risks** still **needs to be developed at European level** – otherwise it is not feasible to consider these risks in the risk management procedures.

- We have also considered **what EU could do to ensure that the financial tools developed to increase sustainable investment flows will be helpful in managing climate and environmental risks**. The EACB proposes that when the effect of decarbonisation on any of the issues or groups mentioned in the title is appreciable, **measures, such as subsidies** (and especially the equal redistribution of proceeds from environmental taxes, cf. the example of the carbon tax in Switzerland), **should be taken in order to alleviate the effects**. In our view the EU should consider the development of special subsidies for financing SMEs carrying out sustainable activities or SMEs that wish to transition (free training, online support platform…). Giving SMEs incentives to provide the most relevant data, e.g. on CO2 emission, could be an option, which would make it easier to invest/lend to SMEs to support sustainability.

- EACB encourages initiatives such as: 1) **implementing the foreseen financial tools in a gradual** (step by step) **way**; 2) **refraining from introducing penalising factors** or any penalising requirements that would discourage investments in specific sectors; 3) **revise the entire budgetary, fiscal and regulatory framework** in order to be geared towards a sustainable and just transition or **use the European Just Transition Fund** to achieve limited negative socio-economic impacts.

- Due to their widespread presence in local areas and often in rural or less urbanized regions, **co-operative banks would propose to accompany and stimulate this with the help of instruments to be put in place to specifically address the social risk related to the transitioning element**. This could be done, for example, in partnership with EIB with specific measures, incentivizing clients via public incentives (i.e. Just transition fund) that would translate in more favourable terms and conditions via the local banks.

- Without data from their clients', financial institutions will not be able to assess their portfolios with regards to ESG performance. For this reason, starting with largest companies would allow for a gradual phase in and slowly fill the gap to enable financial companies reporting in a second phase. Availability of corporates ESG data is also necessary to allow financial institutions and investors to steer their portfolios towards the objectives of the Paris Agreement and of the European Green Deal much more efficiently and on a much broader scale.

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1. STRENGTHENING THE FOUNDATIONS FOR SUSTAINABLE FINANCE

1.1 Company reporting and transparency

- The EACB calls the EU to take the lead to **start to establish a database where corporates in the EU can insert – on a voluntary basis ESG raw data in electronic form**. This EU database or register could be based under one of the main statistics centres in the EU. The **European register should first and foremost focus on registering the taxonomy based information as first building block** (according to the Taxonomy Regulation). As a further step it should aim at the collection of the broader category of ESG raw data from non-financial companies whose reporting is based on the NFRD and which are willing to publish their ESG data in the new database. **The availability of raw harmonized ESG data would allow for comparability, increase transparency, lower barriers and costs**, generate efficiency and attract new players. Especially when linked to taxonomy the database could provide a very valuable source of information to markets and policy makers alike.

1.2 Accounting standards and rules

- EACB sees a need for adjustments to IFRS but opposes a solely „European approach" to IFRS as this would be highly problematic and contradict the objective of uniform international accounting standards. Instead, the Commission would have to convince the IASB of the need for changes

In fact, the following targeted adjustments to IFRS 9 to better integrate ESG aspects regarding securities would be necessary:

a) The SPPI test should be enhanced for ESG purposes. Clarifications in the Basis for Conclusions might also be helpful.

b) An amendment for "Held to Collect" debt securities (measured at amortized cost) is needed so that they may be sold before maturity without compromising their future classification under the HTC Business Model if ESG-related ratings change.

1.4 Definitions, standards and labels for sustainable financial assets and financial products

- Regarding the EU GBS, the EACB is in favor of the **creation of a "mandatory verification regime"**. Pre- and post-impact & allocation reporting and pre-verification are already market practice today, even if not with reference to EU Taxonomy/GBS, but to ICMA. However, post-verification is one of the most important novelties of the TEG proposals and it will likely become market practice. **An accreditation process of external verifiers will be necessary to increase the credibility of the standard** and simplify the current situation of a market where it can be difficult to determine what sets different players apart. We believe that an **ESMA setup represents a good proposal**, but it will be important to ensure that the related legislative framework be flexible enough to allow and adapt to development opportunities. ESMA could align the current practices with Credit rating agencies and bring credibility to the process. The EACB believes that a simple, centralised process that would be accessible to any kind of players, including smaller issuers, should be the right way to follow.

