Frequently asked questions: Action Plan on financing sustainable growth

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Why an EU strategy on sustainable finance?

The signing of the Paris Agreement on 12 December 2015 and the adoption of the UN 2030 Agenda for Sustainable Development on 25 September 2015 marked a noticeable shift in global attitudes towards climate change and environmental degradation. The fact that over 170 countries have now ratified the Paris Agreement sends a powerful signal: the necessity of transitioning to a low-carbon, resource-efficient and circular economic system can no longer be ignored.

To achieve the EU's 2030 climate and energy targets agreed in Paris, including a 40% cut in greenhouse gas emissions, around €180 billion of additional investments a year are needed. The scale of the investment challenge is beyond the capacity of the public sector alone. This is why the EU is already providing massive impetus to help attract the required investments. In particular, the extended and reinforced European Fund for Strategic Investments (EFSI 2.0), in force since 31 December 2017, has a 40% climate-smart investment target. The financial sector has a key role to play in reaching those goals, as large amounts of private capital could be mobilised towards such sustainable investments. However, we also need to ensure that the regulatory framework supports a re-orientation of private capital flows towards sustainable investments while ensuring financial stability.

The Commission is determined to lead the global work in this area and help sustainability-conscious investors choose suitable projects and companies. Capital markets will be key in helping to reorient capital flows towards investments in those sectors and activities that can contribute to the sustainability of our economy. Fostering sustainable investments has been identified as a priority in the Capital Markets Union's (CMU) mid-term review, and the Commission is proposing today a roadmap to lay the right conditions and incentives for investors to fund projects such as low-carbon and energy-efficient infrastructure.

What is the Commission trying to achieve?

In order to develop an overarching strategy in this area, the Commission set up a High-Level Expert Group (HLEG) on sustainable finance at the end of 2016. The group was tasked to prepare a comprehensive blueprint for reforms along the entire investment chain.

On 31 January 2018, the expert group published its final report which offers a comprehensive vision on which elements should underpin a sustainable finance strategy in the EU. The report proposes eight key priorities, including several cross-cutting recommendations and actions targeted at specific sectors of the financial system. The Commission's Action Plan builds on these elements, and presents a strategy on sustainable finance for the EU.

In particular, the Action Plan aims to further connect finance with the specific needs of the European and global economy for the benefit of the planet and our society. The Action Plan has three objectives:

1. Re-orient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth;
2. Manage financial risks stemming from climate change, natural disasters, environmental degradation and social issues; and
3. Foster transparency and long-termism in financial and economic activity.

What strategy is the Commission proposing?

Today's Action Plan includes a series of upcoming key actions covering all actors in the financial system such as:

1. To establish a common language for sustainable finance, i.e. an **EU sustainability taxonomy**. This taxonomy will provide a classification system of climate, environmentally and socially-sustainable activities. It will define what is sustainable and identify areas where investment can make the biggest impact so that capital flows toward activities that contribute to sustainable development.

2. To create **standards** and **labels** for **green financial products**. An EU Ecolabel for green financial products will help to guide investors and flag financial products in line with the transition towards a sustainable economy.
3. To clarify **institutional investors and asset managers' duties** in order to make sure they consider, in an appropriate manner, environmental, social and governance (ESG) issues in their investment decision process and are more transparent towards their clients.
4. To incorporate sustainability in **prudential requirements**. The Commission will explore how banks and insurance companies can contribute to funding projects that will ensure the transition to a more sustainable economy, where justified from a prudential point of view.
5. To strengthen **sustainability disclosure** and to improve accounting rule-making. The Commission will evaluate the current reporting requirements for issuers to make sure they provide the right information to market participants. The Commission will also ensure that accounting rules do not directly or indirectly discourage sustainable and long-term investments.

Is the Action Plan in line with the HLEG recommendations?

The Commission's Action Plan follows up on all key priorities from the HLEG report, some with adaptations with respect to legal and technical constraints, and proposes actions on most of the other recommendations presented in the report. The goal is to ensure the right sequencing and prioritisation, starting with the building of reliable and comparable information on sustainable investments, supported by an EU classification system (taxonomy).

Based on this, further measures can be delivered in line with the market developments, such as actions on standards and labels or adjustments to prudential rules. This way, the development of a market for sustainable financial products can be further supported. The Action Plan is not the end of the process but the launch of several new workstreams.

