

P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance



Climate Change and Sustainable Finance

René Smits

P.R.I.M.E. Finance Annual Conference 2020

3 February 2020, The Hague

Presentation

- Introduction
- Defining ‘sustainable finance’
- Taxonomy and greenwashing
- EU Climate Change Action Plan
- EU prudential supervisory standards (to come)
- ECB and climate change: a legal exploration
- Concluding remarks



Disclosure and disclaimer

- Alternate Member, Administrative Board of Review (ABoR),
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- All views personal



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Sustainable finance: definition (1)



- ❑ Sustainability of banking business
- ❑ Andrea Enria, [Regulation, proportionality and the sustainability of banking](#), speech, Brussels, 21 November 2019

“Regulators and supervisors focus very much on making banks more sustainable. We try to put them in a place where they can withstand shocks and stay in business over the long term. And here, by making sure banks have enough capital and other liabilities that can be written down or converted into equity to absorb losses in a crisis, we have achieved a great deal.

But there is a broader notion of sustainability, of course, which now features prominently in the public debate. It’s about being sustainable on a larger scale, at the level of society. And climate change is one of the key issues.”



Sustainable finance: definition (2)

- ❖ Environmentally sound financing....
- ❖ “to improve the contribution of finance to sustainable and inclusive growth, in particular funding society’s long-term needs for innovation and infrastructure, and accelerating the shift to a low-carbon and resource efficient economy”, and “to strengthen financial stability and asset pricing, notably by improving the assessment and management of long-term material risks and intangible drivers of value creation – including those related to environmental, social and governance (ESG) factors” ([EU HLEG on Sustainable Finance, interim report](#), 13 July 2017)
- ❖ Reflecting financial risks from carbon exposure and loss of biodiversity
- ❖ Twin adoption of the 2030 [Agenda for Sustainable Development](#) and the [Paris Agreement](#) in 2015

Note our language: ‘environ(ne)ment’ / ‘milieu’ / ‘Umgebung’ implies a distance between ourselves and what is around: an anthropocentric view of the interconnected universe



Sustainable Development Goals

Agenda 2030, [UNGA Resolution 70/1](#), 21 October 2015



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Taxonomy and greenwashing

- **‘Taxonomy Regulation’** on the establishment of a framework to facilitate sustainable investment [at the EU Council's website](#)
- **‘Disclosure Regulation’** (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector, [Official Journal L 317/1](#), 9 December 2019
- Taxonomy Regulation: “The criteria for determining whether an economic activity is environmentally sustainable should be harmonised at Union level, in order to remove barriers to the functioning of the internal market with regard to raising funds for sustainable projects, and prevent their future emergence.”
- Disclosure Regulation: part of the commitment of the EU and the Member States to implement the [Sustainable Development Goals](#) (SDGs); “lays down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products.”



European Green Deal

- Commission Communication ([COM\(2019\) 640 final](#)), 11 December 2019: “becoming the world’s first climate-neutral continent by 2050”
- Sustainable Europe Investment Plan
- [Just Transition Mechanism](#)
- CO₂ levy at the borders
- [Sandbag: The Path of Least Resistance](#) (how coal power plants just outside European borders are supplying electricity to the EU while avoiding the carbon price)



Great goals, modest (banking) standards

- In spite of big words and grand goals, criticised for being too minimalist by climate change activists, EU’s recently adopted prudential standards for banks are modest, indeed:
- Just instructions to the [EBA](#) to report
 - by 28 June 2021 on inclusion in SREP of ESG risks (Article 98 (8) [CRD V](#))
 - by 28 June 2025 “whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified”, ‘if appropriate’ followed by a legislative proposal from the Commission ... (Article 501 c [CRR 2](#))
- and disclosure of ESG risks, as defined by EBA report, by large institutions as of 28 June 2022 “on an annual basis for the first year and biannually thereafter” (Article 449a [CRR 2](#))
- So: a potential Basel pillar 2 (SREP) requirement and a minimal Basel pillar 3 (disclosure) requirement and, possibly, future legislation



