afme/
Finance for Europe

State of Play

Status of European Regulatory Developments on Sustainable Finance

February 2020

Association for Financial Markets in Europe
www.afme.eu

Contents

1. Background and executive summary

Following the adoption of the 2015 Paris agreement on climate change and the United Nations 2030 Agenda for Sustainable Development, the European Commission published its "Action Plan: Financing Sustainable Growth"[1] (Action Plan) having three main objectives:

- Reorient capital flows towards sustainable investment, to achieve sustainable and inclusive growth;
- Manage financial risks stemming from climate change, environmental degradation and social issues;
- Foster transparency and long-termism in financial and economic activity.

In May 2018, the Commission adopted a package of measures[2] implementing several key actions announced in its Action Plan. The package included proposals aimed at:

- Establishing a unified EU classification system ("taxonomy") on what can be considered an environmentally sustainable economic activity;
- Improving disclosure requirements on how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes;
- Creating a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks to provide investors with better information on the carbon footprint of their investments.

The Commission has achieved significant progress on the proposals under the Action Plan, with all three main initiatives currently in the process of being implemented. In particular:

Legislative proposals under EU Action Plan on Sustainable Finance

TAXONOMY: A political agreement was reached in December 2019. The final text of the Regulation is expected **to be published in Q2-Q3 2020**. The Commission will later establish the detailed **Technical Screening Criteria** for economic activities through delegated legislation.

DISCLOSURE: In December 2019 the Regulation entered into force and will be **applicable as of 10 March 2021**. European Supervisory Authorities (ESAs) are developing detailed technical standards to aid the application of the Regulation. Most will be adopted via delegated acts **by 30 December 2020**.

BENCHMARKS: The final text amending the EU Benchmark Regulation was published in November 2019. Benchmark administrators, providing new climate benchmarks, will have to comply with the Regulation **by 30 April 2020**. ESAs are now working on the delegated acts that would specify in more detail the Regulation requirements and which are expected to largely be based on the recommendations by the Commission's Technical Expert Group published in **September 2019**.

In addition to outlining in more detail the provisions set out by the legislative proposals in the Action Plan, this document summarises the initiatives and strategies set out by the European Supervisory Authorities and other key stakeholders, as well as the current state of play and next steps. **The appendix provides a snapshot of the key initiatives and their timeline.**

[1] Commission action plan on financing sustainable growth
[2] European Commission – Implementing the Action Plan

2. European Green Deal

Following the EU Action Plan, on **11 December 2019, the Commission presented its EU Green Deal**[3] announcing an ambitious package of measures, targeting all European sectors and industries, for a *just* and *inclusive* transition towards achieving climate neutrality by 2050. In January 2020, the European Parliament adopted its motion for resolution on the European Green Deal,[4] backing the Commission's announcement with large consensus.

The Commission is planning to publish an updated sustainable finance strategy in Q3 2020 ("Renewed Sustainable Finance Action Plan"). The strategy will build on the 2018 Action Plan and is expected to include the integration of ESG factors in corporate governance and the development of labels for retail investment products, among other proposals. **The Commission is expected to launch a consultation on the sustainable finance strategy in Q1 2020.** As part of this renewed strategy, the Commission is undertaking work to **review the EU Non-financial reporting directive (NFRD)[5],** with the objective to increase transparency in environmental reporting and narrow down the ESG data gap.

On 14 January 2020, the Commission published its Sustainable Europe Investment Plan,[6] outlining the strategy to mobilise the EUR 1 trillion in investment necessary to achieve the 2050 climate neutrality goal, through a mix of public and private funding from a variety of sources, including the EU budget, the InvestEU programme and gradually transforming the European Investment Bank (EIB) into a climate bank. The plan also aims at creating an enabling framework for private investors to identify and allocate funds in sustainable products and activities, as well as support for the public sector and local administrations.

As part of the Sustainable Europe Investment Plan, the Commission launched on the same day a proposal for a **Regulation establishing the Just Transition Fund**.[7] The regulation establishes a balanced allocation of funding to promote a shift towards a low-carbon economy while maintaining a special focus on the regions most affected by the transition, due to a heavier reliance on energy produced from fossil fuels. **The Commission also launched a public consultation on the proposal**.[8]

[3] Communication from the Commission - COM(2019) 640 final – The European Green Deal
[4] European Parliament resolution of 15 January 2020 on the European Green Deal (2019/2956(RSP))
[5] Non-Financial Reporting Directive – NFRD – (Directive 2014/95/EU)
[6] Commission Communication on the Sustainable Europe Investment Plan
[7] Proposal for a regulation establishing the Just Transition Fund
[8] Consultation page: European Green Deal – Just Transition Fund

3. EU Taxonomy

In December 2019, Member States endorsed[9] the compromise text of the Taxonomy Regulation (TR)[10] previously agreed by co-legislators (EU Parliament and Council). This is considered to be the key proposal under the EU Action Plan that creates a general framework for the progressive development of an EU-wide classification system of environmentally sustainable economic activities.

To recap, the TR sets out **six environmental objectives:**

- Climate change mitigation;
- Climate change adaptation;
- Sustainable use and protection of water and marine resources;
- Transition to a circular economy, waste prevention and recycling;
- Pollution prevention and control;
- Protection of healthy ecosystems.

The Regulation also establishes **four requirements** for economic activities to comply with in order to qualify as environmentally sustainable. An economic activity should:

- Contribute substantially to one or more of the environmental objectives;
- Not cause significant harm to any of the environmental objectives;
- Must be carried out in compliance with minimum safeguards (such as adherence to international social and business standards and conventions);
- Must comply with technical screening criteria.

