

Green and sustainable finance

SUMMARY

The dramatic consequences of climate change and environmental degradation have brought the need for a more sustainable economy to the top of the agenda. Transforming the EU economy to make it more sustainable requires large investments, especially for enabling a green and low-carbon transition. Given that the public sector alone cannot cover this financial need, solutions have been sought to bring the private sector on board. Green finance involves collecting funds for addressing climate and environmental issues (green financing), on the one hand, and improving the management of financial risk related to climate and the environment (greening finance), on the other. Sustainable finance is an evolution of green finance, as it takes into consideration environmental, social and governance (ESG) issues and risks, with the aim of increasing long-term investments in sustainable economic activities and projects.

The European Union is a global leader in the above domain. In its 2018 action plan on financing sustainable growth, the European Commission set out the EU strategy to connect finance with sustainability. The first deliverables have been three key regulations seeking to create a classification system to determine whether an economic activity is environmentally sustainable (the 'taxonomy'); to make disclosures relating to sustainable investments and sustainability risks clearer; and to establish low-carbon benchmarks. The Taxonomy Regulation is particularly important for driving the consistent development of future legislation, as advocated, in particular, by the European Parliament. The Commission will release a renewed sustainable finance strategy in 2021, and a legislative proposal on the green bond standard.

The interest in green and sustainable finance is rising very fast among investors worldwide, and several voluntary private initiatives have tried to create some market standards. Policymakers have also been very active in launching numerous regulatory and non-regulatory initiatives at global or local level. To avoid market fragmentation, there is a demand for greater harmonisation among the different measures. There is also a need to increase the standardisation and disclosure of non-financial information published by companies and used to evaluate the risks. Doing so will help to increase data availability, to make data more comparable, and to bring more transparency and clarity to investors. Given that climate change and environmental degradation are global challenges, international cooperation is in the common interest; the European Union is actively promoting this through the International Platform on Sustainable Finance.



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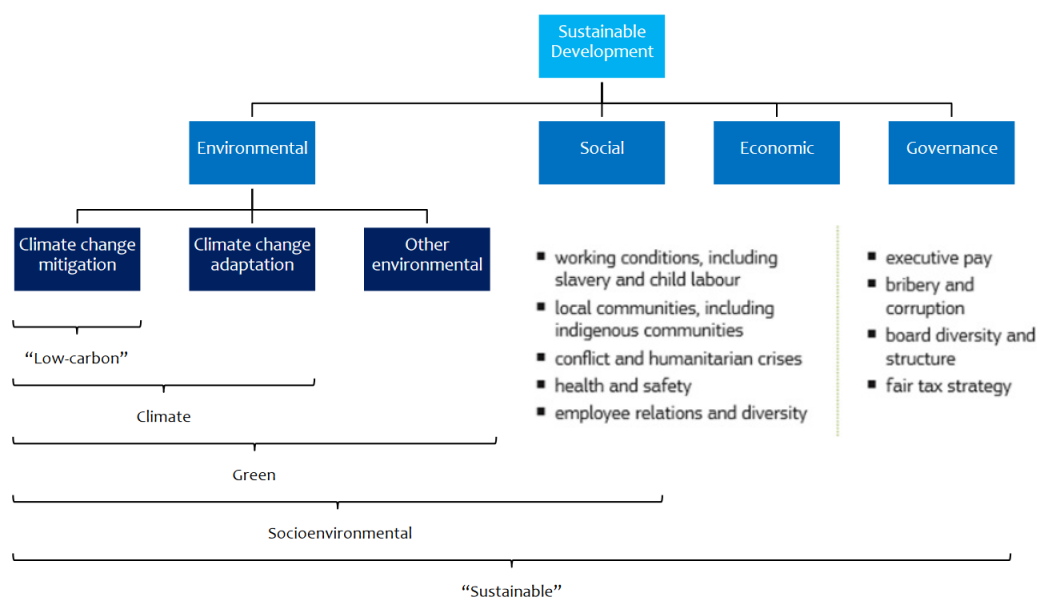
Introduction

Climate change and environmental degradation are sources of risks for the wellbeing of our societies and the prosperity of our economies. The UN Intergovernmental Panel on Climate Change (IPCC), in its special report on [Climate change and land](#), warned how global warming creates threats in terms of desertification (water scarcity), land degradation (soil erosion, vegetation loss, wildfires, permafrost thaw) and food insecurity (crop yield- and food-supply instabilities). Changes in these processes drive risks to food systems, livelihoods, infrastructure, the value of land, and human and ecosystem health. Changes in one process (e.g. wildfires or water scarcity) may result in compound risks, including species extinction, which can also be the cause of a pandemic.