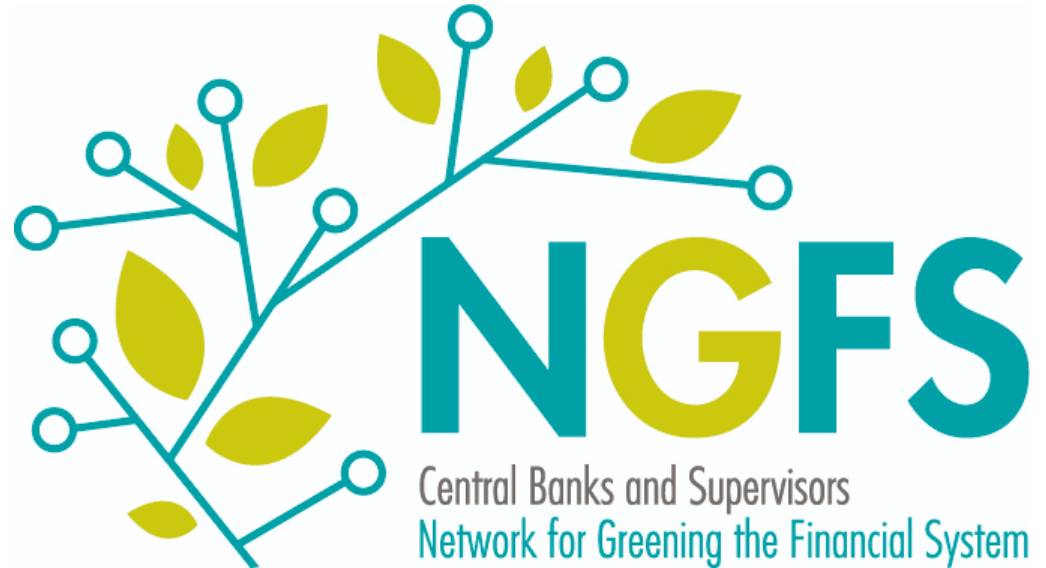
Possibly: “brown penalizing factor” or/and “green supporting factor”

- Article 501 c CRR 2 opens the door for a so called “brown penalizing factor” or/and “green supporting factor” in the late 2020s...
- Andrea Enria: “Any capital relief for green assets must be based on clear evidence that they are less risky than non-green assets” - mentioning the NGFS, he concludes: “we might start voicing a few supervisory expectations for banks in the not too distant future. But we are still in the early stages. We have to look deeper into these issues. And when we take action, naturally we will have to stay **within the limits of our mandate.**” [speech, 21 November 2019](#)



Network for Greening the Financial System (NGFS)

The Central Banks and Supervisors Network for Greening the Financial System (NGFS) is a group of Central Banks and Supervisors willing, on a voluntary basis, to exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy. Its purpose is to define and promote best practices to be implemented within and outside of the Membership of the NGFS and to conduct or commission analytical work on green finance.



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Mandate issues for ECB



- ❑ Clear intention to look at climate change as an issue for the central bank
- ❑ Monetary Policy Strategy Review, [press release](#), 23 January 2020
- ❑ What the ECB can do ([Christine Lagarde's press conference](#), 43:15-48:41):
 - ECB Pension Fund
 - ECB paid-up capital and reserves
 - [CSPP](#): Corporate Sector Purchasing Programme
 - [no mention of [PSPP](#) (Public Sector Purchasing Programme) share for marketable debt instruments issued by international or supranational institutions located in Euro Area]
 - Collateral
 - [no mention of 'green' [T-LTROs](#) (*targeted* long-term refinancing operations, i.e. [linked to \[the banks'\] loans to non-financial corporations and households](#))]
 - Climate risk embedded in risk assessment, models, forecasts
 - Financial stability (outside SSM): stress testing and pilot in ESRB



Legal issues: overview

- ❑ Secondary objective E(S)CB
- ❑ Principle of an open market economy
- ❑ Integration of environmental considerations
- ❑ Binding effect Paris Agreement
- ❑ Independence
- ❑ Democratic legitimacy



Article 127 TFEU

1. The **primary objective** of the European System of Central Banks (hereinafter referred to as ‘the ESCB’) shall be to maintain price stability. **Without prejudice to the objective of price stability**, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with **the principle of an open market economy with free competition**, favouring an efficient allocation of resources, and in compliance with the **principles set out in Article 119**.

