EC CONSULTATION ON THE RENEWED SUSTAINABLE FINANCE STRATEGY

Brussels, 21 April 2020

The Green Finance Observatory is an independent non-profit association set up in 2017.
Our mission is to analyse sustainable finance legislative proposals and related market-based solutions in European environmental policies, to assess whether they can meet their stated environmental, economic and social objectives.
The Green Finance Observatory is registered under the EU Transparency Register with ID 852329329251-06. Only the questions that are relevant to GFO are reproduced here.
We agree to the publication of this response.

Question 1: With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that:

We think that major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.
Removing the 'One in one out' rule for environmental policies would also greatly contribute.

Question 2: Do you know with sufficient confidence if some of your pension, life insurance premium or any other personal savings are invested in sustainable financial assets?

No, we do not know this with sufficient confidence, and no, I do not want to be offered more information with regard to the integration of sustainability criteria, because that it would not address the underlying concern that the taxonomy is not compatible with science.[1]
As long as the taxonomy is not compatible with IPCC findings and recommendations, disclosure and transparency are irrelevant at best and possibly misleading.

Question 3: When looking for investment opportunities, would you like to be systematically offered sustainable investment products as a default option by your financial adviser, provided the product suits your other needs?

[1] See Green Finance Observatory – 50 shades of green part III – Sustainable finance 2.0
https://greenfinanceobservatory.org/2020/03/12/third-policy-report-50-shades-of-green-part-iii-sustainable-finance-2-0/

Yes, but only provided the sustainable investment products are truly green, i.e. are not based on an illusory promise of green growth that has been debunked, and do not including ‘enabling’ or ‘transitional’ activities.

Question 4: Would you consider it useful if corporates and financial institutions were required to communicate if and explain how their business strategies and targets contribute to reaching the goals of the Paris Agreement?

Moderately useful. It would be far more useful to set up and implement binding environmental regulations that align with science. This would be the most effective and fastest way to have corporates and financial sector firms adopt strategies that align with the goals of the Paris Agreement. It would also have the added benefits of providing more harmonization, more clarity and regulatory certainty, and to foster greater innovation.

Question 5: One of the objectives of the European Commission’s 2018 Action Plan on Financing Sustainable Growth is to encourage investors to finance sustainable activities and projects. Do you believe the EU should also take further action to:
- Encourage investors to engage, including making use of their voting rights, with companies conducting environmentally harmful activities that are not in line with environmental objectives and the EU-wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law, with a view to encouraging these companies to adopt more sustainable business models: scale from 1 (strongly disagree) to 5 (strongly agree).
- Discourage investors from financing environmentally harmful activities that are not in line with environmental objectives and the EU-wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law: scale from 1 (strongly disagree) to 5 (strongly agree)

We do not have a strong opinion on the first suggestion (3), as such strategies have had a very limited impact so far.
We strongly agree with the second suggestion (5).
To reach this objective, the EU should introduce a brown penalizing factor mirroring the green supporting factor. This would have the added benefit of preserving EU banks’ solvency, a crucial issue in the current context.
Alternatively, the EU could mandate a phasing out of fossil fuels, which would automatically reorient financing flows to green activities and discourage investors from financing environmentally harmful activities.

Question 6: What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?

In our opinion, the three main challenges for mainstreaming sustainability in the financial sector over the next 10 years are:
- The current inability of sustainable finance to measure impact (only outcome);
- The taxonomy that is not compatible with science, and thus likely to result to mis-selling and loss of confidence over time from investors;
- The great role foreseen for market-based solutions (carbon and biodiversity offsets, catastrophe bonds) despite their poor track record and conceptual issues;

Addressing the three challenges constitutes the main opportunities to correct course and mainstream sustainability.

Question 8: The transition towards a climate neutral economy might have socioeconomic impacts, arising either from economic restructuring related to industrial decarbonisation, because of increased climate change-related effects, or a combination thereof. For instance, persons in vulnerable situations or at risk of social exclusion and in need of access to essential services including water, sanitation, energy or transport, may be particularly affected, as well as workers in sectors that are particularly affected by the decarbonisation agenda. How could the EU ensure that the financial tools developed to increase sustainable investment flows and manage climate and environmental risks have, to the extent possible, no or limited negative socio-economic impacts?

