EACB Position Paper on the European Commission Action Plan on Sustainable Finance

May 2018

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, sustainability and proximity are the three key characteristics of the co-operative banks' business model. With 3.135 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 209 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 80.5 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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INTRODUCTION AND GENERAL VIEWS

In 2016[1] the Paris Agreement entered into force where the key objective among the contracting states is to significantly reduce global warming. The EACB ***expressly supports political targets for creating sustainable and climate-friendly regulatory frameworks in order to significantly reduce the risks and consequences of climate change.*** A major effort on the part of all involved signatory States will be required to actually reach the defined targets on sustainability. At the same time, it will be decisive for a successful implementation that Europe acts with one voice and in unison with the other continents and jurisdictions. The important climate targets can be reached via diverse measures to which public authorities, private households and companies should contribute. In doing so, Europe has to develop solutions that facilitate the action of stakeholders (e.g. banks) in promoting green investments and energy adaptation, while fostering job creation.

On 8 March 2018, on the basis of a report of a High Level Expert Group, the European Commission published the Action Plan 'Financing Sustainable Growth' that provides a concrete overview of additional legislative proposals plus an indicative timeframe.

According to the Commission, € 270 billion must be additionally invested in sustainable projects to reach the targets of the Paris Agreement. This requires a public-private partnership. To unlock this kind of investments, strong new incentives have to be created and existing ones to be strengthened. This includes both economic and regulatory incentives - a realistic CO2 pricing, clear cut environmental laws, enforcement, an enabling environment for sustainability, and green subsidies. In addition, a reassessment of financial sector regulation and supervision is necessary to make sure this regulation is indeed supportive to the transition process.

As a starting point, the Action Plan aims at a standardised definition of sustainable investments. The Commission names this standardised classification system taxonomy. The essential principles and the scope of this taxonomy shall be presented by the Commission by means of a proposed Regulation in the second quarter of 2018. Based on this Regulation for an EU-wide standardized classification system, comprehensive requirements for banks in the areas of disclosure, reporting, risk management, product labelling and corporate governance with regard to green finance shall be implemented.

The EACB and its members welcome the Action Plan on Sustainable Finance and see it as a logical further step to foster the objectives agreed in the Paris agreement. The EACB considers that banks can play a crucial role in financing the global energy transition and the de-carbonization of the economy. This role clearly assumes a special relevance for co-operative banks not least because, by their very inception, they pursue the long term interest and a sustainable business model as sought after in action 10.2 of the Action Plan. With this in mind the EACB Members would be keen to contribute to the further elaboration of the action plan. Co-operative banks also seek to play a crucial role in financing the energy transition, in particular at local and regional level. This can complement measures at macro level, and help to achieve the necessary substantial improvements. (as also pointed out by the HLEG in its final report under point II. 2. " Accelerating the shift to sustainable finance" i).

[1] https://unfccc.int/sites/default/files/english_paris_agreement.pdf

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Co-operative banks have strong distribution networks and are amongst the leaders in green bond issuing in several European countries. Member banks of EACB are signatories of the main international initiatives (i.e. UNEP FI, UN Global Compact, OECD Guidelines, PRI).They have established specific non-financial reporting methodologies through their Sustainability Reporting, obtaining good scores in the ratings by ESG rating agencies.

We believe that sustainable finance is part of the core business of co-operative networks with their focus on serving SMEs, households and individuals throughout the regions of Europe and thus helping to create a more inclusive society that is served by financial institutions capable of directing resources to improve the environment and a more cohesive social fabric.

This is why we also think that co-operative banks should be involved in the European Commission Action plan in order to bring forward their expertise on how sustainable finance can have an impact on risk management and how a legislative framework should take into account the accounting, prudential banking supervisory, and reporting requirements so that such an initiative is manageable and can therefore attain its objectives embarking all relevant stakeholders.

We are confident that the experts we have nominated will substantially contribute not only to the progression of standards for green bonds (co-operative banks have been foremost in the development of the green bond market in Europe and could leverage their expertise in this field), but also to the development of an EU taxonomy , to the design and methodology of a low-carbon benchmark and other climate-related metrics as well as to the discussion around the incorporation of sustainability in prudential requirements.