Pending legal and linguistic review, the final text is expected to be published in the Official Journal of the European Union (OJEU) in Q2-Q3 2020 and will enter into force 20 days after the publication. The dates of application will be specified in the final text. The Commission will later establish the detailed Technical Screening Criteria through Delegated Acts:[11]

- The delegated acts on **Climate Change Mitigation** and **Climate Change Adaptation** objectives should be adopted by the Commission **by 31 December 2020** and will be **applicable as of 31 December 2021**.
- The delegated acts on the remaining four environmental objectives should be adopted by the Commission **by 31 December 2021** and will be **applicable as of 31 December 2022**.

[9] Council of the EU - Press release - 18 December 2019 - Sustainable finance: EU reaches political agreement on a unified EU classification system
[10] COM (2018) 353 final - Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the establishment of a framework to facilitate sustainable investment
[11] Type of the EU legal acts that are legally binding and enable the European Commission to supplement or amend EU legislative acts, for example, in order to define detailed measures.

The scope of the TR has been aligned with the EU Disclosure Regulation (DR)[12] adopted earlier (see also the next section), establishing additional transparency requirements around **all financial products** offered by certain **financial market participants**. Definitions of a "financial product" and a "financial market participant" for the purposes of the TR are established in the DR as follows:

Financial Product	Financial market participant
• a portfolio managed as defined by MiFID II; • an alternative investment fund (AIF); • an insurance-based investment product (IBIP); • a pension product; • a pension scheme; • a UCITS; or • a PEPP.	• an IBIP provider; • an investment firm which provides portfolio management; • an institution for occupational retirement provision (IORP); • a manufacturer of a pension product; • an alternative investment fund manager (AIFM); • a PEPP provider; • a manager of a qualifying venture capital fund • a manager of a qualifying social entrepreneurship fund; • a UCITS management company; or • a credit institution which provides portfolio management.

The TR recognises so-called **transitional activities** (activities for which there are no technologically and economically feasible low-carbon alternatives but which are necessary for the transition towards a low carbon economy in the near term) and **enabling activities** (activities that enable other activities to make a substantial contribution to one or more environmental objectives). Such activities will also need to be assessed against technical screening criteria, with criteria for transitional activities to be reviewed every three years.

Transparency requirements under the TR are different across the following types of products:

- **Products with sustainability objectives** with the underlying investment in environmentally sustainable activities (products defined in Article 9 of the DR): pre-contractual and periodic disclosures need to be made by financial market participants and include the environmental objective(s) that the product contributes to, the extent of investment in taxonomy-compliant activities and share of sustainable, enabling and transitional activities as a percentage of all investments.
- **Products promoting environmental characteristics** (products defined in Article 8 of the DR) – need to disclose the same as above and to comply with the "do no significant harm" principle for those investments that use the taxonomy in the assessment of the degree of their sustainability.
- **Other financial products**: pre-contractual and periodic disclosures need to include a statement that "*The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments*" (namely, the taxonomy).

[12] Regulation of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

The TR also requires all companies preparing non-financial statements under the **EU Non-Financial Reporting Directive** to disclose how and to what extent the company's activities are associated with environmentally sustainable economic activities, effectively **scoping in banks and other financial institutions**. It further specifies that **non-financial undertakings** will have to disclose more specific information on the proportion of revenues as well as the OPEX or CAPEX associated with sustainable economic activities. The detailed content of such disclosures will be defined by delegated acts by 1 June 2021.

The Regulation sets the principle of **technological neutrality** for the development of the technical screening criteria. It means that the criteria should consider specific facts and circumstances in defining what can be considered as environmentally sustainable without directly favouring, or discriminating against, any technology (or economic activity). For example, energy generation from **nuclear** power, which was heavily debated during the political negotiations on the TR due to issues around toxic waste management, would need to be assessed in terms of its contribution to environmental objectives in light of the "do no significant harm principle" similarly to any other economic activity. It is only power generation from solid **fossil fuels** that was explicitly excluded from the definition of a sustainable economic activity under the Regulation.

The first **review** of the TR will take place after two years after its entry into force, and every three years thereafter. The regulation includes a clause allowing the Commission to consider extending the Taxonomy to harmful activities (so-called "**brown taxonomy**"). The development of further iterations of the Taxonomy framework, including the Commission's work on the delegated acts, will build on the inputs of the Technical Expert Group on Sustainable Finance (TEG) and the EU Platform on Sustainable Finance. In particular:

- **TEG recommendations** would be critical to the Commission's work on developing the future delegated acts. In June 2019, the TEG provided its preliminary recommendations[13] and it is expected to publish the final report **in Q1 2020**. The concrete list of activities which will qualify as 'environmentally sustainable' will have to be identified by the Commission when drawing on the advice of the TEG.
- **The EU Platform on Sustainable Finance**, established by the Commission and composed of experts representing both the public and the private sector, will advise the Commission on the development and implementation of the screening criteria, as well as monitoring their impact for subsequent review.

4. EU Disclosure Regulation

The EU Disclosure Regulation (DR) introduces additional disclosure requirements for asset managers and institutional investors to enhance transparency to end investors around:

- Integration of sustainability risks and the consideration of adverse sustainability impacts in asset managers/institutional investors' processes; and
- Sustainability-related information with respect to financial products offered.

In December 2019 the Regulation entered into force and will be **applicable as of 10 March 2021**.

The Regulation will apply to financial market participants (definition provided in the section above on the EU Taxonomy) and financial advisers (insurance intermediaries and undertakings advising on IBIPs; credit institutions, investment firms, AIFMs and UCITS management companies which provide investment advice as defined in MiFID II Directive).

The Regulation introduces a range of other new definitions, including for concepts such as **sustainable investments**, **sustainability risks** and **sustainability factors**.