The EU could ensure that the financial tools developed to increase sustainable investment flows and manage climate and environmental risks have no or limited negative socio-economic impacts by:

- No longer basing them on illusory promises of green growth that obfuscate the trade-offs to be made and the question of distribution.
- Using traditional binding environmental policies instead of price-based mechanisms and other market-based solutions that further disadvantage vulnerable persons.
- Explicitly excluding nature-based solutions and other offset projects, whose social and human rights track record is appalling.[2]

Question 11: In light of the growing negative impact of biodiversity loss on companies' profitability and long-term prospects (see for instance The Nature of Risk - A Framework for Understanding Nature-Related Risk to Business, WWF, 2019), as well as its strong connection with climate change, do you think the EU's sustainable finance agenda should better reflect growing importance of biodiversity loss?

We do not think that EU's sustainable finance agenda should better reflect the growing importance of biodiversity loss, because it cannot: it has been shown that biodiversity and ecosystems are too complex, heterogeneous and interconnected to be valued in monetary terms.
It has also been shown that biodiversity destruction cannot be comprehensively offset. Biodiversity loss can only be seriously addressed by environmental policies curbing biodiversity destruction, not by sustainable finance securitizing biodiversity offset projects.

---

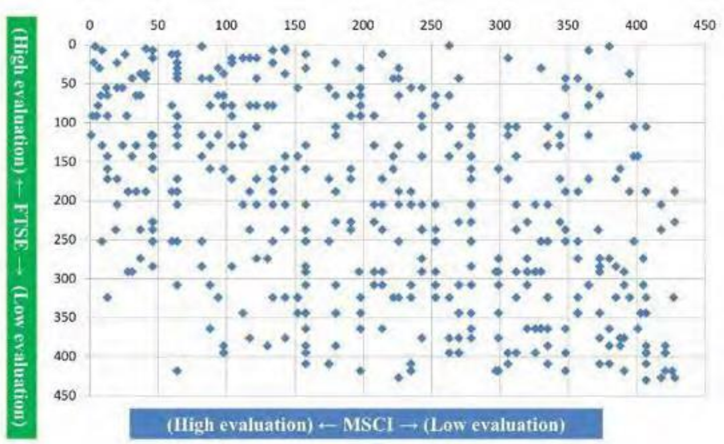
[2] Carbon Market Watch, The Clean Development Mechanism: Local Impacts of a Global System, 29 October 2018, https://carbonmarketwatch.org/publications/the-clean-development-mechanism-local-impacts-of-a-globalsystem/ ;
Bachram H, Climate Fraud and Carbon Colonialism: The New Trade in Greenhouse Gases, Capitalism, Nature, Socialism Vol 15, December 2004, http://www.carbontradewatch.org/pubs/cns.pdf ;
Carbon Market Watch, Open letter to ICAO council representatives & national delegates on ending the Clean Development Mechanism, 29 October 2018, https://carbonmarketwatch.org/publications/open-letter-to-icaocouncil-representatives-national-delegates-on-ending-the-clean-development-mechanism/ ;
Friends of the Earth, New report on human rights violations linked to REDD in Acre, Brazil, 8 December 2014, https://foe.org/news/2014-12-new-report-on-human-rights-violations-linked-to-redd/ ;
The Oakland Institute, Carbon Colonialism: Failure of Green Resources' Carbon Offset Project in Uganda, 2017, https://www.oaklandinstitute.org/carbon-colonialism-failure-green-resources-carbon-offset-project-uganda ;
Motherboard, Ahmed N, Carbon Colonialism: How the Fight Against Climate Change Is Displacing Africans, 1 December 2014, https://motherboard.vice.com/en_us/article/kbzn9w/carbon-colonialism-the-new-scramble-forafrica
Kill Jutta, Franchi Giulia, Rio Tinto's biodiversity offset in Madagascar – Double landgrab in the name of biodiversity?,World Rainforest Movement, Re:Common, March 2016. Online. Available at: https://wrm.org.uy/wp-content/uploads/2016/04/RioTintoBiodivOffsetMadagascar_report_EN_web.pdf
Vidal John, The tribes paying the brutal price of conservation, The Guardian, August 2016. Online. Available at: https://www.theguardian.com/global-development/2016/aug/28/exiles-human-cost-of-conservation-indigenouspeoples-eco-tourism
Re:common, Turning forests into hotels The true cost of biodiversity offsetting in Uganda, Apr 2019. Online. Available at: https://www.recommon.org/eng/turning-forests-into-hotels-the-true-cost-of-biodiversity-offsetting-inuganda/
Friends of the Earth UK, New tricks: biodiversity offsetting and mining, February 2019. Online. Available at: https://policy.friendsoftheearth.uk/publications/new-tricks-biodiversity-offsetting-and-mining
IWGIA, New green powers in the global land grab violate indigenous peoples' rights, October 2017. Online. Available at: https://www.iwgia.org/en/focus/land-rights/2520-new-green-powers-in-the-global-land-grab-violateindigenous-peoples-rights
International Institute for Environment and Development, 'Land grabbing': is conservation part of the problem or the solution?, September 2013. Online. Available at: https://pubs.iied.org/pdfs/17166IIED.pdf
Global Witness, Defenders of the Earth - Global killings of land and environmental defenders in 2016, 2017. Online. Available at: https://www.globalwitness.org/documents/19122/Defenders_of_the_earth_report.pdf.pdf
Carbon Trade Watch, A tree for a fish, December 2014. Online. Available at: http://www.carbontradewatch.org/downloads/publications/CTW_A_Tree_for_a_Fish-EN.pdf