Since the EU Green Bond Standard is a European label (scheme), **verifiers of EU Green Bonds should be supervised/accredited on a European level**.

- The EACB believes that the **EU should develop a standard or label for green (environmental and climate) mortgages and loans** or a narrow standard or label only for energy-efficient mortgages and loans for the renovation of a residential immovable property;

- Furthermore, the **EACB supports the proposal to define a green savings or deposit account in relation with the credit provided to green projects or companies engaged in green economic activities**. However, the EACB suggests to further investigate the feasibility and practicability of this proposal in order to avoid the creation of a framework that could not work for all the financial market participants. **Essential to being able to verify the extent to which a deposit account is 'green' is the possibility to identify and trace the link between the money that is placed in deposit and how that money is then used by a credit institution to provide (green) loans** to applicants for credit.

1.6 Corporate governance, long-termism

We assume that rules on governance have a very high potential to embed sustainability aspects in banking. We therefore would like to stress that the **governance model** of **cooperatives** by its definition and specific nature is **already well-tailored to reflect long- term, sustainability goals**.

If any new measures are taken, the long-term perspective of the cooperative model (Article 54 of the Treaty, Council Regulation (EC) No 1435/2003) must be underlined while its mitigating effects should be well reflected. In particular, it should be highlighted that the cooperative model provides for governance that favors a long-term orientation and a (long-term) customer-focus (customer relationship). Hence, it seems to be already appropriately tailored to encourage long-termism in line with the EBA's policy recommendations.

- **Remuneration**

We do not think that there should be a mandatory share of variable remuneration linked to non-financial performance for corporates and financial institutions. It must remain the responsibility of the financial institution to decide what share of variable remuneration should relate to non-financial performance.

In fact **solid linkage between the non-financial performance and the remuneration does already exist in the current framework applicable to banks**.

CRD IV, the EBA GL on sound remuneration policies take a very holistic approach regarding remuneration. Attributing a mandatory share to non-financial remuneration would complicate matters and may turn against the spirit of this approach. **An overrepresentation of ESG targets should be avoided as it could have a destabilizing effect**.

The current regulatory framework ensures that sustainability targets will be reflected in the banks' objectives and business strategy. A comprehensive approach to ESG considerations is to be developed by the EBA as under the mandate of Article 98 CRD V. In addition, the recently finalised GL on loan origination demand integration and understanding of ESG in the governance of institutions and in their credit granting process.

In this context, also Article 5 SFDR according to which banks which provide portfolio management and investment advice shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks, and make this info public should be mentioned.

Those aspects would have to be considered as company values in variable remuneration while this in turn will encourage behaviours consistent with the ESG aligned approach of banks' staff and management.

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2. INCREASING OPPORTUNITIES FOR CITIZENS, FINANCIAL INSTITUTIONS AND CORPORATES TO ENHANCE SUSTAINABILITY

2.1 Mobilising retail investors and citizens

- The consideration of **retail investors' sustainability preferences will require a dedicated guidance to financial advisers so that they can answer questions from clients**, where relevant. Such guidance could, for instance, be part of the continuous training of advisers. However, what is essential is that **such guidance remain non-binding, sufficiently general and at the discretion of each bank**. Financial advisers must be able to adapt and respond to the specific needs of each client, on a case by case basis. A binding and detailed guidance would only increase the burden on the business relationship. Furthermore, **a binding list of questions to ask the client could result in focusing more on compliance to avoid the risk of sanctions than on adapting to the respective client's profile**. For all these reasons, we would not favour such detailed guidance at an EU level.

2.2 Better understanding the impact of sustainable finance on sustainability factors

- The EU's Securitization Framework may be conducive in developing securitizations aimed at financing Green Projects, but it certainly requires adjustments. In fact there **seems to be a lack of sufficiently flexible regulatory solutions and appropriate incentives for green securitizations**.

More generally, the **barriers on the securitization market are not specific to "green assets"**: the STS framework licensed by EU co-legislators in 2017 did eventually fall short of the expectations that it would facilitate freeing resources to foster new lending to a greater extent. The regulation turned out to be quite restrictive on the one hand and exclude synthetic securitization transactions on the other. Synthetic transactions instead are particularly effective in helping banks to increase balance sheet efficiency.

All these shortfalls in the 2017 securitization framework have been addressed by the industry several times.

