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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS**

# Strategy for Financing the Transition to a Sustainable Economy

## 1. Enhancing the EU sustainable finance framework

**An inclusive economic transformation and recovery from the COVID pandemic requires massive amounts of private finance directed towards the transition to a sustainable economy and a transformation of the financial system. At the same time, climate and environmental risks are increasing. Globally, sustainable finance is booming: investors and businesses see the direction of travel and want to take full advantage of the opportunities on offer.**

**Climate change and environmental degradation are the defining global challenges of our time.** Countries across the world now recognise the urgent need to address these challenges, as demonstrated by their support for the Paris Agreement, and they are setting themselves ambitious targets. With the European Green Deal, the EU made a number of ambitious commitments, in particular to become the first climate-neutral continent by 2050, to reduce emissions by at least 55% by 2030 compared to 1990 levels, and to reverse biodiversity loss and the broader degradation of the environment. To reach these targets, the EU also needs to cooperate globally and support countries in their transition.

**The role of the financial sector to help meet these targets is key.** Europe will need an estimated €350 billion additional investment per year over this decade to meet its 2030 emissions-reduction target in energy systems only, alongside €130 billion for other environmental goals. Environmental regulation needs to be complemented by sustainable finance policies to ensure there is the necessary financing for the transition and that future climate and environmental risks in the financial sector are managed. Unsustainable investments are increasingly likely to become stranded, while climate and environmental challenges are becoming ever more material.

**Sustainable finance policies can support an inclusive recovery from the COVID-19 pandemic**. The EU's framework for sustainable finance will help create new economic, business and job opportunities and strengthen societal resilience to future climate and environmental risks. The EU itself is taking significant steps. Thanks to the 2021-2027 multiannual financial framework and Next Generation EU (NGEU), the Union will spend up to €605 billion in projects supporting the climate and €100 billion in projects supporting biodiversity. 30% of the €750 billion allocated for Next Generation EU will be raised thanks to NGEU green bonds. More generally, across all Member States, sustainable finance tools can make it easier for public authorities to raise sustainable capital on the one hand and, on the other hand, to select and identify sustainable public investments. As the "EU climate bank", the European Investment Bank has also taken important steps to support the transition.[1]

**In 2018, the Commission adopted its first Action Plan on financing sustainable growth. Since then, the EU has put in place the three building blocks for a sustainable finance system,** to

[1] European Investment Bank Group, Climate Bank Roadmap 2021-2025, November 2020, available here.

support the flow of private finance towards sustainable economic activities.[2] They are 1) the development of a clear and consistent classification system of sustainable activities, 2) a comprehensive disclosure framework for financial and non-financial companies in the EU, and 3) a set of clear standards and labels.[3]

**The first building block is the EU Taxonomy.** The Taxonomy Regulation provides a robust, science-based classification system, allowing financial and non-financial companies to share a common definition of sustainability, when determining their investment choices, and providing protection against greenwashing.[4] The first Climate Delegated Act, pending the scrutiny by co-legislators, will apply from 1 January 2022. Its criteria cover the economic activities of roughly 40% of listed companies in sectors which are responsible for almost 80% of direct greenhouse gas emissions in Europe. Future developments of the EU Taxonomy are explained in section 2.1.

**The second building block is a comprehensive mandatory disclosure regime for both non-financial and financial companies.** This provides financial institutions with the sustainability information they need to make informed sustainable investment decisions. It covers both the sustainability impact of a company's activities as well as the business and financial risks faced by a company due to its sustainability exposures (known as the **'double materiality'** concept).

| **EU sustainability disclosure regime for financial and non-financial companies** | | | |
|---|---|---|---|
| **Instrument** | Corporate Sustainability Reporting Directive (CSRD) proposal[5] | Sustainable Finance Disclosure Regulation (SFDR)[6] | Taxonomy Regulation[7] |
| **Scope** | All EU large companies and all listed companies (except listed micro enterprises) | Financial market participants offering investment products | Financial market participants;<br>all companies subject to CSRD |
| **Disclosure** | Report on the basis of formal reporting standards and subject to external audit | Entity and product level disclosure on sustainability risks and principal adverse impacts | Turnover, capital and operating expenditures in the reporting year from products or activities associated with Taxonomy |
| **Status** | Being negotiated; expected to apply from 2023 | Applies from 10 March 2021 | Start applying from January 2022 |

[2] Communication from the Commission "Action Plan: Financing Sustainable Growth", COM(2018) 97 final, 8.3.2018.

[3] See Commission Staff Working Document accompanying the Strategy for the details of implementation of the 2018 Action Plan on Financing Sustainable Growth, SWD(XXX) final, XX.7.2021.

[4] Regulation 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation 2019/2088, OJ L 198, 22.6.2020, p. 13.

[5] Proposal for a directive amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards sustainable corporate reporting by certain undertakings, COM (2021) 189 final.

[6] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019, p. 1.