Several parties have voiced the need for corrective measures and a more sustainable economy. The commitment by numerous countries to the objectives of the 2016 [Paris Agreement on Climate Change](#) has brought forward new political priorities, including more investment into a green low-carbon economy, and a significant shift in the allocation of resources. The European Environment Agency (EEA), in its [State of the Environment Report 2020](#), recommended to 'scale up investments and reorient the financial sector to support sustainable projects and businesses'. This requires public funds to support innovation, while procuring sustainably and supporting impacted sectors and regions, but also entails engaging the financial sector in redirecting private capital to sustainable investment. The Covid-19 pandemic has underlined even more the critical need for coordinated actions to finance a more sustainable economy, at the global level.

The [OECD estimates](#) that €6.35 trillion a year will be required globally to meet Paris Agreement goals by 2030, while the [European Commission estimates](#) that in the climate and energy areas alone an additional annual investment of €240 billion is needed to meet the EU's climate and energy targets by 2030¹. The financial system can contribute to addressing these needs through climate finance, green finance and sustainable finance. **Climate finance** provides funds for addressing climate change adaptation and mitigation, **green finance** has a broader scope as it also covers other environmental goals (e.g. biodiversity protection/restoration), while **sustainable finance** extends its domain to environmental, social and governance factors (ESG). Therefore, green finance should be seen as a subset of sustainable finance; or alternatively sustainable finance can be considered as an evolution of green finance (Figure 1).

Figure 1 – Simplified definitions of the key terms used in this paper



Source: Elaboration on [Definitions and Concepts: Background Note](#), UNEP Inquiry, 2016.

Greening finance and green financing are driving the green transformation of the financial system. **Greening finance** aims to mainstream climate and environmental factors into the financial system and to improve the identification and management of financial risks related to the climate and the environment. **Green financing** aims to mobilise private capital flows in green investments. These drivers are also the backbone of sustainable finance. Moreover, the inclusion of ESG factors in the investment decision-making process allows to consider a broader area of investment and to strengthen financial stability by considering further risks than just the environmental one. Sustainable finance also has a major role to play in '[building back better](#)' and contributing to a sustainable and resilient recovery from the Covid-19 pandemic.

Greening finance

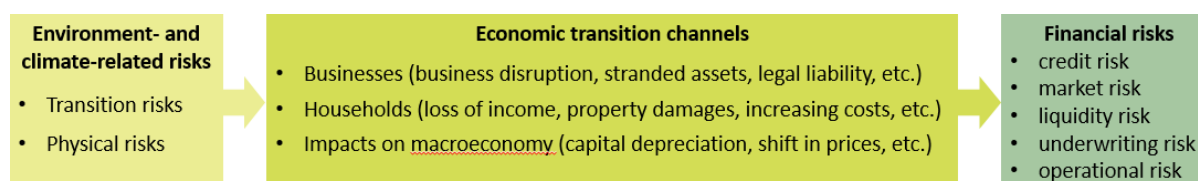
'Greening finance' is short for 'greening the financial system', and corresponds to the diffusion of new tools, procedures and regulations aimed at inducing the financial system to take due account of climate and environmental considerations in financial risk management and, consequently, in investment decision-making. The financial system is increasingly treating climate- and environment-related risks as financial risks, not just as reputational ones. There is more awareness that these risks can become financially material, due to the working of some economic transmission channels (Figure 2).

Climate- and environment-related risks as financial risks

In a famous [speech](#) given on 29 September 2015, then Bank of England Governor, Mark Carney, warned that financial stability may be undermined by the increasing financial risks linked to climate change and identified three major risks:

- **Physical risks** are strictly linked to the physical effects of climate change. There can be acute physical risks caused by disruptive events (cyclones, hurricanes, floods, etc.) or chronic physical risks caused by a longer-term shift in climate patterns (e.g. higher temperature and consequent food and water scarcity because of drought). Physical risks may have financial implications for households and organisations, such as direct damage to assets and indirect impacts from supply chain disruption;
- **Transition risks** are linked to the transition to a less polluting, greener economy, which may lead to changes in the value of a wide range of assets. They are associated with regulatory changes (e.g. stricter rules for CO₂ emissions) and technological changes (e.g. electrification of the car industry) due to the decarbonisation process. On the demand side, they can be caused by a change in consumer behaviour due to an increased environmental consciousness. Transition risks may have financial implications for organisations, such as stranded assets and higher costs of doing business;
- **Liability risks** are strictly linked to the consequences of the above two risks. The actual trend shows an increasing number of litigation procedures from individuals and business claiming compensation for losses. There can be claims for failed attempts to mitigate the impacts of climate change, to adapt to climate change, or to disclose climate-related risks to shareholders. As pointed out in the latest [Climate Chance 2020 Report](#), the financial sector may become a target of climate-related litigation, and this risk is already perceptible.

Figure 2 – Transmission channels from environmental risks to financial risks



Source: Elaboration on [Overview of Environmental Risk Analysis by Financial Institutions](#), NGFS, September 2020.