[13] TEG report on EU taxonomy

Delegated acts will be adopted to establish detailed regulatory technical standards (RTSs) specifying the Regulation requirements. In particular, the European supervisory authorities (EBA, EIOPA and ESMA) have been tasked, through the Joint Research Committee, with developing the following technical standards:

- Website disclosure of adverse environmental sustainability impacts **(by 30 December 2020)**

  RTS to specify content, methodologies and presentation of information in respect of sustainability indicators for climate and other environment-related adverse impacts (Art 4, par 6)

- Website disclosure of social sustainability impacts at entity level **(by 30 December 2021)**

  RTS to specify content, methodologies and presentation of information on indicators in relation to adverse sustainability impacts related to social and employee matters, respect for human rights, and anti-corruption and bribery matters. (Art. 4, par. 7)

- Pre-contractual disclosure for products promoting E or S characteristics **(by 30 December 2020)**

  RTS to specify the details of the presentation and content of the information in pre-contractual disclosure for products promoting E or S characteristics (Art. 8, par. 3)

- Pre-contractual disclosure for products with sustainable investment objectives **(by 30 December 2020)**

  RTS to specify the details of the presentation and content of the pre-contractual information that should be disclosed for financial products that have sustainable investments as their objective. (Art. 9, par. 5)

- Promotion of E or S characteristics and sustainable investments on websites **(by 30 December 2020)**

  RTS to specify content and presentation requirements for the information to be published and maintained on websites for products promoting E or S characteristics or having sustainable investments as their objective (Art. 10, par. 2)

- Disclosure in periodic reports **(by 30 December 2020)**

  RTS to specify content and presentation of information disclosed in periodic reports by financial market participants offering products promoting E or S characteristics or having sustainable investments as their objective (Art. 11, par. 4)

The ESAs' Joint Committee is expected to launch a **consultation on the draft RTSs in Q1 2020**. Additionally, the Regulation will require entities in scope to disclose the following:

- In their **remuneration policies**, information on how those policies are consistent with the integration of sustainability risks. Such information should be published on the entities' websites (Art. 5);
- In their **pre-contractual disclosures**, how sustainability risks are integrated into the entities' investment decisions; and information on the likely impacts of sustainability risks on the returns of the financial products they offer to end investors (Art. 6);
- By **30 December 2022**, financial market participants will need to report whether and how their financial products consider adverse sustainability impacts on sustainability factors (as defined in the Regulation).

An additional Implementing Technical Standard (ITS) on marketing communications will be developed at a later stage to determine the standard presentation of information on the promotion of environmental and social characteristics and sustainable investments.

The ESAs have also been tasked with submitting a report to the Commission on best practices and making recommendations towards voluntary reporting standards, by 10 September 2022 and every year thereafter. The application of the Regulation will be evaluated by the Commission by 30 December 2022, including whether the functioning of the Regulation is inhibited by the lack of relevant data or its suboptimal quality.

Finally, in line with the objective to **enhance consistency in ESG risks integration and disclosures**, the Commission, with the technical advice of ESMA[14] and EIOPA[15], is **developing a series of Delegated Acts under the MiFID II, IDD, UCITS, AIFMD and SII frameworks**. The measures would cover the areas of organisational requirements, product governance, operating conditions and risk management. The DAs would complement the Disclosures regulation, by further mainstreaming ESG consideration into financial institutions' activities, and likely feed into the work to review NFRD and develop a new Sustainable Finance Strategy. **The Commission is expected to hold a public consultation on the draft DAs, potentially followed by their adoption in Q2 of 2020**.

5. Climate Benchmarks and ESG benchmark disclosures

In February 2019 the European Parliament and Council agreed on the text for the creation of two EU climate benchmarks (EU Climate Transition Benchmark and EU Paris-aligned Benchmark) and requiring ESG disclosure for all benchmarks. The main goal of this initiative is to make it easier for investors to select climate-conscious investment strategies. While a plethora of low-carbon indices already exists in the market, they have varying levels of ambition and widely different approaches. Therefore, there arose a need for establishing minimum standards to address potentially illegitimate claims by administrators (e.g. investment companies) about the low-carbon nature of their benchmarks. The text amends the EU Benchmark Regulation. The amending Regulation[16] was published in the OJEU in November 2019. Benchmark administrators who provide the new benchmarks must comply with the Regulation **by 30 April 2020**.

As mentioned, the amendments create two new categories of low-carbon benchmarks, which administrators are eligible to market only after they have ensured compliance with criteria summarised below:

- **EU Climate Transition Benchmarks (EU CTB)**, aiming to lower the carbon footprint of a standard investment portfolio. Benchmarks in this category should be determined as taking into account companies in the investment portfolio that follow a measurable, science-based "decarbonisation trajectory" by end 2022, in light of the long-term global warming target of the Paris Climate Agreement.
- **EU Paris-aligned benchmarks (EU PAB)**, which have the more ambitious goal to select only companies in the investment portfolio that contribute to achieving the 2°C reduction in global average temperature set out in the Paris Climate Agreement.

For other significant bond and equity benchmarks (in addition to the benchmarks detailed above but except for interest rate and currency benchmarks), benchmark administrators must publish detailed information on whether or not, and to what extent, an overall degree of alignment of reducing carbon emissions, or attaining the long-term global warming targets of the Paris Agreement, is ensured. Furthermore, administrators should publish their calculation methodology, explaining the parameters applied, the type and source of data used, and how the benchmark contributes to environmental objectives.

Via delegated regulation, the Commission is empowered (but not required) to specify the minimum content of disclosure obligations that administrators will be subject to when producing benchmarks belonging to the two categories detailed above as well as ESG disclosures for other benchmarks in scope. Additionally, the Commission can specify the minimum standards for harmonisation of the methodology for the two categories, including a method for the calculation of carbon emissions. The Commission is expected to run public consultations during its preparatory work on each of the respective delegated acts (expected **during Q1**

[14] ESMA Technical Advice on Sustainable Finance to the European Commission
[15] EIOPA Technical Advice on Sustainable Finance to the European Commission
[16] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (Text with EEA relevance)

2020). In September 2019, the **TEG published the final report**[17] on climate benchmarks, which will serve as a basis to the drafting of the delegated acts. Additionally, by 1 January 2021, the Commission will adopt a delegated act to specify sectors to be excluded from EU PAB because they do not have measurable carbon emission reduction targets with specific deadlines aligned with the Paris Agreement.