2.4 Digital sustainable finance

As regards the different questions in the consultation regarding digital sustainable finance and how best to use digital tools, the EACB notes that the notion of digital tools is quite wide and could refer to anything from email to chat, to blockchain, central data platforms and APIs or Artificial Intelligence. The EACB would **distinguish between two major perspectives: (1) digital platforms for ESG data and information and (2) digital distribution channels for financial products**.

1. Concerning digital platforms for facilitating the ESG data space: This has been advocating by the EACB since long. In fact, together with five EU trade Associations. We have has **launched a joint initiative calling for EU Action to create a centralized electronic register for Environmental, Social and Governance (ESG) data in the EU** (further details are available at the following link http://www.eacb.coop/en/news/eacb-news/joint-industry-letter-call-for-eu-action-a-centralized-register-for-environmental-social-and-governance-esg-data-in-the-eu.html). We acknowledge that the EU Commission has referred to a EU Green Deal dataspace (in the context of the European Strategy for data) and to a database on physical risks (in the context of the Adaptation to Climate Change Blueprint for a new, more ambitious EU strategy). We see links with our EU ESG central data register proposal.

2. Concerning digital distribution channels for financial products, this is a native feature of market development, and the EU should not intervene with central initiatives in this development.

   For example, co-operative banks are applying the opportunities offered by digitalization in many ways including:

   - Better analysis of data (in line with GDPR) and the application of artificial intelligence
   - Using blockchain or distributed ledger technology in areas of the banking business where they can offer increased efficiency and/or better access compared to other technologies
   - Using apps and API technology to improve communication with customers and – more generally – the customer experience, either by developing in-house solutions or working with third parties
   - **Support of "green investment" opportunities for retail consumers especially on the basis of the locally active co-operative banks and vice versa funding especially local and/or SME in "green projects" such as e.g.: renewable energy** (often performed by co-operatives), sustainable food (incl. supply chain), circular economy, and local social initiatives of citizens (e.g. co-operative for kindergarten or schools).

1.1. Project Pipeline

- Infrastructural projects will be crucial in coming years e.g. in reshaping transportation networks, energy plants, medical care facilities, even more so to stimulate long term recovery post-Covid19. **CRR2 introduced an "infrastructure support factor" (Art. 501a) for a more lenient prudential treatment of such exposures**. However, the criteria to be fulfilled are too complex and even not adequate for certain sectors (e.g. health care), and **should be simplified and streamlined**.

Obstacles also include lack of adequate incentives/policies, short-termism of economic agents or consumption patterns.

Many sustainable projects may be high risk particularly at inception, thus more shared risk arrangements (Public-Private Partnerships**) are needed**. Especially in proof of concept phase, and for capital-intensive businesses, more public funding is required.

Profitability in renewable energy projects greatly depends on public policies; a stable regulatory environment is a key condition for bankability on long term horizons. Having clarity regarding certain regulations e.g. a (minimum) carbon tax or a cap-and-trade-system is also key.

A strategy is needed to transition public funding, representing 45% of EU GDP, via fiscal, budgetary, regulatory measures. This would boost the emergence of green projects, for banks to co-finance, and give a signal to all economic players.

Lack of clarity on the usability of the taxonomy is also a challenge particularly for start-ups, which are key drivers in developing new areas for sustainable solutions.

While SMEs, corporates, retail banks already invest in sustainable projects, the issue is identifying and tagging such assets. Reasons include: administrative burden (especially for granular portfolios); **lack of proper definitions, e.g. a social taxonomy is lacking while loans with positive social impact are sizeable for cooperative banks' lending**; difficulty in obtaining proof or IT fields to tag the assets due to other regulations (Data protection).

- EU SMEs represent the 95% of the total amount of companies. As **local and regional banks, 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 favor 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.

The **EU Regulations on Sustainable Finance and sustainable financial tools** (e.g. green bond, green loans, taxonomy aligned **investments) currently are mainly addressed to large companies and relevant operations/projects**. **A proportionate, simplified and less costly approach should be adopted to support SMEs and smaller investors to invest in sustainability and green transition**. The EIB and other promotional institutions could design innovative SME products to be delivered via banks. **Specific credit guarantees would reduce collateral requirements and stimulate development of standard green banking products for SMEs**.

Other relevant tools could be the use of credit protection facilities, a wider approach to SME-friendly legislation, facilitating business start-ups and cross-border expansion of SMEs, small lot assignment of public contracts to facilitate SMEs' procurement.