Greening the financial system

Since financial risks have an effect on financial stability, policymakers, financial regulators, and supervisory authorities are working in parallel to promote the integration of climate- and environment-related risks into financial decision-making processes and financial risks management. According to the [UNEP Inquiry](#) (an international platform of experts) at the end of 2019, governments and financial regulators developed around 400 policies and measures at the national and regional levels to promote green and sustainable finance (Figure 3).

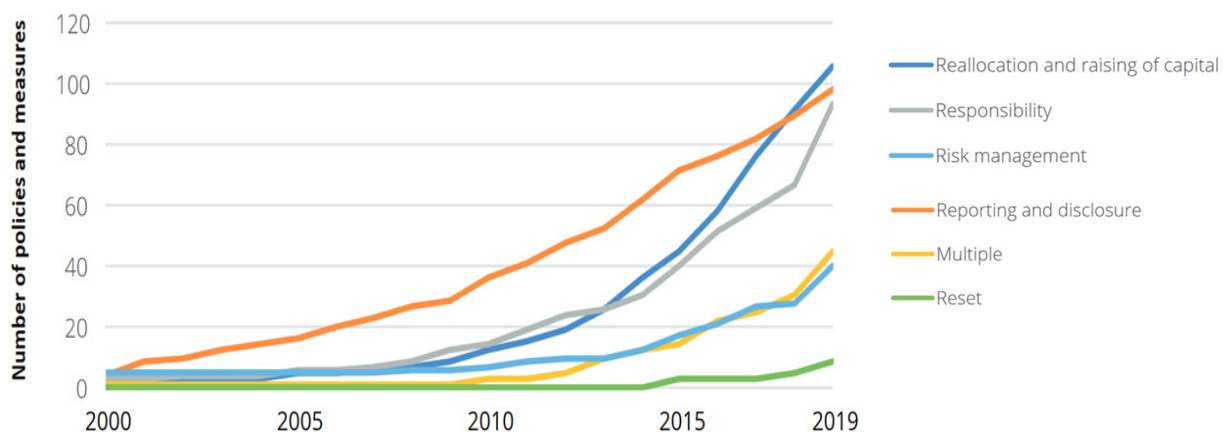
In December 2015, **the Financial Stability Board (FSB)**, an international body that monitors and makes recommendations about the global financial system, established the [Task Force on Climate-Related Financial Disclosures \(TCFD\)](#), composed of members that either prepare or use financial disclosures. In June 2017, the TCFD released its final report, offering [key recommendations](#) for more effective climate-related disclosures to enable stakeholders to understand better the concentration of carbon-related assets in the financial sector and the financial system's exposure to climate-related risks. The TCFD recommendations are recognised as an authoritative guidance on the reporting of financially material climate-related information, and the Commission in its [Guidelines on reporting climate-related information](#) encourages companies to implement them.

In 2016, **the G20** launched a Green Finance Study Group (GFSG)² that focused on five principal areas: greening the banking system; greening the bond markets; greening institutional investment; risk analysis; and measuring progress. In its [G20 Green Finance Synthesis Report 2017](#), it elaborated on the application of environmental risk analysis (ERA) and the use of publicly available environmental data for doing financial risks analysis and informing decision-making.

The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) was established by eight central banks and supervisors in 2017. Since then, the network has grown to more than 80 members and has an important list of observers, such as the EIB, the EBRD, the IMF, the World Bank and the OECD. Among others, the NGFS aims to disseminate [tools and methodologies](#) conceived to manage environmental risks in the financial sector, particularly through the measurement and the assessment of their financial implications, via stress testing and scenario analysis.

The Basel Committee on Banking Supervision (BCBS), the primary global standard setter for the prudential regulation of banks) established a high-level [Task Force on Climate-related Financial Risks \(TCFR\)](#) in February 2020. The TFCR is currently carrying out research to understand climate risk transmission channels and to develop methodologies for measuring and assessing these risks. Following this step, it will consider the eventual need to incorporate climate-related financial risks in the existing [Basel Framework](#) (the set of standards of the BCBS³), and identify supervisory practices to mitigate such risks.

Figure 3 – Evolution of green finance policy and regulatory measures



Source: [UNEP Inquiry 2020](#).

Green financing

'Green financing' stands for 'financing the green economy' or 'financing the green transition', and corresponds to the aim of increasing the level of financial flows towards green investment. The role of finance in the green transition and its importance for climate action is recognised in Article 2.1c of the [Paris Agreement](#), which calls for 'making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development' (UNFCCC, 2015).