Question 13: In your opinion, which, if any, further actions would you like to see at international, EU, or Member State level to enable the financing of the sustainability transition? Please identify actions aside from the areas for future work identified in the targeted questions below (remainder of Section II), as well as the existing actions implemented as part of the European Commission's 2018 Action Plan on Financing Sustainable Growth.

We would like to see the below additional actions at EU level:
- New EU legislation mandating a phasing out of fossil fuels over a period compatible with IPCC findings;
- New environmental regulations curbing the loss of biodiversity to sustainable levels;
- Removing the 'one in one out' rule;
- An end to the EU Emissions Trading Scheme, that has only proven to be a waste of EU taxpayer money with no significant impact on climate change over the past 15 years.

Question 18: How would you rate the comparability, quality and reliability of ESG data from sustainability providers currently available in the market?

We would rate it very low, as shown on the below chart. The chart compares the ESG scores from FTSE and MSCI and shows very clearly the major inconsistencies.



Source: CLSA, GPIF

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

Only to the extent that the standard is consistent with science and the metrics are relevant and meaningful.

Question 31: Should such a potential standard for target-setting sustainability-linked bonds or loans make use of the EU Taxonomy as one of the key performance indicators?

1. Not unless the taxonomy is strongly amended to be aligned with science

Question 41: Do you think that a defined set of EU companies should be required to include carbon emission reductions, where applicable, in their lists of ESG factors affecting directors' variable remuneration?

Integrating carbon emission reductions in directors' variable remunerations would be a welcome development, insofar as it links to real emission reductions, and not 'net' emission reductions.

Question 54: Do you think that green securitization has a role to play to increase the capital allocated to sustainable projects and activities?

1. Green securitization is neither necessary nor beneficial, as there is no need for structured credit instruments to finance green economic activities, regular bonds are sufficient, an as green securitization would create new major risks.

The securitization of carbon and biodiversity offset projects would add the systemic risks of securitization (magnification of the risk of adverse selection, originate to distribute model, delegation of due diligence, procyclicality of leverage, interconnectedness, etc.) to the environmental, social and financial stability issues of offsets (highly uncertain and volatile prices, incalculable additionality, appalling social impact).[3]

The securitization of natural disaster insurance via sovereign catastrophe bonds has also serious documented issues (partial risk transfer, moral hazard, loss of flexibility[4]) that make not suitable.

Question 55: Do the existing EU securitization market and regulatory frameworks, including prudential treatment, create any barriers for securitizing 'green assets' and increasing growth in their secondary market?

The existing EU securitization market and regulatory frameworks do not create any unnecessary barriers, which is the relevant question here.
Shadow banking (whose main activity is securitization) remains far less regulated than traditional banking.

Question 56: Do you see the need for a dedicated regulatory and prudential framework for 'green securitization'?

We do not see the need for a dedicated regulatory and prudential framework for 'green securitization,' as the European Commission has already been extremely generous with the financial industry in its earlier quality label STS securitization, and as green securitization is not indispensable. A softer dedicated prudential framework could however create additional risks for financial stability.

Question 68: In your view, to what extent would potential incentives for investors (including retail investors) help create an attractive market for sustainable investments?

Potential public incentives for investors could boost the market to some extent, however, it is not clear that such incentives are necessary: the evidence seems to suggest that the bottleneck is more the lack of green projects than the lack of demand from investors.
In addition, a related but as relevant question is whether we should provide taxpayer funded incentives for investments based on a taxonomy that is not compatible with what science tells us.

[3] See Green Finance Observatory, 50 shades of green part III, pages 63-65
https://greenfinanceobservatory.org/2020/03/12/third-policy-report-50-shades-of-green-part-iii-sustainable-finance-2-0/
[4] Green Finance observatory, supra, pages 49-59

The obvious answer is not. Hence as long as the taxonomy is not fundamentally altered to align it with science, there should be no subsidies or de-risk mechanisms.

Question 82: In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called "brown taxonomy") at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation?

