Third Expert Meeting of the EU Refining Forum

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Sustainable Finance

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The EU aims to increase its ambition on climate change

2014-2019

Jean Claude Juncker, 2014

A Resilient Energy Union with a Forward-Looking Climate Change Policy

Target

- 40% cuts in greenhouse gas emissions by 2030
- 32% renewables in energy consumption
- 32,5% energy savings

Progress

Climate and energy legislation, if implemented: 45% greenhouse gas emission by 2030

2019-2024

Ursula von der Leyen, 2019

A European Green Deal

Target

- 50% cuts in greenhouse gas emissions by 2030
- Climate-neutral continent by 2050

Targets envisaged

Public money → Investment gap to meet 2030 targets and longer-term climate neutrality: Around **EUR 260 billion p.a.** **Notably private sector investments.** ← **Private capital**

European Commission "Action Plan on financing sustainable growth"

- Adopted on 8 March 2018
- Comprehensive approach; legislative, technical and best-practice based measures
- Sets out 3 main objectives and 10 actions

AP Objectives

1. **Reorientation of capital flows towards sustainable investment**
2. **Integration of ESG risks into risk management and decision-making**
3. **Fostering transparency and long-termism**

Action plan on financing sustainable growth -overview

Commission's actions stretch across the whole investment chain

1	**Taxonomy**	Develop an EU classification system for environmentally sustainable economic activities
2	Standards and labels	Develop EU standards (such as an EU Green Bond Standard) and labels for sustainable financial products (via EU Ecolabel) to protect integrity and trust of sustainable finance market
3	Fostering investment in sustainable projects	Exploring measures to improve the efficiency and impact of instruments aiming at investment support. Mapping on investment gaps and financing.
4	Incorporating sustainability in financial advice	Amend MiFID II and IDD delegated acts to ensure that sustainability preferences are taken into account in the suitability assessment.
5	Developing sustainability benchmarks	Develop climate benchmarks and ESG disclosures for benchmarks
6	Sustainability in research and ratings	Explore how credit rating agencies could more explicitly integrate sustainability in to their assessments. Study on sustainability ratings and research and exploring possible measures to encourage their uptake.
7	Disclosures by financial market participants	Enhance transparency to end-investors on how financial market participants consider sustainability
8	Sustainability in prudential requirements	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)
9	Strengthening sustainability disclosures and improving accounting	Enhance climate and sustainability-related information provided by corporations
10	Fostering sustainable corporate governance	Collect evidence of undue short-term pressures from capital markets on corporations and consider steps for promoting corporate governance that is more conducive to sustainable investments.

European Commission legislative proposals

Most urgent actions of the Action Plan were taken forward as legislative proposals in May 2018.

1 **Establish EU-wide Sustainable Taxonomy**	**Taxonomy Proposal:** Proposal setting out criteria to determine what are environmentally sustainable economic activities (**'taxonomy'**).
5 **Develop Sustainability/low-carbon Benchmarks**	**Benchmark Proposal:** Proposal to create two new categories of benchmarks: (i) a low-carbon benchmark, (ii) and a positive-carbon impact benchmark as well as minimum disclosure requirements for ESG benchmarks.
7 **Clarify institutional investors and asset managers duties**	**Disclosure Proposal:** (i) introduce consistency on **how institutional investors and asset managers should integrate sustainability** in investment decision-making processes; (ii) increase transparency towards end-investors.
4 **Incorporate Sustainability into Financial advice**	Ensuring that sustainability preferences are taken into account in the suitability assessment when providing financial advice by investment firms and insurance distributors. Commission published the **final version** of the delegated act; not yet adopted.

EC Technical Expert Group on Sustainable Finance

The TEG assists the Commission in implementing four specific actions.