Achieving sustainability goals requires major investments. The OECD report [Investing in Climate, Investing in Growth](#) estimates that US\$6.9 trillion of global annual investment in infrastructure is required on average to meet development and climate needs by 2030.⁴ A substantial part of these financial flows will have to come from the private sector. In their publication '[Financing Climate Futures: rethinking Infrastructure](#)', the OECD, the World Bank and the United Nations Environment Program (UNEP) suggest that the financial system can facilitate the match between these investment needs and private capital allocation, by reorienting private capital flows towards more sustainable investment.

Green financing is growing fast through various financial instruments (see Figure 4 below) available to issuers and investors, such as green bonds, green loans, sustainable bonds, sustainability-linked bonds and sustainability-linked loans, blue bonds, and social bonds. Even though social bonds do not contribute directly to green financing, in some cases they may have a positive spill-over effect on the environment (e.g. investment in sustainable food systems) or may accompany green transformation projects (e.g. social bonds for a just transition).

[Green bonds](#) are any type of bond instrument committed to financing environmental or climate projects that invest in any of these areas: renewable energy, energy efficiency, pollution prevention and control, biodiversity, clean transportation, sustainable water management, climate change adaptation, eco-efficient products, production technologies and processes. Since the EIB issued its Climate Awareness Bond in 2007 and the World Bank issued its first green bond in 2008, the green bond market has grown very fast, reaching a value of [US\\$258.9 billion](#) in 2019.

[Sustainability bonds](#) are any type of bond instrument committed to financing a combination of green and social projects, certain green projects having social co-benefits, or certain social projects also having environmental co-benefits. Most of the time, the funds are committed to social or green impact projects that are aligned with the UN sustainable development goals (SDGs). Sustainability bonds include corporate SDG bonds (non-financial), SDG bonds by banks and financial institutions, asset-backed and project SDG bonds, sovereign SDG bonds and municipal SDG bonds.

[Sustainability-linked bonds](#) are any type of bond instrument for which the financial or structural characteristics (e.g. the coupon rate) can fluctuate depending on the achievement of predefined sustainability targets by the issuer. This instrument is relatively new in the market. The first SDG-linked bond was issued in September 2019 by the Italy-based international energy company [ENEL](#). In January 2021, the [ECB](#) made sustainability-linked bonds eligible for inclusion in asset-purchase programmes and for use as collateral.

[Green loans](#) are any type of loan instrument whose funds are committed exclusively to green projects addressing key areas of environmental concern, such as climate change, natural resources depletion, loss of biodiversity, and air, water and soil pollution. A fundamental part of a green loan is the periodic reporting by the borrower to the lender of the actual use of proceeds, also by using qualitative performance indicators and quantitative performance measures (for example, electricity generation, greenhouse gas emissions reduced/avoided, etc.).

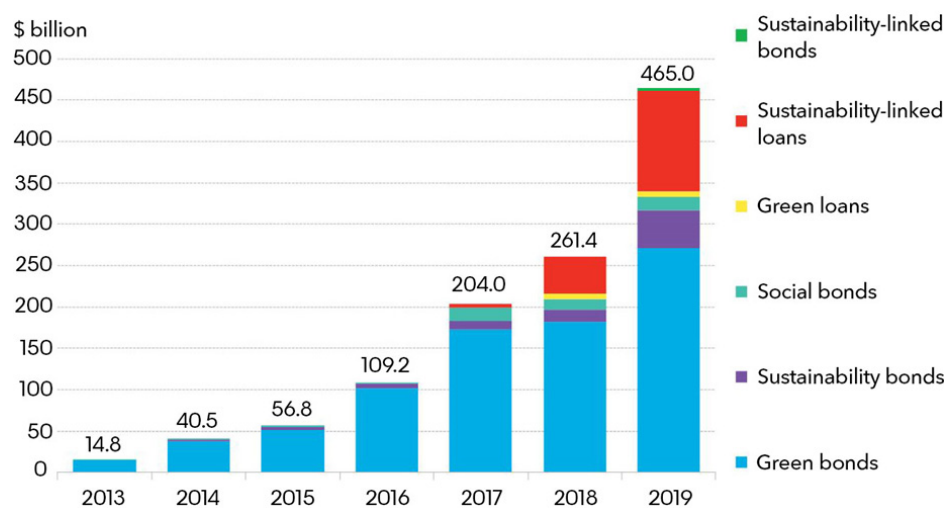
[Sustainability-linked loans](#) are any type of loan instrument paid by the borrower, where the interest rate is dynamic and linked to some selected sustainability performance indicators, such as carbon emissions or an ESG target. In case of achieving the sustainability targets, the borrower benefits from

favourable interest rates, while higher rates are due in case of failure. This mechanism is a financial incentive linked to the attainment of sustainability objectives.

Blue bonds are any type of bond instrument issued by governments, development banks or others, aimed to finance marine and ocean-based projects. The Seychelles Blue Bond was the first blue bond launched in October 2018 by the Republic of the Seychelles to support the expansion of marine protected areas, improve governance of priority fisheries and the development of the Seychelles' blue economy. According to the OECD, the **blue economy** will be worth US\$3 trillion a year by 2030 globally, and therefore blue bond issuance is expected to grow in the coming years.