[7] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

To complement this sustainability disclosure regime, sustainability preferences will be included in investment and insurance advice provided by financial institutions.[8]

**The third building block is a set of standards and labels for sustainable financial instruments.** These make it easier for market participants to align their investment strategies with the EU's climate and environmental goals. They also provide greater transparency to market participants. This is what both the EU Climate Transition Benchmarks and the EU Paris-aligned Benchmarks, created by EU Climate Benchmarks Regulation[9], do. Today, the Commission is adopting a legislative proposal for a European Green Bond Standard.[10] This proposal will create a high-quality voluntary standard, available to all issuers to help attract sustainable investments.

**The EU has – in the space of a few years – created the foundations to make the transition to sustainability and a carbon neutral economy by 2050 possible. The building blocks are now in place.** We have however not yet delivered on all the actions laid out in the ambitious 2018 Action Plan and the Commission is committed to completing that work.

**Since 2018, our understanding of what is needed to meet the sustainability goals has evolved, and the global context has changed. This explains why a complementary strategy to the 2018 Action Plan is now needed.** First, our efforts to incentivise all economic sectors to transition towards more sustainable economic activities have highlighted that we need to take a step-by-step approach, and that greater differentiation between companies' respective starting points in the transition process is needed. Second, citizens' expectations for a more inclusive approach and the need to provide solutions to all actors of the real economy have also increased. The COVID-19 crisis has accentuated this aspect. Third, it has become clearer that we need to improve the contribution of the financial sector itself to sustainability and make it more resilient to the risks posed by climate change and large-scale environmental degradation. Finally, both the European and global ambitions to address climate and environmental challenges have significantly increased and the geopolitical environment has changed. The EU is at the forefront of global efforts in this area but cannot succeed alone.

**This Strategy, building on the 2018 Action Plan, thus identifies four main areas where additional actions are needed for the financial system to fully support the transition towards sustainability.**

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[8] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 87, 31.3.2017, p. 1; Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products, OJ L 341, 20.12.2017, p. 8.

[9] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks, OJ L 317, 9.12.2019, p. 17. Further information is available here.

[10] Reference to the proposal

*[INFOGRAPH on the 4 gaps/policy areas:*

1. *Financing the path to sustainability. This Strategy provides the tools and policies to enable all economic actors across the economy to finance their transition plans, to reach climate and broader environmental goals.*
2. *Inclusiveness. This Strategy caters for the needs of - and provides large-scale opportunities to –citizens and small and medium-sized enterprises (SMEs) to further access to sustainable finance.*
3. *The financial sector´s double materiality. This Strategy sets out how the financial sector itself needs to change to meet Green Deal targets, while also becoming more resilient and combatting greenwashing.*
4. *Global. This Strategy sets out how to foster and promote an international consensus for an ambitious global sustainable finance agenda.]*

To inform this Strategy, the Commission requested advice from the experts of the Platform on Sustainable Finance, delivered in March 2021, and ran an extensive stakeholder consultation in 2020[11]. This Strategy also complements other Green Deal initiatives.[12]

## 2. Towards a financial system fit for the transition

### 2.1. Financing the path of the real economy towards sustainability

**The transition towards EU sustainability goals requires unprecedented efforts to mitigate climate change, rebuild natural capital and strengthen resilience and wider social capital, all as part of a sustainable recovery from the COVID-19 crisis.** The transition pathways of individual economic actors will vary considerably with different starting points and different timeframes, but all pathways must ultimately be consistent with the EU's sustainability goals.

Existing sustainable finance tools support capital flows towards economic activities that substantially contribute to the EU's climate and environmental goals. A more supportive framework is needed to address the challenge of financing the urgent transition of activities that currently are not on the path to contribute to the EU's climate neutrality objectives. For this purpose, the Commission has invited the Platform on Sustainable Finance to suggest options that encourage and recognise investments in economic activities that are valuable and valid steps in the transition towards sustainability.[13]

<u>Broadening the coverage of sustainable activities in the EU Taxonomy</u>

**As announced in the Commission's Communication published in April 2021, the Commission will adopt a complementary Climate Taxonomy Delegated Act** covering

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[11] More details on the questionnaire and the summary of the responses are available here.
[12] More information here.
[13] See Platform on Sustainable Finance, Transition Finance Report, March 2021, available here. In its Transition Finance Report published in March 2021, the Platform experts recommended further steps to encourage transition finance across the whole economy. The key recommendations include (i) ensuring that reporting requirements enable companies, financiers and investors to communicate their transition plans by provide a coherent and consistent reporting and disclosure framework, with particular care of SMEs and bank lending, (ii) extending the EU taxonomy framework to activities that do no significant harm but do not reach a substantial contribution level and considering further measures to incentivise improvements in environmental performance levels, (iii) assessing the need to further complement the landscape of standards and labels, (iv) ensuring that companies can use the taxonomy but also other metrics and science-based tools as part of their corporate transition strategies.

activities not yet covered in the first EU Taxonomy Climate Delegated Act such as agriculture, certain energy sectors and certain manufacturing sectors, in line with the requirements of the Taxonomy Regulation and Better Regulation guidelines. The Delegated Act will also cover nuclear energy activities, subject to and consistent with the results of the specific review process underway in accordance with the EU Taxonomy Regulation.[14]

**Furthermore, the Commission will add technical screening criteria to the Taxonomy to cover the remaining four environmental objectives: water, circular economy, pollution and biodiversity.[15]** As foreseen by the Taxonomy Regulation, the Commission will set out criteria for these objectives in a delegated act to be adopted in the first half of 2022, which will then apply from 2023. This will facilitate environmentally sustainable investments beyond climate.