At this point, the EACB would like to develop and share some initial thoughts regarding the different action items in the Action Plan as follows:

PRELIMINARY VIEWS AND RECOMMENDATIONS

1) The need for a comprehensive approach

The EACB and its member believe that in order for the action plan to reach its full potential, it should be accompanied by a comprehensive approach for economic and financial sector policies across European Member States, including aligning their approaches in the implementation of the Paris agreement. This will provide the overarching policy frameworks. Inconsistencies in those policy frameworks could negatively affect the outcomes that the EC Action Plan can achieve. An additional step to avoid this would be to ensure that the taxonomy to be developed in the context of the Action Plan encompasses already (globally) existing scopes and definitions of the term “sustainability” including the public sector view.
Additionally, it would be advisable to ensure that measures are to incentivize all economic actors (citizens, SMEs, companies and public administrations) towards a more sustainable economic model. Indeed, whilst we agree that the finance industry can and should play an important role, the finance industry alone cannot succeed in steering all economic actors in the right direction.

2) Recognise the corporate governance of co-operatives as an important contributing factor to sustainable finance.

The governance of co-operative banking institutions, expects its directors to act in the company’s long-term interest. In co-operatives, members voluntarily join forces in order to support one another in the attainment of shared purposes. Based on their statutes, the co-operatives' pre-eminent aim is achieving economic advancement of their members. Maximising profit is not an objective per se. In short, the EACB members already respond to the objectives the action plan aims to achieve under action 10.1.ii. "fostering sustainable corporate governance and attenuating short-termism in capital markets".

Co-operative banks are based on lasting relationship to private customers and enterprises. Their success depends strongly on the economic, ecological and social wellbeing of their operating area. The daily financing of sustainable projects in European regions are a main feature of the co-operative banks business model. In line with their mission co-operative banks are committed and support the creation of a sustainable European economy.

At the same time, the EACB believe that a greater emphasis should be put on the value that local and regionally oriented banks such as co-operative banks can bring to sustainable financing by providing a series of tools and policies that are conducive the continued existence of such banks that can finance green growth in the regions via SMEs, households and local actors. Social aims, employment, social inclusion and affordable housing are also key for sustainable finance. This should be a priority in the further steps of the European Institutions in which co-operative banks would like to be closely involved**-** - in particular taking into account the societal dimension and **the positive social (beyond the environmental) impact of their long-term lending activity** at a local level in the regions of Europe.

In a broader perspective, co-operatives and co-operative banks are given a decisive role in the Sustainable Development Agenda 2030 of the United Nations in the course of creating durable and sustainable economic growth and achieving productive full employment (see also the ILO study Co-operatives and the Sustainable Development Goals).

We would therefore recommend that **the corporate governance of co-operatives and long-term approach to finance provided by co-operative banks is recognized in policymaking, as an important contributing factor to sustainable finance. This could also be reflected in the definition of "sustainability" and the relevant taxonomy in particular when applied to social and economic development.**

3) Process regarding the classification system (taxonomy)

The EACB agrees, in principle, with the need for a classification system and is keen to contribute to its development. On the process, we are fully aware of the reasons why the Commission has proposed a two-step approach, proposing a regulation first (in May 2018) and having the elaborated details integrated at a later stage. However, this approach needs careful consideration of its cross-sectional influence on other pieces of legislation, and should be consistent; we understand this is as the decisive cornerstone for the whole initiative and therefore urge the Commission to guide this process with its utmost attention.

The EACB subscribes to the view that – first and foremost - a clear and shared understanding is needed of what "sustainable" means and how 'sustainable finance' policies should look like. In order to kick-start that discussion the EACB would be willing to share with the EC examples several of the sustainable finance policies of its members. Likewise, several of our members already developed policies on green bonds and have emitted such bonds. At the level of the European SIFs and EUROSIF the taxonomy topic has been discussed for a long period of time. This

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experience could prove to be of interest for the discussion on labelling and the EACB members would welcome the opportunity to discuss further.

4) Green supporting factor, including for loans

The EACB considers that policy action on greening the economy should foremost be focused on direct incentives that aim at changing the behavior of producers and consumers. For instance: setting restrictions on emissions, addressing shortcomings in the CO2 price system, using green subsidies to stimulate the transition, deploying regulatory tools, and supervising the progress in that changes are effected. Several of these polices and their implementation can be coordinated - and this is the case – at EU level. Others, like deployment of taxes, belong to the national competence of EU-states. The latter are the most effective and direct means.