Technical Expert Group on Sustainable Finance

- Established in June 2018, original mandate until the end of 2019; extension to September 2020 (max.)
- 35 experts selected (from 240 qualified candidates)

Working Groups	Mandate
Taxonomy	*Legislative Proposal* Technical screening criteria for environmentally sustainable economic activities
Green Bond Standard	*Action Plan* An EU Green Bond Standard
Benchmarks	*Legislative Proposal* Minimum standards for the methodology of "low carbon" and "positive carbon impact" indices
Disclosures (reporting)	*Action Plan* Metrics allowing improving disclosure on climate-related information

Stakeholder inclusion & transparency

- All documents **publicly available** at the Register of Commission Expert Groups.
- **Open feedback and public consultation** on TEG work.
- **TEG reports** on climate-related reporting (January 19), an EU Taxonomy (June 19), an EU Green Bond Standard (June 19) and EU Climate Benchmarks (September 19)

What is the EU Taxonomy?

EU Taxonomy is a list of economic activities with performance criteria for their contribution to six environmental objectives.

IS	IS NOT
A list of economic activities and relevant criteria	A rating of good or bad companies
Flexible to adapt to different investment styles and strategies	A mandatory list to invest in
Based on latest scientific and industry experience	Making a judgement on the financial performance of an investment – only the environmental performance
Dynamic, responding to changes in technology, science, new activities and data	Inflexible or static

Environmental objectives

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

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The Taxonomy proposal: what qualifies?

Substantially contribute to at least one of the six environmental objectives as defined in the proposed Regulation

+

Do no significant harm to any of the other five environmental objecties as defined in the proposed Regulation

+

Comply with **minimum safeguards**

Who will use the Taxonomy and how?

The proposed regulation has three mandatory users:

1. **EU and Member States: Reference point** when creating, for instance, standards or labels for green financial products
2. **Financial market participants** (as defined in the Disclosure Regulation): **Obligation to disclose for their financial products** in how far investments supported comply with EU taxonomy criteria; 3 different "shades of green" at product level ("dark green"/ "light green"/ "mainstream")
3. **Companies** falling under the scope of the **Non-Financial Reporting Directive: Obligation to disclose** in how far their economic activities comply with EU taxonomy criteria (KPIs: turnover; expenditure; investments); for financial undertakings different requirements (KPIs), to be defined at later stage

The EU Taxonomy can also be used on a voluntary basis by others, for instance public authorities.

Climate change mitigation: TEG selected 67 activities in 7 sectors to focus on

(1) High-emitting macro sectors

(2) Enabling sectors

- Agriculture and forestry
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Water, sewerage, waste and remediation
- Transport
- Information and Communication Technologies (ICT)
- Buildings

Climate mitigation – criteria and examples

Type of activity	Characteris tics	Criteria	Examples
Already low - carbon activities	Greening of	Likely to be stable and long term	• Zero to 25g/kwh electricity generation; • nearly zero energy buildings; • zero emissions cars
Activities that contribute to the transition to a low-carbon/ climate-neutral economy	Greening of	Likely to be revised regularly; be tightened over time; eventually to zero.	• Building renovation; • 25-100gCO2e/kWh electricity generation; • Aluminium production below 2.9tCO2e/t; • Road transport vehicles up to 50g/km;
Enabling activities	Greening by	Some likely to be stable and long term, some likely to be revised regularly.	• Manufacture of wind turbines, • Installing efficient boilers in buildings;

EU Taxonomy: State of play and next steps

- **Legal framework (Regulation):**
  - Political agreement with Council and European Parliament on 16 December 2019
  - Formal vote by EP expected in Q2 2020
  - Commission level 2 legislation for climate change mitigation and adaptation objectives in 2020: impact assessment; preparation of delegated acts; adoption by end of 2020; application by 31 December 2021
  - Commission level 2 legislation for further (4) environmental objectives in 2021; application by 31 December 2022
- **Technical work:**
  - TEG update on its Final Report (June 2019) in February 2020, in light of stakeholders' feedback (climate change mitigation and adaptation)
  - TEG may advice on further environmental objectives until the end of its mandate (max. September 2020)
  - New governance structure for developing the EU Taxonomy in 2020: Platform on Sustainable Finance

7 Disclosure on sustainability by financial market participants and financial advisers

Disclosure regulation places the following requirements on financial market paricipants