<u>Extending the EU Taxonomy framework to recognise transition efforts</u>

**While all companies, issuers and investors can use the EU Taxonomy to green their activities and portfolios, the current framework could better recognise investments for intermediary steps on the pathway towards sustainability.** Such investments may significantly reduce harmful climate and environmental impacts.

**In a first step, the Commission will consider proposing legislation to support the financing of certain economic activities**, primarily in the energy sector, including gas, that contribute to reducing greenhouse gas emissions in a way that supports the transition towards climate neutrality throughout the current decade, in line with the Commission's Communication in April 2021.[16]

**Furthermore, the Commission will consider options for an extension of the EU Taxonomy framework.** The aim would be to mobilise finance for activities transitioning on a credible pathway towards sustainability. This would help foster investments into the greening of the economy and improve its overall environmental performance. By the end of 2021, the Commission will publish a report describing the provisions that would be required to extend the scope of the Taxonomy Regulation.[17]

**In addition, as required by the Taxonomy Regulation, the Commission will produce a report on economic activities that do not have a significant impact on environmental sustainability and economic activities that significantly harm environmental sustainability**.

[14] See Communication from the Commission, "EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal", COM(2021) 188, 21.4.2021, p. 7.
[15] Article 9 of the EU Taxonomy Regulation specifies the following six environmental objectives: (a) climate change mitigation, (b) climate change adaptation, (c) the sustainable use and protection of water and marine resources, (d) the transition to a circular economy, (e) pollution prevention and control, and (f) the protection and restoration of biodiversity and ecosystems.
[16] This proposal would aim at defining timeframes and intermediary steps for those economic activities, including for existing investments, which contribute to the transition process in a manner consistent with the European Green Deal, and as a follow-up on the European Council conclusions of 11-12 December 2020, which acknowledge the role of transition technologies such as natural gas.
[17] Report required under article 26(2) of the Taxonomy Regulation.

Extending the framework of sustainable finance standards and labels

**Standards and labels can help channel finance to companies, issuers and investors as they transition towards more sustainable activities and business models**. They can also help investors by creating a transparent, credible framework to prevent greenwashing.[18] To facilitate additional capital flows to interim transition efforts, the Commission will work on other bond labels such as transition or sustainability-linked bond labels.

**Looking ahead, a more general framework for labels for financial instruments could help bring clarity, transparency and coherence to sustainable finance markets.** Beyond financial instruments, the Commission will also consider labels for ESG Benchmarks and financial products, to increase investors' confidence and limit the risk of greenwashing. Finally, adjustments to the Prospectus Regulation may be considered to create minimum requirements for the comparability, transparency and harmonisation of information available for all ESG non-equity securities.

***Action 1: To extend the existing sustainable finance toolbox to facilitate access to transition finance, within and beyond climate, the Commission will:***

a) Adopt a Complementary Climate Delegated Act and, by Q2 2022, adopt a delegated act covering the remaining four environmental goals.
b) Consider proposing legislation to support the financing of certain economic activities that contribute to reducing greenhouse gas emissions, consider options for an extension of the EU Taxonomy framework and publish a report describing the provisions that would be required to extend the scope of the Taxonomy Regulation.
c) Consider a general framework for labels for financial instruments, work on other bond labels such as transition or sustainability-link bonds, an ESG Benchmark label, a minimum ESG standard for financial products and introduce targeted prospectus disclosures.

### 2.2. Towards more inclusive sustainable finance supporting a green recovery

**Citizens, retail investors, consumers and SMEs will be key for a successful transition towards sustainability**. The Capital Markets Union and the sustainable finance agenda together will aim to provide SMEs with more financing opportunities and encourage greater retail investor participation in capital markets.

Empowering retail investors and SMEs to access sustainable finance opportunities

**Citizens and households can make a substantial contribution to transforming the economy by accessing sustainable finance.** For example, green loans can help citizens improve the energy performance of their homes or switch to zero emission vehicles. To encourage green retail lending, the Commission will ask the European Banking Authority (EBA) for an opinion on the definition

[18] The use of marketing to portray an organisation's products, activities or policies as environmentally friendly when they are not.

and possible supporting tools for green retail loans and green mortgages. The Commission will also explore ways to support the uptake of energy efficient mortgages in the framework of the Mortgage Credit Directive review. The Commission will launch an EU-wide information campaign addressed to businesses and households on the features and benefits of such loans.

**In addition, the Commission will encourage greater retail investor engagement by seeking improvements in the level of sustainability expertise of advisors and further integrating sustainability considerations in financial literacy frameworks**. Financial advisors are the main point of contact for retail investors. That means they need to be well qualified to support the uptake of sustainable finance. The Commission will take steps to strengthen the sustainability expertise and qualification of advisors. The Commission, together with the OECD and its International Network on Financial Education, are working to enhance the financial literacy of citizens. They will publish joint financial competence frameworks for adults and youth reflecting the skills and knowledge citizens need to support their financial well-being and further access and allocate sustainable finance.