Social bonds are any type of bond instrument committed to financing social projects, including projects aiming at creating food security and sustainable food systems, at sustaining vulnerable groups in the aftermath of a natural disaster, or at alleviating unemployment stemming from a socioeconomic crisis. Compared to green bonds, the use of social bonds is still limited, but investors are showing an increased interest in them, as happened in October 2020 when the Commission issued the first emission of **EU SURE social bonds**.

Figure 4 – Global sustainable debt annual issuance, 2013-2019



Source: [BloombergNEF](#), Bloomberg L.P.

EU action

The 2018 EU action plan on financing sustainable growth

The transition to a sustainable economy will require large investments. As Commission Vice-President, Valdis Dombrovskis, [stated](#), 'to meet our Paris targets, Europe needs between €175 and €290 billion in additional yearly investment in the next decades'. In December 2016, the Commission established a high-level expert group (HLEG) to develop a comprehensive EU strategy on sustainable finance. On 8 March 2018, based on the [HLEG final report](#), the Commission published its [Action plan on financing sustainable growth](#), where it set out the strategy to connect finance with sustainability and identified three main objectives: reorienting capital flows towards sustainable investment; mainstreaming sustainability into risk management; and fostering transparency and long-termism.

The first deliverables have been three key regulations: to create a sustainable [taxonomy](#) for the EU (Regulation (EU) 2020/852) (see box below); to make [disclosures](#) relating to sustainable investments and sustainability risks clearer (Regulation (EU) 2019/2088); and to establish low-carbon [benchmarks](#) (Regulation (EU) 2019/2089), setting the requirements for 'EU Climate Transition Benchmarks' and 'EU Paris-aligned Benchmarks'.

The EU Taxonomy Regulation

Adopted in June 2020, the Regulation on the establishment of a framework to facilitate sustainable investments (the Taxonomy Regulation) sets out an EU-wide classification system for sustainable economic activities, aimed at facilitating sustainable investments. The EU taxonomy covers six 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; 5) pollution prevention and control; and 6) protection and restoration of biodiversity and ecosystems. Legal provisions determine, for those six environmental objectives, the principle that an environmentally sustainable economic activity must contribute substantially to at least one environmental objective and do no significant harm to any of the other objectives (*Do no significant harm principle (DNSH) principle*). Furthermore, the activity should be carried out in compliance with the minimum international social and labour standards and should comply with technical screening criteria, adopted by the Commission through delegated acts. The taxonomy will be fully operational when all the [delegated acts](#) have been published. Establishing a standard EU-level definition of what qualifies as an environmentally sustainable economic activity, it aims to avoid market fragmentation, to protect private investors against the risks of greenwashing,¹ and to provide the basis for further meaningful action in areas such as disclosures, prudential rules, benchmarks and EU eco-labels on financial products. Just as energy-labelling guides consumer choices towards energy-efficient products, benchmarks and labels would aim to guide investor choices towards investments in environmentally sustainable activities. The review clause of the Taxonomy Regulation commits the Commission to publish a report by 31 December 2021, describing the provisions that would be required to extend the scope of this regulation to cover economic activities that significantly harm environmental sustainability ('brown' activities), activities that do not have a significant impact on environmental sustainability (low impact activities), and other sustainability objectives, such as social objectives.

European Green Deal

In the framework of the [European Green Deal](#), among other initiatives, the Commission announced its intention to put forward a renewed sustainable finance strategy, a legislative proposal for an EU green bond standard and a review of the Non-financial Reporting Directive.

[The renewed sustainable finance strategy](#) will build on the 2018 action plan and, according to the Commission, help to create an enabling framework for private investors and the public sector to facilitate sustainable investment. The strategy is expected to contribute to redirecting more intensively private capital flows to green investments, to embedding a culture of sustainable corporate governance in the private sector and to supporting businesses' transition towards sustainability in the course of their recovery from the impact of the Covid-19 outbreak. On 8 April 2020, the Commission launched a [consultation](#) on the future strategy, which was closed on 15 July 2020. The renewed strategy is expected to be published in 2021.

The Commission has announced [that the EU green bond standard](#) will be among its key legislative initiatives for 2021. Green bonds play an increasingly important role in financing assets needed for the low-carbon transition. For example, Commission President, Ursula von der Leyen, announced that the Commission would set a target whereby 30 % of the €750 billion Next Generation EU would be raised through green bonds. However, there is no uniform green bond standard within the EU for now. The TEG provided recommendations on this subject and published a [Usability guide for the EU green bond standard](#). In the context of the public consultation on the renewed sustainable finance strategy, the Commission launched a [targeted consultation](#) on the establishment of an EU green bond standard, which ran from 12 June to 2 October 2020. The legislative proposal on the EU green bond standard is expected to be published in 2021.