Scope	What to disclose	Where to disclose	Who should disclose
All investment products	**How negative impacts on financial returns arising from sustainability risks are integrated in risk policies**	Websites, pre-contractual information, marketing communication	all financial entities
	How the financial entity considers adverse impacts on sustainability factors (negative externalities)	Websites, pre-contractual information	compulsory for financial entities >500 and holding companies, other entities to disclose on a comply or explain basis
Investment products with sustainability characteristics or objectives	**How these sustainability characteristics or objectives are met**	Pre-contractual information, websites, periodical reports, marketing communication	all financial entities

Source: *European Commission: Proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (2018).*

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Disclosures relating to sustainability investments and sustainability risks: State of play and next steps

- Regulation is cross-cutting and concerns several EU regulatory frameworks (MIFID II, UCITS, AIFMD, Solvency II and IORP2)
- Sets harmonised rules to incorporate sustainability risks and factors in investment decision-making and risk management
- Regulation entered into force at the end of 2019 and will apply from 10 March 2021 (some provisions applicable only from 1 January 2022)
- EIOPA, ESMA und EBA will work out technical standards in 2020/2021

EU Climate Benchmarks

Two essential measures:

Minimum Standards
for two types of Benchmarks

EU Climate Transition Benchmarks

EU Paris-aligned Benchmarks

+

Benchmarks ESG Disclosures

- ESG factors are one of the key elements of the benchmark methodology
- All benchmarks should disclose whether or not they pursue ESG objectives and disclose key ESG factors in the benchmark statement
- As of 31 Dec 2021, also should report on their degree of alignment with the Paris Agreement.

Source: *European Commission:Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (2018).*

EU Climate benchmarks: State of play and next steps

- Regulation – amending the existing Benchmark Regulation - entered into force at the end of 2019; applicable in all Member States by end of April 2020
- Commission delegated acts defining the minimum standards for EU Climate Benchmarks under preparation (for April); delegated acts drawing on the TEG's final report on low-carbon benchmarks of September 2019
- Two new categories of climate benchmarks; **voluntary labels**
- **1. "EU climate-transition benchmark";** portfolio of assets/ companies that are reducing or aim to reduce their CO_2 emissions; Benchmark portfolio should allow, at least, GHG reduction of 30% compared to the market or parent index
- **2. "EU Paris-aligned benchmark";** portfolio of assets/ companies whose strategy is in line with the Paris Climate Agreement targets of limiting global warming to 1.5 degree Celsius; at least GHG reduction of 50% compared to the market or parent index

EU Green Bond Standard (TEG proposal)

Main principles	(1) **Voluntary standard** applicable for both listed and non-**listed** bonds (2) Builds on best **market practices** (transparency and use-of-proceeds approach) (3) Applicable to **EU or international** green projects and issuers
Recommendations establishing the standard	#01: Create a voluntary EU Green Bond Standard. #02: The EU-GBS should comprise four core components: (1) alignment of Green Projects with the EU Taxonomy, (2) Green Bond Framework, (3) reporting on allocation and impact and (4) verification by accredited verifiers. #03: Encourage the set-up of a voluntary interim registration process for Verifiers of EU Green Bonds for an estimated transition period of up to three years until a permanent ESMA-led accreditation scheme comes into force.

Financing the Green Transition as part of the "European Green Deal"