New options for tapping debt and equity markets for SMEs (e.g. Sustainable Mini Bonds) and the potential for common standards for sustainable credit and loans to SME could be explored.

2.5 Incentives to scale up sustainable investments

- Sustainable investments should be profitable and more attractive than other investments but, because of mandatory prospectus reporting and assurance, sometimes they face higher costs than mainstream investments. For this reason it could become relevant the possibility to introduce fiscal benefits and preferential prudential treatments for sustainable investments.

In our view, **some barriers to attracting sustainable investment could be broken through the creation of eco-labels**. For investors would be better aware of the environmental specificities of the financial products they are investing in, addressing at the same time the lack of education that persist in this field.

ESG data is currently in larger scale so expensive that small investors (e.g. small pension funds) do not have resources to buy it directly. Even if they had resources to buy it - they would not likely have resources to understand and analyse it correctly. In addition to this, the lack of a common EU standard for ESG reporting and the absence of a European definition of materiality contribute to increase market barriers and inefficiencies.

We also believe that **another issue could be related with the insufficient number of projects to finance**. The role of our members in the European economy is not to develop

sustainable projects but to finance them. **An increase in sustainable projects will naturally be supported by an increase in sustainable investments**.

- In our view the EU should consider the following three incentives in order to facilitate access for SMEs carrying out sustainable activities or wishing to transition:

1) **Special subsidies for financing SMEs carrying out sustainable activities** or SMEs that wish to transition (free training, online support platform…);

2) **Tax incentives for green investments**;

3) SMEs will especially benefit from increased use of standardisation and sharing of data. **Giving SMEs incentives to provide the most relevant data, e.g. on CO2 emission, could be an option**, which would make it easier to invest/lend to SMEs to support sustainability.

3. REDUCING AND MANAGING CLIMATE AND ENVIRONMENTAL RISKS

3.1 Identifying exposures to harmful activities and assets and disincentivising environmentally harmful investments.

- **While a brown taxonomy would provide further indications regarding climate risk, we fear that its development at this stage might produce unintended consequences, especially if not complemented by consistent public and private measures promoting greening of industries**.

It would rather expose further some industries, constraining credit flow, while they have to deal with the challenges of reconverting. As such industries still secure substantial workplaces, and the Covid19 crisis is having sweeping impact on the labor market, it would be destabilizing to put them under further strain. Market forces will push brown companies to transition or disappear.

Stronger transition risk could emerge, faster than anticipated, as financial outflows or as financing constraints. Accompanied by significant decline in customer demand this could severely affect financial stability and society. This while brown activities may simply turn to other funding sources (self-funding; third-country investors).

Setting transition periods and targets for companies in the most polluting industries should be paralleled by EU transition funds to avoid sudden insolvencies and job losses, and include funds for reskilling affected workers.

The green taxonomy already categorizes assets based on a significant no harm principle for environmental objectives, and delegated acts will establish technical screening criteria. **The harm criteria could reveal quite relevant from a credit risk perspective**, helping to recalibrate practices and portfolios.

It is now key to operationalize the green taxonomy, as it was only just adopted and there is no experience in implementation and workout.

Also, supervisory initiatives (such as the Guide on climate and environmental related risks being developed by the Single Supervisory Mechanism, or the mandate for EBA under Art. 98 CRD V)

and dialogue will already lead institutions to develop, for risk management and SREP purposes, methodologies to screen and assess customers. This will allow banks to understand risks and engage with customers where needed, without giving rise to abrupt changes to credit flows or regulatory requirements.

- The **current macro-prudential policy toolbox for the EU banking sector** (systemic risk buffer, countercyclical capital buffer, O-SII buffer etc.) **is fully sufficient to address and absorb potential systemic financial stability risks related to climate change**.

Since financial stability risks stemming from climate change do not constitute a specific risk category (they rather reveal their effects via existing risk categories, like credit or operational risk), they can be addressed within the frame of the current macro-prudential policy toolbox. Hence, **there is no need for specific (new) macro-prudential tools. We see no need for further regulatory action to expand the current macro- prudential policy toolbox for the EU financial sector in this area.**

Contacts:

- Ms. Elisa Bevilacqua, Head of Department Sustainable Finance, elisa.bevilacqua@eacb.coop
- Mr. Giovanni Betti, Adviser, giovanni.betti@eacb.coop