[The Review of the Non-Financial Reporting Directive](#) (NFRD) is part of the strategy to strengthen the foundations for sustainable investment. Under the [current NFRD](#), large listed companies, banks and insurance companies with more than 500 employees are required to publish reports on the policies they implement in relation to: environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery, and diversity on company boards.

As required by the directive, the Commission has published [guidelines on non-financial reporting](#) in 2017, and [guidelines on reporting climate-related information](#) in 2019. On 28 February 2020, the Commission launched a [consultation](#) on the review of the NFRD and expects to adopt a proposal to [revise the NFRD](#) in early 2021.

European Parliament

On 28 May 2018, the European Parliament adopted a [resolution](#) in response to the Commission Action plan on sustainable finance. Members of the EP largely supported the Commission's action plan, agreeing on the essential role of the financial sector as regards sustainability as well as on the need of policies to correct market failures. The Parliament emphasised the need to define an EU sustainability taxonomy and called for having a unified standard for green bonds. The Parliament stressed that the financial sector, in its core function of allocating capital, should include ESG indicators in investment analysis and investment decisions. It furthermore pointed out that the inaccurate assessment or the misleading presentation of climate and other environmental risks of financial products can constitute a risk to market stability. The Parliament also emphasised that the identification, management and disclosure of ESG risks are an integral part of consumer protection and financial stability, and should therefore fall under the mandate and supervisory duties of the European supervisory authorities. The Parliament underlined the role of sustainable finance in its [resolution of 28 November 2019 on the 2019 UN Climate Change Conference in Madrid, Spain \(COP 25\)](#), where it invited the international financial institutions to swiftly adopt and develop green finance in order to bring about a successful decarbonisation of the global economy.

The Parliament had an [important role](#) in defining the Taxonomy Regulation, calling for the criteria and the set of harmonised indicators to be reasonable, proportionate and ensuring coherence with existing Union legislation. Furthermore, the Parliament asked that their impact on the entire industrial value chain and the life cycle of technologies should have been taken into account. The Parliament also insisted on strictly applying the 'do no significant harm' (DNSH) principle when defining sustainable activities. The Parliament attaches great importance to the development and use of the EU taxonomy, mentioning it in recent legislative and non-legislative dossiers. Just as examples, in the report on the proposal for a regulation establishing a [Recovery and Resilience Facility](#), and in the resolution on the [Sustainable Europe Investment Plan](#), the taxonomy is recalled as a tool to screen investments contributing to a green transition. In this resolution on the Sustainable Europe Investment Plan – How to finance the Green Deal, adopted on 13 November 2020, Parliament stressed the central role of the EU taxonomy in the promotion of green investment. In the process of overseeing the ECB, the European Parliament is participating actively in the current debate on the role of the ECB in greening its monetary policy and the financial system, as a supervisory authority. In its 12 February 2020 [resolution](#) on the ECB annual report, the Parliament included a specific section on 'actions against climate change'. While respecting the ECB mandate and independence, the Parliament recalled that the ECB, as an EU institution, is bound to the Paris Agreement on Climate Change, and that this should be reflected in its action; the Parliament called on the ECB to implement the ESG principles into its policies. The recent [ECON own-initiative report](#) calls on the ECB to align its collateral framework with climate change-related risks and to disclose its level of alignment with the Paris Agreement, as well as examining such alignment in the banking sector. It furthermore welcomes the fact that the purchases of green bonds and their share of the ECB's portfolio continue to increase; and encourages efforts to increase research capabilities regarding the impact of climate change on financial stability and the euro area. The report is due to be debated in plenary in February 2021.

European Central Bank

The [ECB](#), within the limits of its mandate, has increasingly considered [climate](#) as a key issue to be addressed in the framework of its tasks. The ECB collaborates with other central banks and supervisors globally in the Network for Greening the Financial System (NGFS), and it is an [observer](#) in the Platform on Sustainable Finance. Climate change is taken into account in the ECB's

macroeconomic models, forecasting methods and risk assessments. ECB financial stability experts measure and assess the risks posed to the financial system by climate change, and communicate them to market participants and to policymakers. With regard to monetary policy and investment portfolios, the ECB has invested in green bonds as part of its asset purchase, taking into account the need to avoid market distortions. As a banking supervisor, the ECB engages with banks to raise awareness of risks emerging from climate change. On 27 November 2020, the ECB published a [Guide on climate-related and environmental risks for banks](#) with the aim to improve the disclosure and management of climate- and environment-related risks. The guide explains ECB expectations towards banks in relation to risk management and disclosure; it furthermore analyses how physical and transition risks may affect prudential risk categories, such as credit risk, operational risk, market risk and liquidity risk. Importantly, the ECB will carry out its next supervisory stress test in 2022 on climate-related risks. In early 2021, the ECB set up a [climate change centre](#) to steer the work on climate issues already being done in different departments of the bank.