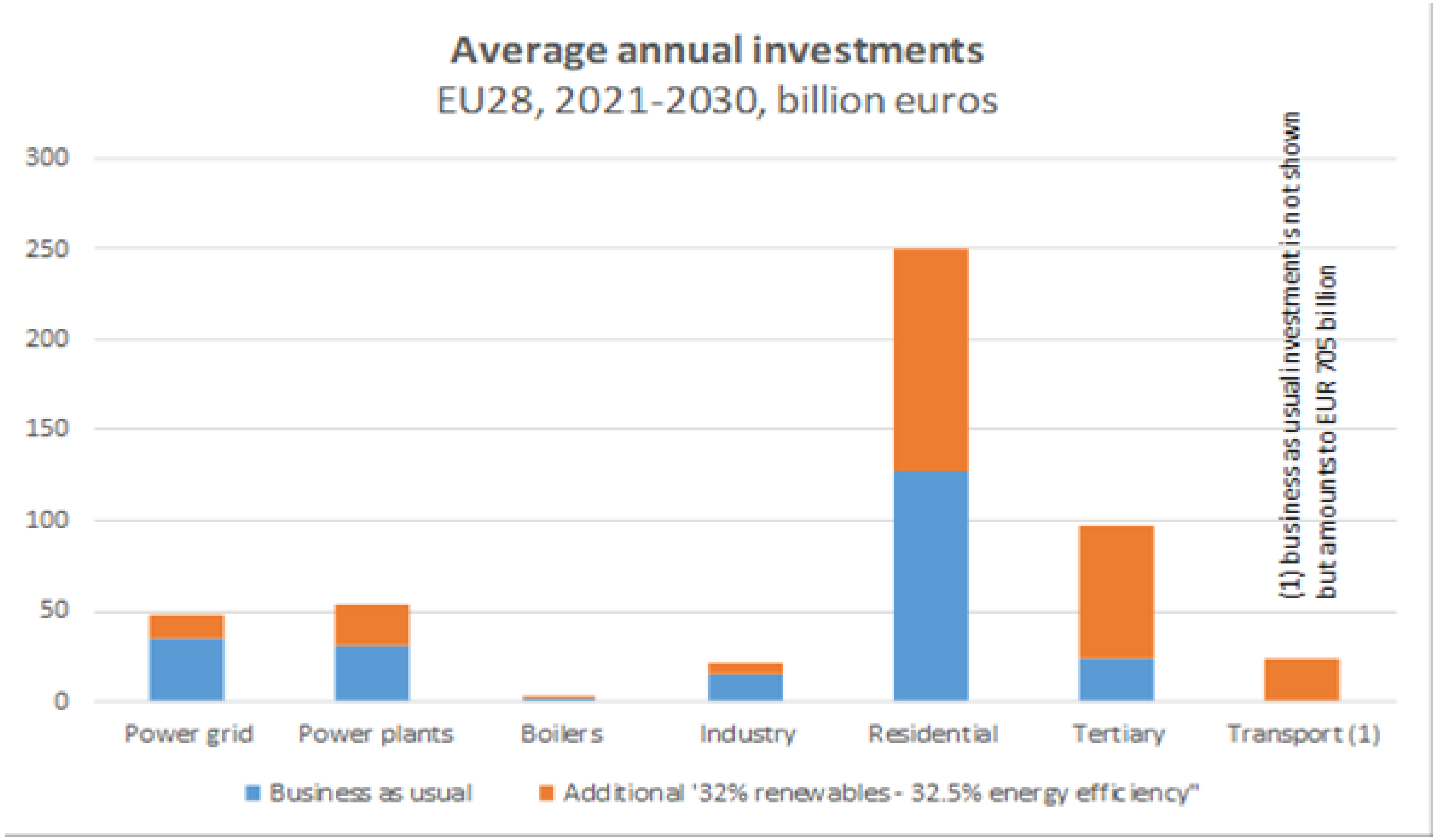
Ambition: Reaching EU 2030 climate goals and Paris Agreement targets; achieving climate neutrality by 2050 while making the EU's economy more competitive and resource-efficient

Encourage investments and raise finance

EU Budget	Overall Commission's target: At least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework
European Green Deal Investment Plan	**European Green Deal Investment Plan** adopted on 14 January 2020; increase sustainable investments and finance through (1) public funding; (2) enabling frameworks and (3) technical assistance/ project pipeline
Private/ capital market finance	**Renewed Sustainable Finance Strategy** foreseen in Q3 2020: Building on the current Action Plan for financing sustainable growth; complementing and contributing to the European Green Deal Investment Plan

Thank you very much!

Additional investments (p.a.) needed to achieve 2030 climate and energy targets



Commission modelling; Figure derived from the EUCO32-32.5 scenario (in line with key technology assumptions of the EUCO family scenarios, see https://ec.europa.eu/energy/en/data-analysis/energy-modelling/euco-scenarios).