In December 2019, the TEG published its **Handbook on Climate Benchmarks and benchmarks' ESG disclosures**[18], which is meant to serve as a user-guide following the publication of the final TEG report. It compiles responses to frequently asked questions regarding the EU CTB and EU PAB and the disclosure guidance on ESG considerations. By December 2022 the Commission will review the standards of EU CTB and EU PAB as well as prepare a report on the impact of the Regulation and the feasibility of an "ESG benchmark".

6. EU Ecolabels for Retail Financial Products

In December 2019, the Commission's Joint Research Centre (JRC) published its second technical report[19] on the ecolabel for retail financial products, with a draft proposal on the scope and criteria for granting an ecolabel to such products within the EU. Once developed, the criteria will be adopted under the EU Ecolabel Regulation.

As stated in the report: *the **EU Ecolabel is a pass-or-fail system** (binary). In other words, the label is either awarded (if criteria are fulfilled) or it is not. Two products with the EU Ecolabel may have different levels of environmental performance, but the EU Ecolabel does not distinguish between them. However, there are two types of criteria – 'mandatory' and 'optional'. If a criterion is mandatory, complying with it is a necessary condition for the label to be awarded. 'Optional criteria' function within a points-based system. The product receives a number of points depending on which optional criteria it complies with. Then, the total number of points is calculated and there is a minimum threshold that needs to be achieved in order to be awarded the label.*

The original **product group scope** included **investment products subject to the PRIIPs[20] regulation** (equity, fixed income and hybrid funds, including UCITS and AIMs; as well as IBIPs). The scope has now been extended beyond PRIIPs to include **fixed-term deposits** or **savings deposit products**. The following **criteria pillars** were identified with a view to enhancing the environmental benefits of investments:

- **Portfolio composition**, specifically in terms of green economic activities (as defined by the EU Taxonomy). It adopts a 3-pocket approach to better distinguish between companies investing principally in green activities, to enable investment in transition activities and to leave room for diversification.
- **Exclusions based on environmental aspects -** focus on the potentially harmful environmental effects of activities financed.
- **Exclusions based on social aspects and corporate governance practices -** aim to address social concerns potentially associated with investments and consider corporate governance practices of the investee companies.
- **Engagement** – aims to drive positive environmental improvements by encouraging companies to change their activities and behaviour.
- **Information for retail investors and Information appearing on the EU Ecolabel -** notes the information to be communicated to consumers.

The publication of the **final criteria** is expected in **Q1 2021**.

17 TEG Final Report on Climate Benchmarks and Benchmarks' ESG Disclosures
18 TEG Handbook of Climate Transition Benchmarks, Paris-Aligned Benchmakr and Benchmarks' ESG Disclosures
19 JRC Technical Report 2.0 - Development of EU Ecolabel criteria for Retail Financial Products
20 Regulation (EU) No 1286/2014 on packaged retail and insurance-based investment products (PRIIPs)

7. Review of NFRD

As part of its efforts to increase transparency in sustainability reporting and enhance the availability of ESG information, the Commission is taking steps to **review the Non-financial reporting directive (NFRD)**[21], the EU law laying down the rules on disclosure of non-financial and diversity information by large companies, including how they integrate ESG factors in their strategies and manage social and environmental risks.

EU rules on non-financial reporting only apply to **large listed companies** and **public interest entities** (includes all banks and insurance companies) with more than 500 employees, covering approximately 6,000 companies and groups across the EU. The directive requires companies to include **non-financial statements** in annual reports, outlining the policies implemented in relation to environmental protection, social responsibility, human rights protection, diversity and anti-corruption measures. In line with the so-called principle of **double materiality**, companies should disclose not only how sustainability issues may affect the company, but also how the company affects society and the environment.

In 2017, as required by the Directive, the Commission published **non-binding guidelines** for companies on how to report non-financial information.[22] In June 2019, as part of the Sustainable Finance Action Plan, the Commission published additional guidelines on reporting climate-related information, which integrate the recommendations of the Task Force on Climate-related Financial Disclosures.[23] The current requirements give companies significant flexibility in disclosing information. Companies may use international, European or national guidelines to produce their statements. As a result of companies adopting a variety of different approaches, information in non-financial statements is often incoherent and incomparable with each other.

Demand for reliable, comparable and relevant non-financial information from users of investment products has increased substantially. In addition, as noted in this document, the **taxonomy regulation** will require companies under the scope of the NFRD to disclose how their activities are associated with environmentally sustainable activities according to the taxonomy. The review is expected to introduce stricter reporting requirements, building on existing regional and global frameworks, aimed at the development of **an EU-wide standard for ESG reporting**[24]. The measures, intended at narrowing down the current data gap, will encourage a more consistent reporting and the development of common metrics, benchmarks and KPIs.

On 20 February 2020, the Commission launched a public consultation on the review of NFRD[25] which will run until mid-May. The consultation aims to collect stakeholders' views regarding possible revisions to the provisions of the NFRD, focusing on eight key areas:

1. Quality and scope of non-financial information to be disclosed;
2. Standardisation;
3. Application of the principle of materiality;
4. Assurance;
5. Digitisation;
6. Structure and location of non-financial information;
7. Personal scope (which companies should disclose);
8. Simplification and reduction of administrative burdens for companies.

The inputs received through the consultation will feed into the **Commission's proposal for a regulation amending NFRD, expected to be published in Q4 2020**,[26] as well as inform the work on future European and international initiatives on mainstreaming sustainable finance.