Supplementary indirect incentives can also be considered. The EACB supports the European Commission's proposal to look into risk differentials for capital charges for banks. This includes researching a so-called green supporting factor, building on the development of the EU sustainability taxonomy. The EACB agrees with a step-by-step approach and to take into account research in risk differentials using actual data, such as for energy-efficient mortgages.

Further, the EACB warns against the implementation of higher capital requirements for whole categories of assets that are deemed 'less sustainable'. Such brown factors do not address the roots of the problem and could even prove to be counterproductive, disrupting risk management policies and the financing of the economy.

5) EU Green bonds standard

Banks belonging to the EACB membership have always been very active in the Green Bond markets- as arrangers, as issuers and in the market governance.
On the governance, 3 among 8 banks which are members of ICMA Green Bond Principles, are co-operatives and are part of the governing Executive Committee- which represents a remarkable market share. Furthermore, Credit Agricole CIB was the first European bank to co-author the Green Bond Principles in 2014, while Rabobank and DZ Bank have been early supporters of the initiative.
On the arrangement side, investment banks members of the EACB have a >11% market share in the total underwriting of Green Bond, Social Bonds and Sustainability Bonds on a global basis, according to Bloomberg. This underlines the importance of EACB banks as a very experienced group of underwriters (combining Credit Agricole, Natixis, Rabobank, DZ Bank, Raiffeisen and CréditMutuel).
On the issuance side, several EACB Banks have been regular issuers of Green Bonds and Social Bonds with a market share of 20%[2] .

The EACB considers that the development of the green bond market may be stimulated by setting up an EU Green Bond Standard (EU GBS) and by integrating this standard into EU regulations. This is a step further than the voluntary certification of green bonds so far. Provided it is done well the EACB considers that this gives more clarity to the market and is to be regarded positively. The EACB would like to further engage on this topic with the Commission.

[2] See also leaflet: the engagement of co-operative banks to green and sustainable finance & fight against climate change.

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Regarding our expectations to a future common EU-standard for Green Bonds we refer to the "Green Bond Principles" which have been established by a private initiative and which we are following on a voluntary basis today. Any initiative of the European Commission to implement these (or similar) as common standard in the EU would be highly appreciated and welcomed. In designing the new standards we would encourage the EU Commission to take into account the specificities of the co-operative banking groups/networks . The EACB suggests to allow a certain flexibility when it comes to the direct link for the flow of funds between the (green) bond and the related loans, to reflect the situation of a central institutions of the respective co-operative group/network which may raise funds through green bond issuance on the capital markets while local/regional members of the group/network use such funds to finance their portfolios of sustainable loans, leveraging the potential substantially in this area by increasing the regional impact of such financing into local communities and SMEs in the EU.

For a presumptive impact calculation on CO2-effects of a particular loan or financed project we would very much welcome a harmonized European standard replacing the current diverse national provisions. Regarding the reporting provisions for green bonds we prefer a standardized approach on a portfolio basis, because any additional transparency on a single loan/project-basis could be in conflict with the new rules on data protection.

In addition, we would like to highlight the fact that Green/Social/Sustainable bonds obviously depend on the use of proceeds of those bonds, which in many cases are in fact loans pursuing a positive social and/or environmental impact. That is why co-operative banks, with their unique retail focused strategy of financing the real economy in Europe are well placed to understand the nature of underlying assets which can be defined as allowed 'use of proceeds' of Green/Social/Sustainable bonds.

6) Fiduciary duty and investment advice

Sustainability factors can serve as an additional parameter for evaluating the long-term performance of companies and projects and their consideration -where appropriate. That is why, financial institutions and investment entities are increasingly seeking to integrate sustainability factors in their investment process and decisions and to monitor and mitigate their risk where necessary. In this context, the suitability assessment process is a key step in finding out essential facts about the client to determine their investment objectives.

Having said that:

- The understanding of what is "in the best interest of the client" is a rather subjective notion. And whilst advisers and other fiduciaries may in general (seek to) integrate sustainability factors in their investment process and decisions, this is always subject to 2 additional conditions namely (1) this is intended and supported by their clients (2) the impact on the financial return is appropriately considered. The latter may be particularly relevant if the impact of a more sustainable choice leads to significantly less return on investment for the investment period pursued by the investor. In this context, as already highlighted under point 1, it is also important to consider the differences between the role, influence and purposes of the different actors in financial markets, bearing in mind that clients and asset owners are the ones to ultimately set their investment objectives and wishes. The investors`s selection of a suitable investment product is based on varied needs shaped by his or her individual values and investment goals.
- Admittedly, that the introduction of a sustainability objective should not become a tickbox exercise but both flexibility and proportionality should be ensured. Any one-size fits all

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approach would limit the possibility to act according to specific investors' situation and would introduce aspects of a planned economy into a market economy.