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Key features of the Taxonomy

- Reflecting technological and policy developments: The Taxonomy will be updated regularly by the Platform on Sustainable Finance which will replace the TEG after its mandate.
- Building on market practices and existing initiatives
- What’s not green is not necessarily brown. Activities that are not on the list, are not necessarily polluting activities. The focus is simply on activities that contribute substantially to environmental objectives.
- Facilitating transition of polluting sectors
- Technology neutral

The “spotlight on taxonomy” provides a useful summary of the taxonomy and its features.

The TEG report on taxonomy – June 2019

TEG	Composed of 35 experts from civil society, academia, business and the finance sector, as well as 10 additional members and observers from EU and international public bodies	• All assessments made by TEG were based on scientific evidence, literature and international practice • TEG report initial focus is on climate change mitigation and adaption
7 Sectors, 67 activities	• highest-emitting macro sectors (represent 93.2% of GHG emissions in the EU)	Agriculture and forestry Manufacturing Electricity, gas, steam and air conditioning supply Water, sewerage, waste and remediation Transport Information and Communication Technologies (ICT) Buildings
Screening criteria	• Substantial contribution to one environmental objective (for climate change mitigation → e.g. GHG emission thresholds) • Do not significant harm to any of the other environmental objectives	

Substantial contribution to climate change mitigation

Characteristics	Type of activity	Criteria	Example
"Greening of"	Already low carbon (very low, zero or net negative emissions). Compatible with net zero carbon economy by 2050.	Likely to be stable and long term	Electricity generation from solar PV
	Contribute to a transition to a zero net emissions economy in 2050 or shortly thereafter, but are not currently close to a net zero carbon emission level.	Likely to be revised regularly and tightened over time	Manufacturing of steel
"Greening by"	Activities that enable emissions reductions in either of the two previous categories.	Some likely to be stable and long term, some likely to be revised regularly	Manufacturing of wind turbines

Activities that undermine mitigation objectives are not included.

Defining substantial contribution to climate change adaptation

- **Principle 1:** The economic activity reduces all material physical climate risks to the extent possible and on a best effort basis.
- **Principle 2:** The economic activity does not adversely affect adaptation efforts by others.
- **Principle 3:** The economic activity has adaptation-related outcomes that can be defined and measured using adequate indicators.

Substantial contribution to adaptation to climate change

***Adaptation of* an economic activity**
A process aimed at ensuring that an economic activity can perform under a changing climate

***Adaptation by* the economic activity**
An economic activity that contributes to adaptation of other economic activities

5 Key elements of the February 2019 political agreement between co-legislators on benchmarks

EU Climate Transition Benchmarks	The EU Climate transition benchmarks brings the resulting benchmark portfolio on a **decarbonisation trajectory**, meaning a **measurable, science-based and time-bound trajectory to reduce carbon emissions**.
EU Paris-aligned Benchmarks	The EU Paris-aligned Benchmarks brings the resulting benchmark portfolio's carbon emissions **in line with the Paris Climate Agreement goal to limit the global temperature to 1.5°** compared to pre-industrial levels.
Benchmarks ESG Disclosures	The Benchmarks ESG disclosures ensures that **ESG and climate-related considerations can be integrated in the valuation** of assets across various asset classes
Other key elements	• Extension of the transitional period for providers of "critical benchmarks" — interest rates such as Euribor or EONIA — by two extra years until 31 December 2021. • Extension of the period for mandatory contributions/administration to five years. • Extension of the transitional period also covers the possibility for benchmarks administered in third-countries to be used in the EU for another two years.

Commission is now preparing delegated acts with minimum methodological standards. There will be a public consultation on their contents at the turn of the year.

TEG proposed standards for 2 types of climate benchmarks with ESG disclosure requirements

Climate Benchmarks

EU Climate Transition Benchmark (EU CTB)

- Minimum of **30%** relative decarbonisation
- Voluntary: green to brown ratio at least equal

EU Paris-aligned Benchmark (EU PAB)

- Minimum of **50%** relative decarbonisation
- activity exclusions based on fixed thresholds
- Voluntary: Green to brown ratio at least 4

Both types of climate benchmarks must:

- Demonstrate a significant decrease in GHG emissions intensity compared to their underlying investment universes or parent indices.
- Be sufficiently exposed to sectors relevant to the fight against climate change.
- Demonstrate their ability to reduce their own GHG emissions intensity on a year-on-year basis.
- Baseline exclusion (controversial weapons, societal norms, etc.)