European Investment Bank

In its role of a multilateral development bank, the EIB has been a pioneer in climate and green finance, and is [one of the largest multilateral providers of finance for climate-related projects](#) globally. Thanks to this strong legacy, Commission President von der Leyen proposed to turn the EIB into [Europe's climate bank](#) in her political guidelines, while in June 2019 the European Council invited the EIB to [step up its activities in support of climate action](#). The EIB Group will aim to support €1 trillion worth of investments in climate action and environmental sustainability between 2021 and 2030, and will gradually increase the share of its financing dedicated to climate action and environmental sustainability to reach 50 % of its operations in 2025. In November 2019, the EIB Board of Directors took the commitment of aligning all EIB Group financing activities from the end of 2020, and announced that the EIB would end financing for fossil fuel energy projects from the end of 2021. It started a process of review of the 2015 [EIB Climate strategy](#), which ended with the publication of the new [Climate Bank Roadmap for 2021-2025](#) in November 2020, setting out how the EIB intends to become the EU's climate bank. The roadmap focuses on four key areas: accelerating the transition, ensuring a [Just Transition](#) for all, supporting Paris-aligned operations, and building strategic coherence and accountability.

Technical expert group on sustainable finance (2018-2020)

The Commission set up a [Technical expert group](#) on sustainable finance (TEG) in 2018 to assist it in developing the EU taxonomy, the EU green bond standard, methodologies for EU climate benchmarks and disclosures for benchmarks, and guidance on improving corporate disclosure of climate-related information. On 18 June 2019, the TEG published its [Report on EU green bond standard](#), proposing the Commission to create a voluntary, non-legislative EU green bond standard that would be aligned with the EU taxonomy. On 9 March 2020, the TEG published its [Final report on the EU taxonomy](#), containing recommendations for the design of the EU taxonomy, for the technical screening criteria concerning economic activities making a substantial contribution to climate change mitigation or adaptation, and providing implementation guidance for companies and financial institutions. The TEG's mandate ended in September 2020.

Platform on sustainable finance

Set up under the Taxonomy Regulation, the [Platform on sustainable finance](#) (platform) is an advisory body that is made up of experts from the corporate and the public sector, academia, civil society, industry and finance. In particular, the platform will advise the Commission on the preparation of the technical screening criteria for determining when an economic activity can be considered taxonomy-aligned (the so-called 'delegated acts' supplementing the Taxonomy Regulation), on the review of the Taxonomy Regulation and on covering other sustainability objectives including social objectives and activities that significantly harm the environment. Furthermore, the platform will monitor and report on capital flows towards sustainable investments, and more broadly on sustainable finance policy.

International Platform on Sustainable Finance

On 18 October 2019, the EU and seven countries launched the [International Platform on Sustainable Finance](#) (IPSF) with the aim to exchange best practices in environmentally sustainable finance; to compare initiatives in this field, and to enhance international cooperation. Its members are public authorities from Argentina, Canada, Chile, China, India, Indonesia, Japan, Kenya, Morocco, New Zealand, Norway, Senegal, Singapore, Switzerland and the EU, [representing 55 % of the world's greenhouse gas emissions and half of the world's population and GDP](#). Even though the IPSF is not a standard-setting body, its work is aimed at [preparing the ground for the international standard setters to develop globally applicable sustainable finance standards](#).

The way forward

Scenario

Market and regulatory trends indicate that there is an increased interest in green and sustainable finance among investors and policymakers. However, despite the rapid uptake of green and sustainable finance on the financial markets and the increased political focus they enjoy, their growth needs to be accelerated in order to achieve the targets indicated by the Paris Agreement and the 2030 UN Agenda for Sustainable Development.

While climate change remains a global emergency, the [Covid-19](#) outbreak has had severe consequences on the economy (in the autumn of 2020, the [Commission forecast](#) a 7.4% drop in GDP in 2020). The urgency of tackling climate change and environmental degradation coincides with the urgency of reacting rapidly to the economic shock caused by the pandemic. Both of them need investment in large amounts, as soon as possible. Both of them require a transition in the economy, and a sustainable one. A 'sustainable green transition' is at the heart of the Recovery plan for Europe, just as [climate and environmental justice](#) are at the core of the 'Building back better' programme of the new US president.

Financial markets have reacted to the Covid-19 crisis in multiple ways. While stock markets registered an increase of intra-day trading and volatility, ESG funds proved to be more resilient and out-performed non-ESG funds, which is a clear signal of resource reallocation towards more sustainable investment. Meanwhile, the sustainable finance landscape has also seen the acceleration of some existing trends, such as an increased interest in the social and governance dimension of sustainable investment, and a broader consideration of environmental objectives.