Yes, but only if the purpose of this brown taxonomy is to identify, stop subsidizing and disincentivize these brown activities, not reward them for marginal improvements that ultimately delay structural change.
It is quite surprising that this possibility is not even listed in the options proposed.

Question 86: Following the financial crisis, the EU has developed several macroprudential instruments, in particular for the banking sector (CRR/CRDIV), which aim to address systemic risk in the financial system. Do you consider the current macroprudential policy toolbox for the EU financial sector sufficient to identify and address potential systemic financial stability risks related to climate change?

The current macroprudential policy toolbox is clearly insufficient, which is not a surprise as most post crisis regulation has been micro-prudential in nature, and as macro-prudential regulation proposals were never completed, from bank separation to shadow banking regulation.

Question 89: Beyond prudential regulation, do you consider that the EU should take further action to mobilize banks to finance the transition and manage climate-related and environmental risks?

No. We consider, however, that the EU should take further action to set up and implement environmental regulations phasing out fossil fuels and curbing biodiversity loss immediately. This would in turn automatically mobilize banks to finance the transition.

Question 98: Are there any specific existing initiatives (e.g. private, public or other) you suggest the Commission should consider when supporting more businesses and other stakeholders in implementing standardized natural capital accounting/environmental foot printing practices within the EU and internationally?

The question is quite surprising given the major rejection of the habitat banking proposal by European citizens only a few years ago, and in light of the well-known intractable issues of putting a monetary value on ecosystem functions.[5]
The natural capital approach has been amply documented to be a conceptual dead-end, and it would be interesting to know on what environmental grounds the Commission still supports this approach.

Question 100: Is there a role for the EU to promote more equal access to climate-related financial risk management mechanisms for businesses and citizens across the EU?
- Yes/No/Do not know.
- If yes, please indicate the degree to which you believe the following actions could be helpful, using a scale of 1 (not helpful at all) to 5 (very helpful) and substantiate your reasoning:
- Financial support to the development of more accurate climate physical risk models.
- Raise awareness about climate physical risk.

[5] Green Finance Observatory, 50 shades of green part II: the fallacy of environmental markets https://greenfinanceobservatory.org/2019/05/23/second-policy-report-50-shades-of-green-part-ii-the-fallacy-of-environmental-markets/

- Promote ex-ante “build back better” requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe.
- Facilitate public-private partnerships to expand affordable and comprehensive insurance coverage.
- Reform EU post-disaster financial support.
- Support the development of alternative financial products (e.g. catastrophe bonds) offering protection/hedging against financial losses stemming from climate- or environment-related events.
- Create a European climate-related disaster risk transfer mechanism.

Promoting ex-ante “build back better” requirements to improve future resilience of the affected regions and or/sectors after a natural catastrophe is a very welcome proposal, that could greatly contribute to increase resilience.

Given the many issues associated with public-private partnerships and catastrophe bonds, we believe that the EU should not promote their development.
Sovereign catastrophe bonds in particular have been shown to only partially transfer the risk, create moral hazard, reduce flexibility to intervene, and potentially increase financial instability. They should therefore not be promoted.[6]

The recent failure of the World Bank’s pandemic bonds to pay out for the 2018 Ebola epidemic in Congo and its extremely long time to trigger (>100 days) in relation to the Covid-19 pandemic[7] offer a useful lesson that we hope the Commission will take into consideration.

Question 101: Specifically, with regards to the insurability of climate-related risks, do you see a role for the EU in this area?

We see a role for the EU to harmonize building practices, ensure that they are sound and energy neutral, and to ensure that all member states are able to play their role of insurer of last resort based on a principle of national solidarity.

[6] Green Finance Observatory, 50 shades of green part III: sustainable finance 2.0
[7] Asgari N, Financial Times, Ebola outbreak fails to trigger World Bank pandemic bonds, 27 July 2019; https://www.ft.com/content/385ed732-aee3-11e9-8030-530adfa879c2
Jonas O, Nature, Pandemic bonds: designed to fail in Ebola, 13 August 2019; https://www.nature.com/articles/d41586-019-02415-9
Baker M, Euromoney, When will coronavirus Covid-19 trigger the World Bank's pandemic bond? 4 March 2020 https://www.euromoney.com/article/b1klyqsykl0d0m/when-will-coronavirus-covid19-trigger-the-world-bank39s-pandemic-bond
Bloomberg, Deadly Virus Fails to Trigger World Bank’s Pandemic Bonds, 10 April 2020 https://www.bloomberg.com/news/articles/2020-04-10/deadly-virus-fails-to-trigger-world-bank-s-pandemic-bonds