[Article 119 also refers also the principle of an open market economy with free competition]



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Article 3 TEU

1. The Union's aim is to promote peace, its values and **the well-being of its peoples**.
2. (...)
3. The Union shall establish an internal market. It shall work for **the sustainable development of Europe** based on **balanced economic growth** and price stability, a highly competitive social market economy, aiming at full employment and social progress, and **a high level of protection and improvement of the quality of the environment**. It shall promote scientific and technological advance.
It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, **solidarity between generations** and protection of the rights of the child. (...)
4. The Union shall establish an economic and monetary union whose currency is the euro.
5. In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, **the sustainable development of the Earth**, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and **the protection of human rights**, in particular the rights of the child, as well as to the **strict observance and the development of international law**, including respect for the principles of the United Nations Charter.
6. The Union shall pursue its objectives by appropriate means commensurate with the competences which are conferred upon it in the Treaties.



Article 11 TFEU

Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development.

[Article 11 is one of the ‘integration provisions’ of the TFEU which require that specific objectives are taken into account in all policies and activities, including: gender equality (Article 8), employment, social inclusion, education and human health, (Article 9), non-discrimination (Article 10), consumer protection (Article 12), animal welfare as animals are sentient beings (Article 13) // Article 7: consistency clause]



Counterarguments

- By maintaining price stability, ECB already fulfils secondary objective
- ‘Market neutrality’ [not a Treaty term] requires respect for market outcomes – what if markets are dysfunctional by not incorporating externalities in price?
- ‘Political decisions’ are not for the central bank to make



Concluding remarks – my views

- ❑ Prudential rules: speeding up change
- ❑ ECB: wide scope of action to include climate change effects of monetary policy measures in their design
- ❑ Clear mandate ECB: not ‘may’ but ‘must’ act
- ❑ By acting ECB may restore market functioning in financial transaction markets and nudge towards sustainability of finance





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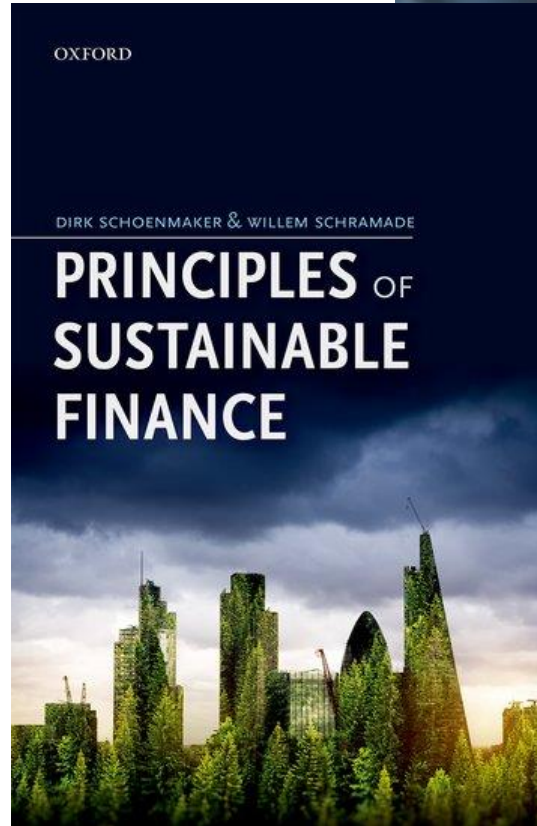
*People to follow
Acknowledgements*

[Javier Solana](#),
[University of Glasgow](#)

[Yolaine Fischer](#),
[Banque de France](#)

[Bart Bierman](#),
[Finnius Financial Law](#)

[Mark Carney](#),
Governor,
[Bank of England](#),
UN Special Envoy on
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[Dirk Schoenmaker](#),
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Thank you



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