Does the Action Plan envisage legislative proposals?

Today's Action Plan sets out a roadmap for further work which combines legislative and non-legislative actions. Legislative include a combination of new measures and targeted amendments to existing rules. Non-legislative actions will ensure that current market practice can be taken into account, ensure adaptability of framework to ensure the sustainability of our economy and minimise administrative burden. The Commission, as always, stands ready to act more forcefully if needed to achieve the policy objectives.

What is an EU sustainable taxonomy? Why is it needed?

There is currently a patchwork of classification systems for green/sustainable activities across the EU. This creates uncertainty for investors who want to invest with sustainability objectives in mind. An EU sustainable taxonomy would mean a uniform and harmonised classification system that is essential to determine which activities can be regarded as sustainable across the EU and allow us to build up far-reaching reform that could set the global benchmark for sustainable finance.

Such a classification system is needed because it would:

1. provide appropriate signals to economic actors on what activities are considered sustainable;
2. protect private investors by avoiding risks of green-washing (i.e. preventing that marketing is used to promote an organisation's products, aims or policies as environmentally-friendly when they are in fact not); and
3. avoid market fragmentation by providing a single system of classification.

Why is the Commission proposing to widen the scope of the EU Ecolabel to financial products?

Consumers are increasingly interested in investing in products with a positive sustainability impact. However, the lack of well-defined standards makes it more difficult for investors to channel their funds into financial products that invest in sustainable assets.

The success of the **EU organic** label and the **EU Eco** label shows that labels help to guide consumers and increase their protection. Labelling schemes for sustainable financial products would be very useful for non-professional investors to easily identify investments that comply with green or low-carbon criteria and would also contribute to raise awareness about these products.

The EU Ecolabel Regulation lays down a voluntary EU-wide scheme subject to surveillance and control mechanisms, with well-established governance rules and convergence tools. The Commission aims to

explore the use of the EU Ecolabel framework for certain financial products. It would be applied once the EU sustainability taxonomy is adopted.

How can the EU encourage investments in sustainable projects?

The EU budget supports the mobilisation of private capital for sustainable projects directly through funding programmes and technical assistance.

In particular, the European Fund for Strategic Investments crowds in the private sector to finance sustainable projects across the EU. The European Investment Advisory Hub - the EU's gateway to investment support - is providing technical assistance to the development of projects. It thereby helps to build capacity for projects that are often technologically, economically and legally complex. Moreover, the Advisory Hub cooperates with local partners such as promotional banks across Member States to provide more match-making and increase local accessibility.

In December 2017 the co-legislators agreed to the Commission's proposal to boost even further the financial and technical support for sustainable infrastructure investment as part of the European Fund for Strategic Investments and the European Investment Advisory Hub. In the context of the work on the next Multi-annual Financial Framework, the Commission has also come forward with the idea of establishing a new single investment fund to provide financial support to sustainable investment for all EU policies. .

Building on the ongoing efforts to reinforce advisory capacity, the Commission will take further measures that will improve the efficiency and impact of instruments aiming at sustainable investment support in the EU and in partner countries.

How will the Commission incorporate sustainability into capital requirements?

Capital requirements aim to strengthen banks against economic shocks, improve risk management and ultimately ensure financial stability. They need to reflect, first and foremost, the risk of the investments made.

Currently, the EU financial rules do not discriminate between 'green' or 'brown' investments. The thinking behind any potential change in prudential rules is based on the assumption that ignoring risks associated with climate change and other sustainability factors can create longer-term risks for financial stability and costs for banks and insurers, whose assets are exposed to such risks (see ESRB report).

Therefore, identifying a legally-enforceable classification system will need to go hand in hand with a thorough capital calibration in order to not undermine the effectiveness of the EU prudential rules. On this basis, the Commission will explore the feasibility of recalibrating the capital requirements for banks (so called “green supporting factor”) when it is justified from a risk perspective, while ensuring that financial stability is safeguarded.

Why is the Commission proposing to clarify institutional investors' and asset managers' duties on sustainability?

The duties of care, loyalty and prudence that require institutional investors and asset managers to act in the best interest of their clients are laid down in various EU rules (Solvency II, IORP II, UCITS, AIFMD, MIFID II etc). However, these rules are not always clear nor consistent across sectors when it comes to sustainability (environmental, social, governance) factors and risks in the investment decision process.