[21] Non-Financial Reporting Directive (NFRD) (Directive 2014/95/EU)
[22] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information)
[23] Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information
[24] As in the remarks by the Commission Executive Vice-President Valdis Dombrovskis at the IFRS Foundation Conference (19 February 2020)
[25] Public consultation on the revision of the non-financial reporting directive
[26] Proposal for a Regulation - Non-financial reporting by large companies (updated rules)

8. Preventing Short-Termism

Under Action 10 of the EU Action Plan, the Commission invited the ESAs to collect evidence of undue short-term pressure from capital markets on corporations, and to consider, where necessary, further steps based on such evidence.

In December 2019, the ESAs published reports with their findings and policy recommendations. The reports build on a review of relevant literature, the ESAs' own research and the inputs submitted by financial market participants through survey responses. The reports constitute a first step towards the development of other possible future legislative initiatives on sustainable finance. Such measures will most likely impact the upcoming review of the Non-Financial Reporting Directive, the 2022 review of the Shareholders Rights Directive and the future work of the adoption of an international set of ESG disclosure standards.

ESMA Report[27]

ESMA reports that, for respondents to its public survey, **the most common time horizon for general business activities does not exceed five years** – this being particularly true for investment research. ESMA recommends that the Commission should monitor the impact of **ESG integration** on promoting long-termism, and to consider these drivers for short-termism in its ongoing work on **MiFID II**.

To enhance the ability of **ESG disclosure** to support long-term investment decisions, ESMA recommends the immediate adoption of delegated acts specifying key general principles for high-quality **non-financial information** and to establish a limited set of specific disclosure requirements, followed by the adoption of an **international set of ESG disclosure standards**. ESMA also suggests the inclusion of non-financial statements in the annual financial report. ESMA found no evidence on the consequences of the implementation of **IFRS 9** on long-term investment practices, possibly due to its recent application.

ESMA recommends that the application of **SRD II** is appropriately monitored in order to assess its impact **on investor engagement**. ESMA also recommends that the Commission should consider the introduction of a **vote on the non-financial statement**, as well as evaluating the impact of national incentives for the promotion of shareholders' long-term perspective.

Regarding the **remuneration** of corporate directors, ESMA recommends the introduction of ESG criteria in the **evaluation of performance targets**. ESMA also recommends that the Commission should consider requiring Member States to develop adequate **monitoring frameworks**.

[27] ESMA report on undue short-term pressure on corporations

EBA Report[28]

On banks' time horizons and long-term sustainability considerations, EBA reports that the time horizon favoured and taken into account by EU banks for defining the business model and setting their strategy seems to be mostly around 3-5 years and recognises that other aspects, such as governance and risk management processes, may be of a more 'perpetual' nature and could be considered to be longer.

On infrastructure finance and the impact of Basel III reforms, EBA reports that Basel III reforms on banks' infrastructure finance are not considered to be unduly exacerbating short-termism and that, despite a significant investment gap for sustainable investment projects, the provision of infrastructure finance has grown steadily and banks provide roughly 80% of green infrastructure finance across G20 countries.

On the impact and implementation of IFRS 9, EBA reports that, overall, while there are recurrent concerns over the effect of IFRS 9 and fair value on the provision of long-term finance, including from banks to corporates, the role of IFRS 9 in exacerbating short-termism should not be overestimated, given especially its expected benefits for financial stability, but, going forward, it is important to continue assessing its impact and monitor its implementation.

Overall, EBA did not find evidence of undue short-term pressure in banking practices, except for some originating from **capital markets** (dividends, share buyback, reporting to the market), claiming this is due to data limitations. EBA clarified early on the distinction between short-termism and short-term finance, as well as between long-term finance and sustainable finance. EBA also noted that banks tend to renew exposures and refinance risks, thus the relatively short maturity of funding granted does not mean that banks necessarily exit loans at maturity or end relationships with clients.

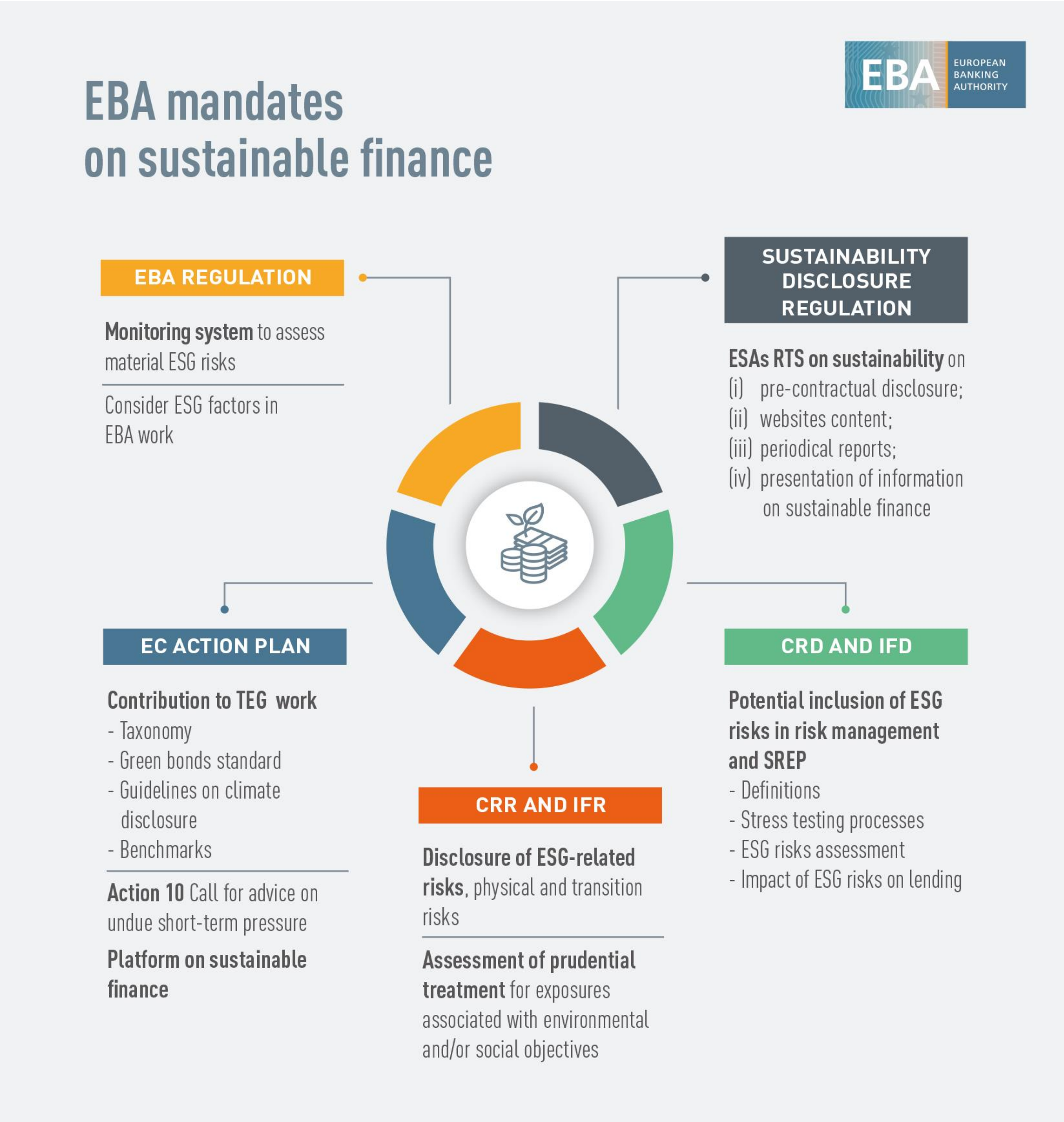
The report puts forward **four recommendations** to promote a longer-term horizon in banks' practices:

- **More explicit legal provisions on sustainability in the Capital Requirements Directives (CRD)**, to foster the adoption of longer-term perspectives, in particular in relation to corporate governance and risk management.
- **Maintaining a strong regulatory prudential framework** as a precondition for long-term investments. A safe and stable financial system is critical to foster an environment that is more conducive to long-termism and to support longer-term investment and decision-making.
- **Enhance long-term disclosures in NFRD** to enhance disclosures of long-term risks and opportunities, from the side of both banks and corporations, ensuring comparable and reliable disclosures.
- **Improve information flows and data access on ESG risks** and consider developing platforms or centralised databases on environmental data in the financial sector.

[28] EBA report on undue short-term pressure from the financial sector on corporations

9. EBA Action Plan on Sustainable Finance

On 6 December 2019, EBA published its Action Plan[29] outlining plans, deliverables and mandates to cover ESG-related factors and ESG risks between 2020 and 2025. The plan includes the approach and associated timelines for the reports, advice, guidelines and technical standards to be developed by EBA under its remits.[30]



Source: EBA Action Plan on Sustainable Finance, page 9

[29] EBA Action Plan on Sustainable Finance
[30] The EBA's remit and mandates on ESG factors and ESG risks are set out in the following legislative acts: amended EBA Regulation; revised Capital Requirements Regulation (CRR 2) and Capital Requirements Directive (CRD 5); new Investment Firms Regulation (IFR) and Investment Firms Directive (IFD); Commission's Action Plan: Financing Sustainable Growth and related legislative packages.

In addition to its report on short-termism and the mandate to develop technical standards to be implemented under the EU Disclosure Regulation, the EBA will focus on the integration of ESG factors in **risk management**, climate-related **stress testing** and **prudential treatment** of assets with sustainability considerations. In particular:

- EBA will develop the work on the **incorporation of ESG factors into risk management and supervision.** EBA will launch a **discussion paper in Q2/Q3 2020**, followed by a **final report by 28 June 2021** on risk management (including scenario analysis and stress testing), integration of ESG risks into governance, and supervision.
- EBA is developing comprehensive technical standards to implement and update the Pillar 3 **disclosure requirements included in the Capital Requirements Regulation (CRR)**. EBA will submit the technical standards to the Commission in June 2020, one year before the first requirements become applicable. **EBA also expects to launch a public consultation on the draft standards in 2020.**
- EBA will develop a **dedicated climate change stress test** and common methodologies to assess the effects on financial stability of adverse environmental developments and the impact of transition risk stemming from environmental policy changes. **On 22 January 2020, EBA launched a public consultation**[31] on possible future changes to the EU-wide stress test, taking into account climate risk stress testing, which will run until 30 April 2020. **On 21 February 2020, EBA hosted a public hearing** on the consultation. In addition, EBA expects to undertake a **sensitivity analysis in H2 2020** on a sample of volunteering banks.
- EBA will assess whether there should be a **dedicated prudential treatment** of exposures related to assets or activities associated with sustainability. To that end, EBA will develop methodologies and criteria to assess the risk of such exposures and assess the potential effects of a dedicated prudential treatment on financial stability and bank lending. EBA is expected to come forward with a **discussion paper in 2022-2024**, followed by a **final report to be published by 28 June 2025**.

In January 2020, EBA published a paper[32] examining the level of understanding and **current market practices in the area of ESG integration in banking activities**. The paper also outlines a series of European and global initiatives, focusing on TCFD recommendations[33] and the state of their implementation.

In its report, EBA notes that ESG factors are not sufficiently mainstreamed into banks' risk management practices and this may thus justify action from regulators and supervisors.

EBA also highlights the lack of available data as an obstacle to performing scenario analysis, as recommended by the TCFD. EBA also encourages the Commission's review of the NFRD and stresses the potential benefits in terms of availability, quality and comparability of data.

Finally, the paper suggests the development of a green finance framework as a next step, identifying the main impediments that need to be overcome including the lack of common definitions for green assets and of measures that provide economic benefits for issuing green products.