**The EU economy includes 23 million SMEs.** The COVID-19 crisis has made it more challenging for SMEs to attract the financing they need to support their transition efforts. Furthermore, SMEs often lack the capabilities and awareness to seize opportunities offered by sustainable finance.[19] Supporting SMEs in accessing sustainable finance will be essential in their transition.

**SMEs should benefit from greater access to sustainability advisory services based on their specific needs.** The Commission stands ready to support Member States to provide capacity building and technical advice on how SMEs can voluntarily report on sustainability risks and impacts. To that end, and in line with the proposed CSRD, the Commission will prepare a simplified voluntary sustainability reporting standard that shall provide SMEs with a proportionate tool. In addition, the Invest EU programme and the Enterprise Europe Network will continue to provide de-risking mechanisms and advisory services for SMEs.

<u>Exploiting the opportunities digital technologies offer for sustainable finance</u>

**Digital technologies can provide essential solutions for citizens, investors and SMEs to participate more easily in their transition to sustainability**. The Commission will enable and encourage innovative solutions to help SMEs use digital sustainable finance tools and to support retail investor understanding of the sustainability impact of financial products.

**The Commission will also consider the sustainability impact of digital finance technologies**. While digital technologies are important enablers in the transition, there are concerns about the environmental impact and increasing energy needs of data centres and distributed ledger

[19] The Commission Technical Expert Stakeholder Group on SMEs (TESG) emphasises the need to work with small companies, support them in complying with sustainability reporting requirements and increase their visibility towards investors while safeguarding proportionality in their disclosure efforts.

technologies, notably for crypto-assets.[20] The EU Taxonomy already covers green data centres and green digital solutions and should be expanded to include more activities needed for the development of sustainable digital solutions and use of sustainable crypto-assets.

Insurance: offering greater protection from climate and environmental risks

**By increasing insurance coverage, the financial system can better protect the economy and society against certain climate-related and natural disaster risks.** A small increase in insurance coverage can significantly reduce the economic cost of climate-related disasters for taxpayers and governments. The recently adopted Climate Adaptation Strategy[21] will create the enabling conditions to support society's resilience to climate change and reduce the risks. A natural disaster insurance dashboard prepared by European Insurance and Occupational Pensions Authority (EIOPA) will indicate potential insurance coverage gaps.[22] In addition, the Commission will initiate a Climate Resilience Dialogue to exchange best practices and identify ways to address the climate protection gap, either through recommendations or through voluntary commitments.

Supporting credible social investments

**The recovery from the pandemic emphasises the need for a just transition that supports workers and their communities affected by economic activities transitioning**. The steep increase in social bond issuance shows that investors are increasingly looking for investments opportunities in projects that aim to achieve positive social outcomes and promote respect for human rights. This trend encourages finance institutions to intensify their engagement with companies to help them integrate human rights and social factors in their strategies and activities.

**Sustainable finance disclosure requirements for financial market participants already include certain social factors, but steps will be considered to better reflect them.** Before December 2022, the Commission will engage with the ESAs to further improve the regulatory technical standards under the SFDR, to clarify indicators for both climate and environment-related principal adverse impacts and principal adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Furthermore, the Commission will publish a report on a social taxonomy, as required by the Taxonomy Regulation, by the end of 2021.[23]

| ***Action 2: To improve the inclusiveness of sustainable finance, the Commission will:*** |
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[20] The EU Blockchain Observatory and Forum plans to publish a study on energy consumption of different blockchain mechanisms by June 2021.
[21] Communication from the Commission, "Forging a climate-resilient Europe - the new EU Strategy on Adaptation to Climate Change", COM(2021) 82 final, 24.2.2021.
[22] European Insurance and Occupational Pensions Authority, The pilot dashboard on insurance protection gap for natural catastrophes, December 2020, more information here.
[23] The Platform on Sustainable Finance will present its recommendations on the merits and feasibility of extending the EU Taxonomy framework to include a social taxonomy in October 2021, considering both social objectives and governance aspects.

a) Ask the EBA for an opinion on the definition of and support to green loans and mortgages, explore options to facilitate their uptake (2022), and increase the access of SMEs to sustainable finance advisory services.
b) Enable and encourage innovative solutions using digital technologies to support SMEs and retail investors and integrate sustainable finance related data in the data spaces under the European Data Strategy.
c) Identify insurance protection gaps through EIOPA's natural disaster dashboard and initiate a Climate Resilience Dialogue with all relevant stakeholders (2022).