The public consultation on long-term and sustainable investment, suggested that institutional investors and asset managers do not necessarily consider sustainability factors and risks within their financial decision-making but tend to focus rather on financial factors and risks with a primary aim to maximise returns in the short-term. Consequently, they may disregard or underestimate the long-term effects that sustainability factors might have on the performance of their investments. Furthermore, there is a lack of transparency on how they consider sustainability factors in their investment decision-making process. As a result, their clients may not get the full information they need to inform their investment decisions.

How will the Commission reinforce disclosure from companies on sustainability issues?

The EU Directive on disclosure of Non-Financial Information, adopted in 2014, requires large public interest entities (i.e. large companies with more than 500 employees listed on a regulated market as well as non-listed banks and insurance companies) to disclose material information on key environmental, social and governance aspects as of 2018 (for the 2017 financial year). Market participants should be given sufficient time to implement the recent regulatory changes introduced by the directive.

At a first stage, the Commission will reinforce the disclosure of sustainability information within the

current reporting requirements. It will amend the guidelines on non-financial reporting and promote best practices. The actions that may require legislative changes will be addressed in a comprehensive manner as part of a broader Fitness Check on public corporate reporting. A consultation will be launched in the coming weeks.

What will the Commission do on corporate governance?

Corporate governance is the framework of rules and practices that a board of directors follows to ensure accountability, fairness, and transparency in a company's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community).

Corporate governance can be an effective tool for making finance and the economy more sustainable. Sustainability starts at the top. It requires discussions and strategic planning at board level, as well as proper control and accountability mechanisms. The regulatory framework needs to enable companies to create long-term value.

The Commission will explore and analyse possible measures to foster corporate governance strategies that bring more sustainability.

Why does the Commission focus on short-termism?

Investments into environmental and social objectives require a long-term orientation. Sustainability cannot develop in a context where incentives, market pressures and culture prompt market participants to focus on near-term performance at the expense of the mid to long-term objectives. Therefore, a central focus on the sustainability agenda is to reduce the undue pressure for short-term performance.

The Commission invites the European Supervisory Authorities (ESAs) to collect evidence of undue short-term pressure in capital markets on corporations and consider, if necessary, future steps based on such evidence.

What will be the task of the technical expert group on sustainable finance?

The Commission has published a call for applications for a technical expert group on sustainable finance. This group will be set up in 2018 and its mandate will be to:

1. prepare a report providing a taxonomy for climate change mitigation and adaptation and other environmental activities;
2. issue a report on an EU Green Bond Standard, laying out the criteria and processes green bond issuers should adhere to, including the use of the EU classification system;
3. issue a report on the design and methodology of a low-carbon benchmark;
4. develop climate-related metrics.

Once the legal framework on taxonomy is in place, the Commission will consider establishing a platform on sustainable finance composed of relevant stakeholders from both the public and private sector.

What's the timetable?

The Action Plan includes a timetable for all actions that will be rolled out by Q2 2019.

With this Action Plan, the Commission launched a call for applications for a technical expert group on sustainable finance.

In May 2018, the Commission will put forward proposals on the duties of institutional investors and asset managers regarding sustainability and the principles and scope of an EU taxonomy for climate change and other environmental and social activities.

In Q2 2018, the Commission will amend Markets in Financial Instruments Directive (MIFID II) and the Insurance Distribution Directive (IDD) delegated acts to enhance sustainability in suitability assessment.

In Q1 2019, the expert group will publish a report on a taxonomy on climate change activities. This will be followed in Q2 2019 by a report on a taxonomy on climate change adaptation and other environmental activities as well as a report on green bond standards.

In Q2 2019, the Commission will publish its fitness check of EU legislations on public corporate reporting and amend its non-binding guidelines on non-financial reporting. The Commission will also adopt a delegated act on the content of the prospectus for green bond issuances and publish a comprehensive study on sustainability ratings and research.

Following the adoption by the co-legislators of the Regulation on an EU sustainability taxonomy, the Commission will create EU Ecolabels for financial products and explore possible measures to

incorporate climate and environmental risks into prudential requirements in line with the EU taxonomy.

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