[31] 22 January 2020 - EBA consults on the future of the EU-wide stress test framework
[32] EBA Staff Paper Series – Sustainable Finance Market Practices
[33] Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)

Source: EBA Action Plan on Sustainable Finance, page 11

10. ESMA's Strategy on Sustainable Finance

On 6 February 2020, ESMA published its Strategy on Sustainable Finance[34], setting out how ESMA will place sustainability at the core of its activities by embedding ESG factors in its work. The key priorities for ESMA highlighted in the strategy include:

- Completing the regulatory framework on transparency obligations via the Disclosures Regulation. ESMA will work with the EBA and EIOPA to produce joint technical standards;
- Reporting on trends, risks and vulnerabilities of sustainable finance, including indicators related to green bonds, ESG investing, and emission allowance trading;
- Using the data at its disposal to analyse financial risks from climate change, including potentially climate-related stress testing in different market segments;
- Pursuing convergence of national supervisory practices on ESG factors with a focus on mitigating the risk of greenwashing, preventing mis-selling practices, and fostering transparency and reliability in the reporting of non-financial information;
- Participating in the EU Platform on Sustainable Finance that will develop and maintain the EU taxonomy and monitor capital flows to sustainable finance; and
- Ensuring ESG guidelines are adhered to in the entities that ESMA supervises directly, while being ready to accept any new supervisory mandates related to sustainable finance.

11. Climate-risk stress-testing: Bank of England

In addition to EBA's mandate to investigate the integration of ESG factors into supervision and assess the resilience of the financial sector against environmental risks, in December 2019, **the Bank of England launched a public consultation**[35] on its proposal for stress testing the financial stability implications of climate change, which will run until 18 March 2020. The consultation was accompanied by the publication of a **discussion paper**[36] on climate-related stress testing in the Biennial Exploratory Scenario (BES), setting out BoE's proposed framework for the 2021 BES exercise. The outcome of the consultation, and the approach adopted by BoE, will likely influence the work of the Network for Greening the Financial System (NGFS)[37], as well as other European and global initiatives in this area.

The objective of the BES will be **to test the resilience of the largest banks and insurers to the physical and transition risks** associated with different possible climate scenarios, and the financial system's exposure to climate-related risk. The BES will use exploratory scenarios to size these risks and explore how firms might respond to them materialising, rather than testing firms' capital adequacy. The key features of the BES are:

- **Three distinct scenarios** that cover physical and transition risks, as well as macro-variables;
- **Participation of both banks and insurers**, with an assessment of spill-over effects amongst each other;
- **Time horizon extended to 30 years**, to account for the distinguishing features of climate-related risks;
- **Analysis of counterparties' business models** to capture the exposure to climate-related risks;
- **Disclosure of aggregate results** of the financial sector's resilience, rather than individual firms.

[34] https://www.esma.europa.eu/press-news/esma-news/esma-sets-out-its-strategy-sustainable-finance
[35] Bank of England consults on its proposals for stress testing the financial stability implications of climate change
[36] The 2021 biennial exploratory scenario on the financial risks from climate change
[37] The Network for Greening the Financial System (NGFS) is a group of central banks and supervisors willing, on a voluntary basis, to exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and mobilize mainstream finance to support the transition toward a sustainable economy. The work of the NGFS is now focused on preparing practical best practice tools for supervisory authorities and financial institutions on climate and environment-related risk management, including scenario-based climate risk analysis.

The final BES framework will be published in the second half of 2020 and the results of the exercise will be published in 2021. A similar initiative is expected for 2020 from the **Banque de France**, which has already surveyed insurers and banks on the management of climate change risk,[38] while the **Dutch National Bank** has developed a framework[39] to conduct climate stress testing by analysing four "severe but plausible" transition scenarios involving a mix of policy- and technology-shocks.

12. Conclusions

Since the ratification of the 2015 Paris Agreement and the launch of the 2018 Commission Action Plan, there has been significant progress in the adoption of measures to support the transition towards a net zero-emissions economy. As the voice of Europe's wholesale financial markets, AFME welcomes the progress made so far and is committed to a continued and constructive dialogue with regulators and stakeholders. As originators, underwriters and traders of sustainable financial products, AFME members have a key role to play in the development of sustainable finance.

The development of a uniform classification system for defining environmentally sustainable economic activities has been a key priority for AFME. We have been fully supportive of the EU Taxonomy initiative from its outset by advocating for a pragmatic, scientific-based, flexible, progressive and proportionate framework that is dynamic and adaptable to reflect changes in technology and that takes into account the nature and the scale of economic activities. We think that agreeing on the Taxonomy framework was a significant step forward by the policymakers towards achieving the objectives set by the Action Plan. While we express our full support for the Taxonomy, we note that its use should still be adapted in the future for a broader range of financial products to provide finance providers with more investment options. Furthermore, robust and reliable data, supporting the implementation of the Taxonomy, still needs to be built up. This could be aided by the harmonisation of sustainability reporting requirements to help collect the necessary data. We therefore welcome the Commission's initiative to review the NFRD.

AFME stands ready to consider changes to the prudential treatment of assets integrating ESG considerations, as this could provide for additional incentives for investment in transition activities. However, we maintain that all measures to incorporate ESG risks in the prudential framework should be aligned with risk and, at this stage, there is insufficient data to justify this. In addition to the initiatives aimed at filling such a data gap, AFME welcomes Bank of England's exercise on stress-testing for climate-related risks. It is widely expected to set the foundations for uniform methodologies to measure the correlation between the level of sustainability of assets and their risk, as well as to assess the impact of climate-related risks on financial stability and the broader economy in the UK, Europe and beyond. Though we note that it is important that the scope and granularity of proposed tests are feasible for banks to undertake in order to produce robust results, we are fully supportive of the initiative and are working to contribute to its development via providing our feedback as part of the currently available public consultation.