### 2.3. Improving the financial sector's resilience and contribution to sustainability: the double materiality perspective

**To support the European Green Deal, the financial sector itself will need to be more resilient to the risks posed by climate change and environmental degradation and improve its contribution to sustainability.** The concept of double materiality consists of the systematic integration of both outside-in and inside-out ESG risks by financial actors across financial decision-making processes. It is crucial that both angles of the materiality concept are duly integrated for the financial sector to contribute pro-actively and fully to the success of the European Green Deal. [add infographic of double materiality approach]

<u>Enhancing economic and financial resilience to sustainability risks [outside-in ESG risks]</u>

**Sustainability risks are often forward-looking and can affect financial stability and the financing of the real economy.** Climate change and biodiversity losses create risks that can be systemic and may not be visible at the individual asset level.[24] Risks might also arise from a disorderly and sudden transition. It is therefore vital to understand the nature and degree of these exposures and how they interact and evolve over time. Furthermore, complementary steps are needed to ensure a consistent integration of sustainability factors in risk assessment and management in the financial sector.

***Reflecting sustainability risks in financial reporting standards and accounting***

**The Commission strongly supports ongoing international work on integrating sustainability considerations into financial reporting and accounting and will seek the highest level of ambition.** Building on the progress initiated by the 2018 Action Plan on Financing Sustainable Growth, the Commission will work with the European Financial Reporting Advisory Group (EFRAG), European Securities and Markets Authority (ESMA) and the International Accounting Standards Board (IASB) to assess whether International Financial Reporting Standards (IFRS) standards appropriately integrate sustainability risks. Financial reporting standards and practices determine the value of investments and are therefore a key element for embedding sustainability

[24] Climate change and biodiversity losses are also interlinked, see here.

risks in financial market decision-making. In particular, it should be assessed whether climate and environmental risks are adequately and timely recognised and reported in financial statements.

***Improving transparency of credit ratings and rating outlooks***

**Credit Rating Agencies (CRAs) play an important role in the financial system by assessing the credit risk of financial and non-financial issuers.**[25] Stakeholders continue to express concerns around the lack of transparency on how CRAs incorporate sustainability factors in their methodologies. Subject to further assessment of the effectiveness of the existing measures by ESMA, the Commission will consider proposing an initiative to improve transparency and ensure the inclusion of ESG factors in credit ratings and credit outlooks.

***Identifying and managing sustainability risks at the level of financial sector entities***

**The ability of banks, insurance companies and investors to manage and absorb financial losses arising from sustainability risks is key for financial stability and the resilience of the real economy during the transition.** While financial sector entities and supervisors are making efforts to capture climate and environmental factors in risk management systems and prudential capital requirements, progress remains insufficient.[26]

**The Commission will propose amendments to the CRR/CRD to ensure ESG factors are consistently included in risk management systems of banks.** To achieve this, clear requirements will be set to identify, measure, manage and monitor sustainability risks in the risk management frameworks, including climate change scenario analysis for banks. To complement this and as part of the annual supervisory assessment the role of supervisors in assessing such risks will be clarified and strengthened. Finally, the EBA will bring forward the date of its ongoing assessment of the prudential treatment of exposures from 2025 to 2023 and the Commission will consider its findings carefully.

**The Commission will also consistently integrate sustainability risks in the risk management systems and supervision of insurers.** Amendments to the Solvency II Directive will be proposed, including climate change scenario analysis by insurers. Similarly to the approach taken in the banking sector, EIOPA will assess the risk differentials between sustainable and other exposures in insurance.

***Managing sustainability risks at system level***

**Increasing the resilience of the financial system to shocks requires the identification, measurement and management of risks at the system level.** The Commission will strengthen its cooperation with European supervisors and the European Central Bank (ECB) with the aim of

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[25] CRAs include in their opinions and methodologies ESG factors that they consider of importance for the creditworthiness of financial instruments or companies. Credit ratings or rating outlooks are opinions regarding the likely direction of a credit rating over the short term, the medium term or both, and they do not aim to provide a holistic assessment of ESG impacts.

[26] BlackRock and Financial Markets Advisory (EIOPA), Interim Study on "Development of tools and mechanisms for the integration of environmental, social and governance (ESG) factors into the EU banking prudential framework and into banks' business strategies and investment policies", December 2020, available here. [to be updated with the final report].

capturing and mitigating all systemic sustainability risks impacting long-term financial stability. To achieve this, further steps will be taken to stress test the resilience of the financial system, covering relevant financial sectors. As part of this, coherent methodologies and scenarios need to be developed to quantify sustainability risks and monitor financial stability risks.

**To advance efforts in measuring the financial risks stemming from a significant loss of biodiversity, the Commission will prepare a report on the measurement and presence of such risks in the EU.** The loss of biodiversity and ecosystems, the depletion of natural resources and the levels of pollution in our oceans and air are accelerating. As a result, financial institutions are increasingly exposed to risks from financing companies that contribute to biodiversity loss or that depend on biodiversity and ecosystem services for the production of goods and services. The Commission report will also look at approaches and methods to measure potential risks and outline next steps in this area.

**Finally, addressing and managing systemic risks requires adequate tools for macro-prudential authorities and financial sector entities.** With the support of the ESAs, the Commission will consider how to address systemic sustainability risks in prudential frameworks. Additionally, it will consider whether macro-prudential tools are fit to address climate and environment-related financial stability risks as part of an upcoming review of the banking macro-prudential framework. In the medium term, further work will be conducted on broadening the scope to non-banking sectors and to other environmental risks based on advice by the ESAs, the ESRB and the ECB.