Benchmarks ESG disclosure

- ESG factors are one of the key elements of the benchmark methodology
- All benchmarks should disclose whether or not they pursue ESG objectives and disclose key ESG factors in the benchmark statement; also should report on their degree of alignment with the Paris Agreement.

Asset Classes

All, except interest-rate and currency benchmarks

KPIs

Relevant to each asset class

supported by global standards

Climate Scenario Alignment

Which temperature scenario?

Methodology and data used

Disclosure templates

1. Methodology
2. Benchmark statement
3. Climate Scenario Alignment

Source: European Commission:Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (2018).

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Disclosure requirements: covering a large ESG space

Example from listed equities:

ESG	
	Consolidated ESG Rating
	ESG Ratings Top Ten Constituents
	UNGC Violations %
	International Standards Signatories %

E	
	Consolidated Environmental Rating
	Carbon intensity
	Fossil Fuel Sector Exposure %
	Green Revenues %
	Exposure Climate-Related Physical Risks
	Exposure Climate-Related Physical Risks Methodology
	Green Bonds %

S	
	Consolidated Social Rating
	Social Violations
	Controversial Weapons %
	Controversial Weapons Definition
	Tobacco %
	Tobacco Definition
	Human Rights (Index)
	Income Inequality
	Freedom of Expression

G	
	Consolidated Governance Rating
	Board Independence %
	Board Diversity %
	Corruption
	Political Stability
	Rule of Law
	Stewardship Policies

Climate Scenario Alignment	Standardised reporting on climate scenario alignment: temperature scenario, methodology, data used

Key elements of the EU Green Bond Standard

Green projects	• Alignment with the environmental objectives and technical screening criteria as defined in the **EU taxonomy** • Physical or financial assets, tangible or intangible: any capital expenditure and selected operating expenditure such as maintenance costs related to green assets that either increase the lifetime or the value of the assets, as well as research and development costs, and relevant public investments and public subsidies for sovereign and sub-sovereigns • Green assets qualify without a lookback period, and eligible green operating expenditure shall qualify with a maximum of three years lookback • The use of proceeds is specified either in the prospectus or in the final terms of the bond
Green bond framework	• Document explaining issuer's alignment with the EU taxonomy and environmental objectives, green bond strategy, project selection, methodologies and processes for allocation and impact reporting of the Green bond or Green Bond program • The issuer must produce it when confirming the alignment with the EU Green Bonds standard
Reporting	• Allocation and Impact reporting become mandatory • Allocation report needs to be published annually until full allocation of the bond proceeds, and Impact report at least once at the full allocation, and both reports thereafter, in case of any material change.
Verification	• Issuers shall appoint an external verifier that needs to be accredited • Verification applies (i) to the Green Bond Framework and (ii) to the Allocation Reporting

8 Incorporating sustainability in prudential requirements

Banks	• Final text of **CRR 5** was published in July. • **Large listed banks will have to disclose ESG risks starting from 2022**. • **EBA mandated to explore the 'feasibility'** of the introduction of a more risk-sensitive treatment of exposures related to environmental and/or social objectives. Based on the outcome, EBA may issue relevant guidelines. • COM is launching a **study to explore how to incorporate ESG factors in banks' strategies and prudential requirements**, including: 1) the incorporation of ESG risks into EU banks' risk management; 2) the integration of ESG risks into prudential supervision; and 3) the integration of ESG objectives into banks' business strategies and investment policies.
Insurance Companies	**EIOPA opinion on sustainability under Solvency II** of 30 September 2019: • Insurers should take into account sustainability risks that they are exposed to through their assets and liabilities; • Where insurers rely on service providers, they should assess whether sustainability risks are already taken into account by the service provider; • Insurers should conduct scenario analyses (pillar 2) as a plausibility check on balance sheet valuation and the level of capital requirements. The Commission will consider whether and what legal changes are needed to implement EIOPA's recommendations during the next mandate.