- It would be important to ensure that all types of finance investment are covered by the objectives of the action plan. Whilst banks, institutional investors and asset managers are subject to specific action items, it would need to be ensured that other important sources of capital (e.g. venture capital, equity investment) are also captured. This point is also reflected in the Final report of the High-Level Expert Group on Sustainable Finance (under point II. Key recommendations sub point 2. clarify investor duties to better embrace long-term horizon and sustainability preferences).

7) Disclosure and non-financial reporting

The EACB critically accompanies the call for an upgraded disclosure framework for reporting non-financial material information and the development of official sustainability standards. It should have a look at already existing work.

Having said that, a European interpretation of such existing work should reflect the particularities of the European economies and their impact on sustainability. Additionally, it would have to reflect the specificities and of diversity of the European banking markets.

Moreover, as Directive 2014/95/EU (NFRD) is in its first year of implementation it would be too early to add elements before having assessed the existing non-financial reporting framework in its entirety. If necessary, targeted adjustment may be considered in NFRD. A proportionate approach is necessary. The members of EACB will gladly provide their views on this issue.

8) Need for proportionality

Whilst the EACB is aware that the Commission, Council and Parliament in recent years have developed more awareness of the need for proportionality in developing its regulatory initiative, we make a call not to lose sight of the unintended consequences that a too far-reaching regulatory framework and supervisory (reporting) around sustainability may have.

The EACB is very conscious that banks would have to produce an extensive set of comprehensive information and meet documentation requirements involving IT and organizational changes and challenges. For instance, every single client would have to be asked for his individual preference regarding sustainability. A separate asset class for sustainable finance would have to be reflected in the risk management systems of every single bank. The corporate governance policy of the institution would have to follow sustainability aspects. Furthermore, banking products would have to be labelled according to their degree of sustainability. Additionally, the implementation of the Directive on Disclosure of Non-Financial Information (Directive 2014/95/EU), of which we recognize the merits, does not go without great deal of administrative burden, particularly impacting local or smaller banks that have large number of customers to process and large number of diverse projects in their portfolios or have less resources for reporting

This may add to already heavy requirement and major organizational and administrative efforts that in particular smaller co-operative banks face in implementing complex pieces of legislation such as MiFID2. In order to allow proper functioning of the market and the local economies the principle of proportionality should be observed and allow some degree of flexibility, while avoiding unnecessary bureaucratic burden for those smaller entities.

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The EACB stresses that particular attention should be put so that potential new sustainability requirements ***are carefully balanced and proportionate to the goals pursued***. If concretely these requirements add more "red tape" to the already heavy burden that many (typically local or regional banks) banks face, then these banks will be incentivized to the opposite i.e. not to participate in the fight against climate change. The related costs would prevail the benefits. This in turn will leave mostly larger actors and non-banks in this economic arena to finance sustainable projects, further weakening the diversity of the banking sector, concentrating risks to fewer actors while enshrining an unleveled playing field. This is a mistake to be avoided. Co-operative banks therefore would propose to perform **an impact analysis of concrete actions to be pursued** on the retail activity of the climate measures of the European Commission's work, including consideration for exemption thresholds to adapt the administrative burden of reporting the financing as internal activities

SUMMARY

In conclusion, co-operative banks expressly support the political targets for creating sustainable and climate-friendly regulation frameworks in order to significantly reduce the risks and consequences of climate change, as well as to improve social cohesion.

Co-operative banks, with their broad networks and geographical reach can play a key role in the development of a more inclusive and sustainable finance, taking into account both environmental and social aspects.

Additionally, co-operative banking groups/networks are active players in the field of sustainable finance both as underwriters and as originators/issuers of sustainable loans and bonds.

Specifically, co-operative banks are eager to collaborate in the assessment of the main building blocks of the European Commission Action Plan such as taxonomy, reporting, risk management and impact on accounting, with a view from a practical and retail perspective.

Co-operative banks call the Commission to take into account the comments above in the forthcoming work to be launched in the framework of its Action Plan.

We remain available to answer any further questions on this paper.

Contact:

The EACB trusts that its comments will be taken into account.

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