***Action 3: To enhance economic and financial resilience to sustainability risks, the Commission will:***

a) Work with EFRAG, ESMA and the IASB on how to appropriately reflect sustainability risks in financial reporting standards and accounting.
b) Consider putting forward an initiative to ensure that relevant ESG risks are systematically captured in credit ratings and rating outlooks in a transparent manner, subject to further assessment by ESMA (2023).
c) Propose amendments in the CRR/CRD to ensure the consistent integration of sustainability risks in risk management systems of banks, including climate change scenario analysis by banks (2021).
d) Propose amendments in the Solvency II Directive to consistently integrate sustainability risks in risk management of insurers, including climate change scenario analysis by insurers (2021).
e) Strengthen long-term financial stability through increased cooperation on financial stability risk assessment, regular stress tests, an assessment of macro-prudential tools and a study dedicated to risks stemming from biodiversity loss.

Accelerating the contribution of the financial sector to transition efforts [inside-out ESG risks]

Beyond the management of sustainability risks by financial institutions, the success of the European Green Deal depends on the contribution of all economic stakeholders' and their incentives to meet its targets. To that end, financial institutions must translate EU sustainability goals into their long-term financing strategies and decision-making processes. That includes better measuring, monitoring and disclosing of their progress on a regular basis.

***Reinforcing science-based target setting, disclosure and monitoring of the financial sector's commitments***

**Financial institutions should disclose their transition and decarbonisation plans, including intermediate and long-term targets and how they plan on improving their environmental footprint**. Enhanced transparency on targets, indicators, definitions and methodologies will be key to help monitor the effectiveness of actions taken overtime. The CSRD proposal adopted by the Commission in April 2021 will require large EU companies and listed companies including banks, insurers and investors to disclose a range of sustainability targets and the progress towards achieving them. In addition, and building on the regulatory technical standard under the SFDR, the Commission will aim to strengthen the disclosure and effectiveness of decarbonisation action by financial market participants for all investment products.

**In this regard, voluntary pledges by financial institutions globally to adopt strategic science-based climate and environmental targets are commendable.**[27] The Commission will examine to what extent more guidance is necessary to ensure voluntary pledges are credible and to allow progress to be monitored over time across the EU. For example, financial institutions may use the EU Taxonomy and other sustainable finance tools to achieve their interim and ultimate targets at entity and portfolio level.

***Clarifying the fiduciary duties and stewardship rules of investors to reflect the financial sector's contribution to Green Deal targets***

**Directing financial flows towards Green Deal targets requires anchoring both the consideration of outside-in and inside-out ESG risks in the strategies and investment decision making processes of investors.** On 21 April 2021, the Commission published six amending delegated acts which require financial firms, such as advisers, asset managers and insurers, to include outside-in ESG risks in their procedures and to consider the sustainability preferences of their clients. This will need to be complemented by further action for the 125,000 pension funds in the EU managing collective schemes on behalf of around 75 million Europeans. To enhance their contribution to the Green Deal targets, it is critical that the fiduciary duties of investors and pension funds towards members and beneficiaries also reflect the inside-out ESG risks of investments as part of investment decision making processes.

**Specifically, the Commission will ask EIOPA to assess the potential need to broaden the concept of the "long-term best interest of members and beneficiaries" and introduce the notion of double materiality in the pension framework**. The aim would be to ensure that the

[27] As evidenced by, for example, the UN Net Zero Asset Owner Alliance, United Nations Environment – Finance Initiative. Further information are available here.

framework better reflects members and beneficiaries' sustainability preferences and broader societal and environmental goals. More broadly, in collaboration with the ESAs, the Commission will consider and assess further measures to enable all relevant financial market participants and advisers to consider sustainability impacts of their investment decisions on a systematic basis.

**Additionally, the Commission will support investors' engagement activities to hold investee companies accountable for aligning their business strategies and activities with EU sustainability goals.** The Commission will review relevant frameworks relating to investors' stewardship and engagement activities, including the Shareholder Rights Directive II.

***Improving the availability, integrity and transparency of ESG market research and ratings***

**To carry out their transition efforts, financial institutions will need a wide array of information to identify sustainability risks, opportunities and impacts of their investee companies and clients.** To that end, the CSRD proposal adopted by the Commission in April 2021 will require large, listed EU companies to disclose similar sustainability targets to those for financial sector players, therefore providing meaningful, comparable and forward-looking sustainability data across the finance value chain. In addition, the European Single Access Point will create an EU-wide mechanism offering easily accessible, comparable and digitally usable databases on the public reporting requirements of companies, including sustainability information.

**Subject to a public consultation and an impact assessment, the Commission will consider proposing an initiative to strengthen the reliability and comparability of ESG ratings.** ESG ratings have an increasingly important impact on the operation of capital markets and on investor confidence in sustainable products. Such an initiative will build on the Commission's study published in January 2021 that identified a lack of transparency in the operations of ESG ratings providers, the low level of comparability between ESG ratings and potential conflicts of interests.[28] The increasing demand for sustainable investments also puts the focus on the need for unbiased and reliable ESG research, based on transparent and comparable methodologies.