Scale-up

After the disruption caused by the pandemic, the need to scale up green and sustainable finance and the importance of international cooperation are even more evident. As noted in the first IPSF annual report, the absence of coherent definitions of green investments (taxonomies) and the low degree of [standardisation and transparency](#) may limit the growth of green and sustainable finance worldwide. Around the globe, several countries have drawn up roadmaps for sustainable finance, others have also introduced regulatory framework to enhance standardisation. However, their initiatives may reflect in different ways their local needs, environmental priorities and stages of market development, causing fragmentation. The need of overcoming this situation is also recognised in the [new EU-US agenda for global change](#), which proposes to jointly design a global regulatory framework for sustainable finance, learning from the experience of the EU taxonomy. [International cooperation](#) is key to facilitating regulatory harmonisation and standardisation of market practices. While exchanging best practices, the IPSF suggests working for a convergence on three tools: taxonomies, standards and labels for sustainable financial products and instruments, climate and environmental disclosure. They are essential in evaluating the sustainability of investment, assessing the risks and monitoring the performance. Aligning these tools will also facilitate coming up with a better definition of the non-financial data they use; this in turn will trigger data standardisation and better data availability through an increased volume of investment by data

providers. In order to provide investors access to data, the Commission announced in its [Capital Markets Union new action plan](#) the establishment of a [European Single Access Point](#) for financial and non-financial information publicly disclosed by companies.

Emerging trends

The disruption caused by the pandemic has shown humanity how fragile its relationship with the environment is, while also heightening our awareness of the need to preserve biodiversity and natural capital. Investment in these areas may not be bankable, as private investors perceive them as too small-scale, too risky and/or not profitable enough. [Natural capital finance](#), as argued by Finance Watch,⁵ needs a harmonised system of metrics and methodologies to assess the impacts, risks and dependencies of economic and financial activities on nature.

The pandemic has also highlighted the need for improved resilience of our societies and hence an increased need for investment in health and social protection. [Social finance](#) may offer tools such as social bonds; these would be issued, for example, by the Commission to finance the SURE programme.⁶ The financial market has shown a very high interest in the [EU SURE bonds](#) with record overbooking, and there is a growing appetite for social investment. This trend becomes even more important considering that the green revolution in the economy will have a social impact and that environmental reforms need to go hand in hand with equity and social inclusion.

Another emerging trend links to the concept of transition and to the allocation of resources to transitional activities and 'brown activities', with the aim of making them less polluting. [Transition finance](#), as argued by the European Banking Federation,⁷ needs better consideration within the discussion on sustainable finance, in order to guarantee adequate access to finance for entire sectors and the possibility to improve their sustainability. On the other hand, it is essential to avoid financing investment lock-in in carbon-intensive assets or processes, which could result in stranded assets. [Green public finance](#) also has an important role in scaling-up sustainable finance by adopting the EU taxonomy and the DNSH principle enshrined in the EU taxonomy, when investing in public infrastructure or delivering financial support to private investment.

Going digital to promote green finance

Non-financial information and data are essential for measuring the sustainability of activities. [Digitalisation](#) can help enrich the variety and quality of data available by collecting and analysing climate or environmental-related data through satellite mapping. Big data, artificial intelligence and machine learning can be used to capture and elaborate high-frequency data and information. Digitalisation can also contribute to reaching new markets, through crowdfunding or new fintech applications matching issuers with investors. For instance, the adoption of decentralised ledger technology (DLT) for green bonds can lower the costs for municipal green bond issuance and increase investors' confidence in investing in green projects for their local communities. Considering how sensitive [millennials and generation Z](#) are to climate and environmental issues and how eagerly they use digital devices, there is an opportunity to foster sustainable investing through digital channels.

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ENDNOTES

- ¹ The estimate is a yearly average investment gap for the 2021-2030 period, based on PRIMES model projections used by the Commission in its impact assessment of its proposal for an energy efficiency directive (2016), [SWD\(2016\) 405](#).
- ² In 2018, it was renamed the G20 Sustainable Finance Study Group (SGFS) and produced the [2018 Sustainable Finance Synthesis Report](#).
- ³ The [Basel Framework](#) is the full set of standards of the Basel Committee on Banking Supervision (BCBS), which is the primary global standard setter for the prudential regulation of banks. The membership of the BCBS has agreed to fully implement these standards and apply them to the internationally active banks in their jurisdictions.
- ⁴ The OECD estimation is consistent with the [IEA 2°C 66 % scenario](#).
- ⁵ Finance Watch, [Nature's Return](#), May 2020.
- ⁶ The Commission has aligned the EU SURE Social Bond Framework with the ICMA Social Bond Principles (source: [European Commission](#)).
- ⁷ European Banking Federation, [Renewed sustainable finance strategy: Important considerations from the banking sector](#), July 2020.

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