***

[38] Bulletin de la Banque de France 225/8 - Climate change: what are the risks for the French financial sector?
[39] An energy transition stress test for the financial system of the Netherlands

Annexes

afme/ Finance for Europe — Indicative timeline of upcoming initiatives in Sustainable Finance

2019

Dec
- Commission announces the EU Green Deal
- ESAs publish reports on Short-Termism
- BoE launches consultation on stress-testing

2020

Jan – Q1
- Commission announces the Sustainable EU Investment Plan
- Commission launches consultation on Just Transition Fund proposal
- EBA launches consultation on climate-risk stress-testing

Q1

Commission to launch consultations on:
- New Sustainable Finance strategy
- Review of NFRD
- Draft Disclosures RTSs
- Draft Benchmarks DAs

Q2 – Q3
- EBA to launch consultation on ESG risk management
- EBA to launch consultation on Pillar 3 ESG disclosure
- Commission to launch consultation on draft DAs to MiFID II

Q3
- Commission to announce the new Sustainable Finance strategy

Q4
- Commission to launch proposal for the review of NFRD

Dec
- ESAs to draft RTSs on Disclosures Regulation

2021

Q1
- Commission’s JRC to publish final criteria for Ecolabel

Jun
- Commission to draft DAs on taxonomy disclosure for NFRD reporters
- EBA to publish final draft ITS on Pillar 3 disclosure (ESG)
- EBA to publish final report on ESG integration in risk management

Dec
- Commission to adopt DAs on Taxonomy for climate risk mitigation and adaptation

2022-2025

Jun-2022
- Commission to publish draft review of Shareholders Rights Directive II (SRD)

Dec-2022
- Commission to adopt DAs on Taxonomy for remaining environmental objectives

2022-2024
- EBA to launch discussion paper on prudential treatment of green exposures
- EBA to publish guidelines on ESG integration in risk management and supervision

Jun-2025
- EBA to publish final report on prudential treatment of green exposures

Table 1: Legislative initiatives under the Commission's Sustainable Finance Action Plan

Legislative initiative	Application	Next steps
Taxonomy Regulation	**31 Dec 2021** for climate-risk mitigation and adaptation environmental objectives; **31 Dec 2022** for the rest of environmental objectives.	**Q1 2020 (expected Feb):** TEG to publish its final report on taxonomy for climate risk mitigation and adaptation; **31 Dec 2020**: Commission to adopt Delegated Acts on technical screening criteria for climate risk mitigation and adaptation. **31 Dec 2021:** Commission to adopt Delegated Acts on technical screening criteria for the rest of environmental objectives. **1 June 2021:** Commission to adopt a Delegated Act on the additional transparency requirements for financial and non-financial undertakings
Disclosure Regulation	10 March 2021	**31 Dec 2020:** ESAs to prepare (most of) the Regulatory Technical Standards (RTSs), for adoption by the Commission.
		ESAs are expected to launch a public **consultation** on the draft RTSs in **Q1 2020.**
Benchmarks Regulation	30 April 2020	**Expected in Q2 2020:** Commission to adopt Delegated Acts on the basis of TEG's final report on climate benchmarks and responses to a public consultation.
		Commission is expected to launch a public **consultation** on the delegated acts in **Q1 2020.**

Table 2: Selected initiatives under the EU Green Deal

Initiative	Type	Next steps
Sustainable Europe Investment Plan	Non-legislative	**January 2020:** Commission Communication on the Sustainable Europe Investment Plan
Just Transition Fund	Legislative	**January 2020:** Proposal for a regulation establishing the Just Transition Fund
Renewed Sustainable Finance Strategy	Non-legislative	**Q3 2020:** Renewed "Action Plan on Sustainable Finance" to be communicated by the Commission.
		Commission is expected to launch a public **consultation** on the renewed strategy in **March 2020.**
Revision of the Non-Financial Reporting Directive (NFRD)	Legislative	**Q4 2020**: Commission expected to publish legislative proposal
		Feb 2020: EFRAG published report "How to improve climate-related reporting: A summary of good practices from Europe and beyond"
		Feb 2020: Commission launched public **consultation** on NFRD revision, with the deadline of **14 May 2020.**

Table 3: Other key initiatives

Initiative	Authority	Next steps
Report on incorporation of ESG into risk management and supervision	EBA	**June 2021:** Final report to be released **2022-2024:** Possible update of relevant guidelines or new guidelines
		Q2/Q3 2020: Discussion paper to be published accompanied by a public consultation
Updated implementing technical standard (ITS) on Pillar 3 disclosure	EBA	**2021:** Final draft ITS to be submitted to the Commission
		2020: Consultation paper to be published
Report on classification and prudential treatment of assets from a sustainability perspective	EBA	**June 2025:** Final report to be released
		2022-2024: Discussion paper to be published accompanied by a public consultation
Proposed framework for the 2021 Biennial Exploratory Scenario (BES) exercise	Bank of England	**H2 2020:** Final BES framework to be published **2021:** Results of the exercise to be published
		Dec 2019: Discussion paper was published accompanied by a public consultation (deadline – 18 March 2020)

***

AFME contacts

Tonia Plakhotniuk, Associate Director, Policy

Tonia.Plakhotniuk@afme.eu

+44 (0)20 3828 2717

Richard Middleton, Managing Director, Head of Policy
Richard.Middleton @afme.eu

+44 (0)20 3828 2709

Pablo Portugal, Managing Director, Advocacy
Pablo.Portugal@afme.eu

+32 2 788 39 74

About AFME

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policymakers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

London Office
39th Floor
25 Canada Square
London E14 5LQ
United Kingdom

Switchboard:
+44 (0)20 3828 2700

Brussels Office
Rue de la Loi, 82
1040 Brussels
Belgium

Switchboard:
+32 (0)2 788 3971

Frankfurt Office
Bürohaus an der Alten Oper
Neue Mainzer Straße 75
60311 Frankfurt am Main
Germany

Switchboard:
+49 (0)69 153 258 967

AFME is registered on the EU Transparency Register, registration number 65110063986-76

www.afme.eu