***Action 4: To strengthen the contribution of the financial sector to sustainability, the Commission will:***

a) Reinforce financial institutions' science-based target setting and transition planning through mandatory disclosures and it will develop guidance to help monitor progress of the financial sector's pledges on climate and environmental targets.
b) Ask EIOPA to assess the need to review the fiduciary duties of pension funds and investors to reflect inside-out ESG risks as part of investment decision making processes, including stewardship and engagement activities (by 2022).
c) Consider proposing an initiative to strengthen the reliability and comparability of ESG ratings and further assess certain aspects of ESG research, to decide on whether an intervention is necessary.

[28] European Commission and Environmental Resources Management (ERM), *Study on sustainability-related ratings, data and research*, 6.1.2021, available here.

*Addressing greenwashing*

**With the growing demand for sustainable investments, the risk of greenwashing also increases in finance and in all sectors**. Greenwashing attempts can generate significant reputational risks for the actors involved and create a loss of trust in sustainable finance products and the financial system in general. Supervisors will need to make full use of their legal mandates and powers, and build up appropriate supervisory capabilities to ensure that investors and consumers are adequately protected against unsubstantiated sustainability claims throughout the product lifecycle.

**With the support of the European Supervisory Authorities, the Commission will assess whether supervisory powers, capabilities and obligations are fit for purpose.** Based on this assessment and on a monitoring of greenwashing risks by the European Supervisory Authorities, the Commission will consider steps to ensure a sufficient, consistent level of enforcement and supervision to address greenwashing.

***Monitoring an orderly transition of the EU financial system***

Achieving an economy 'Fit for 55' by 2030 and climate neutrality by or before 2050 will require collaborative action among Member States, financial supervisors and relevant public authorities to monitor and adjust the pace of the transition if deemed necessary across the EU. The Commission will assist Member States in assessing the EU investment gap, and to develop a robust monitoring framework to measure progress made by their financial sectors.[29] Supervisory authorities should play an important role to help with the consistent integration of the double materiality perspective across the financial system. The Commission will strengthen the cooperation with all relevant public authorities, including supervisors to help define intermediate targets for the financial sector, understand better whether ongoing and prospective progress is sufficient, and thus facilitate taking a more collaborative policy action by all relevant public authorities where necessary.

***Action 5: To monitor an orderly transition and ensure the integrity of the EU financial system, the Commission will:***

a) Monitor greenwashing risks and assess and review the current supervisory and enforcement toolkit available to National Competent Authorities, to ensure that supervisory powers, capabilities and obligations are fit for purpose, with the support of the European Supervisory Authorities.
b) Assist Member States in assessing the EU investment gap and developing a robust monitoring framework to measure progress made by their financial sectors (by 2023).
c) Strengthen the cooperation with all relevant public authorities, including Member States, the European Central Bank, the European Systemic Risk Board, the European Supervisory

[29] For example, the Network for Greening the Financial System (NGFS) published a "Dashboard on scaling up green finance" in March 2021 that developed a set of indicators that make it possible to track the degree of progress towards greening the financial system.

Authorities and the European Environmental Agency, on a common approach to monitor an orderly transition and ensure the double materiality perspective is consistently integrated across the EU financial system (by 2022).

### 2.4. Fostering global ambition

**Global challenges call for global action. However, jurisdictions differ on starting points, levels of ambition and ultimate objectives.** To fully exploit the global potential of sustainable finance, international forums and networks are increasingly coordinating sustainable finance initiatives.[30] Building on its domestic achievements, the EU has established itself as a leader in sustainable finance internationally and is actively contributing to their global work. This leadership can be a source of inspiration for other jurisdictions across the world and a source of business opportunities for the EU financial sector globally. With EU actors the largest issuers of green bonds and major sustainable EU investors, dynamic green markets contribute to strengthening the international role of the euro and making the EU the major global hub for sustainable finance.

**The Commission sees the need for a high level of ambition for a robust international sustainable finance architecture that embraces the concept of double materiality and supports EU partner countries.** This architecture must encompass robust international governance, a solid rulebook and a monitoring framework. As a first step, the Commission suggests that the Financial Stability Board (FSB) expands its mandate to cover the contribution of the financial system to global climate and environmental objectives.

**The Commission invites all international partners to deepen cooperation on sustainable finance, in particular to provide the private sector with usable tools and metrics, such as taxonomies.[31]**

Promoting an ambitious consensus in international forums

**The EU will advocate for international forums and standard-setters to develop ambitious standards and principles for disclosure, building where appropriate on the recommendations of the Task Force on Climate-related Financial Disclosures**.[32] International disclosure standards sometimes overlap, can be inconsistent and vary on ambition. In line with the CSRD proposal, the EU advocates for comprehensive sustainability reporting standards that address all sustainability issues and that capture the double materiality perspective.

**The EU will continue to cooperate with its partners in international fora to agree on common objectives and principles for taxonomies.** The EU is actively engaging in the G20 and the International Platform on Sustainable Finance (see below) to avoid fragmented approaches, which

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[30] Such as the G20 and the G7, the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the Network for Greening the Financial System (NGFS), the Coalition of Finance Ministers for Climate Action.
[31] EU-US Summit Statement, "Towards a renewed Transatlantic partnership", 15.6.2021, par. 10.
[32] Such as the IFRS Foundation and the Alliance of global sustainability reporting initiatives.

would lead to increased transaction costs, insufficient cross-border capital flows and a drag on financial innovation.

**Global efforts are key to tackle the financial stability implications of climate risks**. The EU is spearheading efforts on a fully-fledged climate risk monitoring framework and actively contributing to the work of the FSB. Notably, the EU actively supports the work of the Task Force on Climate-related Financial Risks in the Basel Committee on Banking Supervision to identify and address potential gaps in the Basel framework and the work of the International Association of Insurance Supervisors to integrate climate-related risks into insurance supervision.

<u>Advancing and deepening the work of the IPSF</u>

**To foster international cooperation, the European Commission and seven other jurisdictions launched the International Platform on Sustainable Finance (IPSF) in October 2019.**[33] The IPSF, which aims to promote integrated markets for sustainable finance and work on usable tools and metrics. It has 17 members and is acknowledged as a key international sustainable finance initiative.[34] In autumn 2021, the IPSF will provide (i) a Report on a Common Ground Taxonomy, setting out the commonalities between existing taxonomies developed by public authorities, (ii) a Report on Sustainability-related Disclosures, which will provide a comprehensive and holistic comparison of disclosure requirements for companies, asset managers and institutional investors, and (iii) its Annual Report.

**The IPSF will report on its work on a 'Common Ground Taxonomy' based on the 'new' taxonomies developed by its members, and on sustainability disclosures.** The IPSF will embrace the concept of double materiality. In addition, it will intensify knowledge sharing on key sustainable finance areas, such as biodiversity and transition of the financial system towards shared sustainability aims. Finally, the Commission expects the IPSF to keep growing in terms of membership, strengthen its governance structure and propose a new work-plan by autumn 2021.

<u>Supporting third countries in their transition efforts</u>

**The Commission will develop a comprehensive strategy and dedicated tools to help scale up sustainable finance in its partner countries.** Developing countries face massive investment needs to finance their sustainable development.[35] Private investors can play a positive role to this end, but dedicated support will be critical to collectively deliver on the global sustainability agenda. The Commission will also support efforts to build back better globally, notably via the Neighbourhood, Development and International Cooperation Instrument (NDICI), by promoting the scaling up of the sustainability bond markets in lower and middle-income countries. In addition to this, international climate finance contributions play a key role to support developing countries.

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[33] See all the details about the IPSF, its objectives, membership and workplan in SWD (2021) XXX final, p. XX.

[34] Members represent 55% of greenhouse gas emissions, 50% of the world population and 55% of global GDP, see membership here. The IPSF is also recognised as a knowledge partner to the re-established G20 Sustainable Finance Working Group (SFWG).

[35] According to OECD estimates, USD 6.9 trillion of investment in infrastructure is required annually by 2030 to meet development needs globally in a climate-compatible manner. About 70% of these infrastructure investments will need to be deployed in EMDEs.

***Action 6: To set a high level of ambition in developing international sustainable finance initiatives and standards and support EU partner countries, the Commission will:***

a) Promote an ambitious consensus in international forums, to mainstream the concept of double materiality, for disclosure frameworks, and agree on objectives and principles for taxonomies.
b) Propose to expand the work of the IPSF to new topics and strengthen its governance.
c) Support EU partner countries in their transition efforts, by developing a comprehensive strategy and dedicated tools to help scale up sustainable finance.

## Conclusion – Implementation and way forward

**In three years, the Commission has taken unprecedented steps to create the foundations for sustainable finance.** This ambitious framework needs to be finalised and consolidated to address the challenges stemming from massive transition investment needs towards our increased climate and environmental targets and the renewed global context. The Strategy for Financing the Transition to a Sustainable Economy aims at addressing these challenges and make the framework workable and coherent. The Commission will report on the implementation of this Strategy by the end of 2023 and will actively support Member States in their efforts.

**This Strategy is setting tangible steps to factor-in the objectives of the European Green Deal into the financial system, and to make sure actors across all sectors of the economy can finance their transition regardless of their starting point. These policies do not work in isolation**. They complement the indispensable changes in environmental policies set out in the European Green Deal, including sectoral legislation, taxation and the Emission Trading System. This Strategy also supports greater coherence of sustainability frameworks for the public and the private sectors. It builds on the Commission's collaboration and partnerships with external sustainable finance initiatives to foster financial sector leadership towards achieving EU sustainability goals and help with the inception, piloting and implementation of its policies.

**The Commission calls on all relevant stakeholders, from central banks to Member States, citizens, local authorities and financial and non-financial companies, to take action in their respective areas and maximise the transformative impact of this Strategy.**