10 steps to accelerate the Sustainable Finance Agenda

The financial sector plays a key part in the effort to ensure a green and sustainable transition of the European economy. In the Danish financial sector, we are actively engaged to ensure that the sector contributes to this transition. The Commission's Action Plan on Financing Sustainable Growth from 2018 has been an important step for this transition, but further action is needed and we look forward to the Commissions' Renewed Sustainable Finance Strategy in 2020.

In this context, Finance Denmark recommends[1] *the following 10 steps to further accelerate the Sustainable Finance Agenda:*

1. ***Extend the taxonomy to apply to bank lending***
2. ***Further develop the taxonomy***
3. ***Develop a predictable governance system to ensure that the taxonomy works in practice***
4. ***Put in place EU standards and labels that increase transparency for consumers***
5. ***Develop an EU model for measuring carbon footprint on investments and lending***
6. ***Ensure access to standardised and digitalised sustainability data to increase transparency***
7. ***Create clear guidelines for prudential requirements on sustainable finance***
8. ***Ensure quality and transparency in sustainability rating methodologies***
9. ***Drive forward the sustainable transition by the necessary fiscal and economic measures***
10. ***Work to ensure global standards on sustainable finance***

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The sustainable transition of the economy is one of the most important and urgent political agendas. The EU has acknowledged this with its firm support to the Paris Agreement and the UN Sustainable Development Goals (SDGs). Reaching these objectives will call for significant investments that by far exceed the public financing capacity, thus necessitating private investments of an unprecedented scale. The financial sector affects all parts of the economy and, therefore, plays a central role in the transition to a carbon-neutral society and sustainable development. In addition to ensuring the development of sustainable solutions in all parts of the

[1] *In December 2019, Finance Denmark received concrete recommendations from the Forum of Sustainable Finance, an expert group established to provide guidance, on how the Danish Financial sector can strengthen its contribution to the sustainable transition of our society.*

economy, Finance Denmark furthermore supports the use of proportionality in the requirements for both financial and non-financial companies, especially SMEs.

Finance Denmark fully supports the Commission's clear focus on and commitment to tackling climate and sustainability challenges. The Commission's European Green Deal framework as presented in December 2019 provides an important first roadmap in this respect.

Finance Denmark recommends that a renewed Sustainable Finance Strategy takes account of the following 10 steps:

1. ***Extend the taxonomy to apply to bank lending***

Finance Denmark welcomes the agreement on an EU taxonomy, which is the centrepiece for almost all efforts from the financial sector and regulatory initiatives on sustainable finance. The taxonomy also has an important value in setting a common framework on how to integrate sustainability in the rest of the European economy and internationally.

The EU taxonomy and transparency go hand in hand. By defining criteria for what can be considered as 'environmentally sustainable economic activities', the taxonomy is central in how – not only the financial sector, but also the broader economy – will work with sustainability in the future (e.g. in business strategies, product development, reporting, risk assessment, credit rating, investments, loans, issuances, investment advice, etc.)

Although the EU taxonomy was initially developed for sustainable investments, Finance Denmark supports that the taxonomy should be applied to all relevant bank activities, most importantly lending. To this end, Finance Denmark is actively engaged in the EBF/UNEP FI Banking and Taxonomy project developing guidelines for how to apply the taxonomy to bank lending activities.

Finance Denmark supports that the efforts to apply the taxonomy to banking activities also draw on inspiration from existing international frameworks to support the banking industry in contributing to sustainable development, such as the UNEP FI's Principles for Responsible Banking, which Finance Denmark along with several Danish banks signed in September 2019.

Finance Denmark's recommendations:

- *The taxonomy should be extended to apply to bank lending as well as investment activities.*
- *The work to extend the taxonomy to bank lending should build on the work carried out in the EBF/UNEP FI banking and taxonomy project.*
- *The EU Commission should continue to actively engage in and support the EBF/UNEP FI project.*

2. *Further develop the taxonomy*

Sustainability is more than climate and environment. Therefore, we quickly need to move forward in working with a common approach that also ensures transparency on social and governance issues, incl. to support the UN's Sustainable Development Goals (SDGs).

The Danish financial sector wishes to actively support and engage in efforts to extend the taxonomy to social and governance issues for investment and lending activities. This work, as with defining what is considered as environmentally sustainable, should be based on existing EU and international standards and frameworks, such as the UNEP FI's Principles for Responsible Banking.

Extending the taxonomy to cover social and governance issues is a prerequisite for thorough integration of sustainability in investment advice.

Finance Denmark supports the further development of the taxonomy to the remaining four EU environmental objectives (i.e. 3. sustainable use and protection of water and marine resources 4. transition to a circular economy, waste prevention and recycling 5. pollution prevention control, and 6. protection of healthy ecosystems). Finance Denmark supports the different categories of economic activities included in the taxonomy (low-carbon, transition, and enabling activities).

Moreover, Finance Denmark supports a three-category approach as described in Article 4 of the Taxonomy Regulation (i.e. dark green which are "environmentally sustainable investments" corresponding to article 9 products in the Disclosure Regulation (SFDR); light green which are "products that promotes environmental characteristics" corresponding to article 8 products in the Disclosure Regulation (SFDR) and mainstream products which are products, where the underlying economic activities have not been analysed in terms of their taxonomy-compliance, and hence, according to the Taxonomy Regulation article 4 must include a disclaimer text stating "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments", to be applied in the coming requirements for regulatory technical standards/guidelines on the inclusion of ESG in investment advice.

Finance Denmark's recommendations:

- *Finance Denmark supports and wishes to actively engage in efforts to extend the taxonomy to cover social and governance issues for investment and lending activities.*
- *This work should be based on existing EU and international standards and frameworks, such as the UNEP FI's Principles for Responsible Banking.*
- *Extending the taxonomy to cover social and governance issues is also a prerequisite for a thorough integration of sustainability in investment advice.*

3. ***Develop a predictable governance system to ensure that the taxonomy works in practice***

Going forward, it is important that the taxonomy is continuously revised and adapted to the fast-moving international work with sustainability in a predictable and transparent manner. This includes making sure that the taxonomy is updated to reflect the technological development and new definitions of sustainability. At the same time, the governance of the taxonomy technical screening criteria (TSC), as well as rules related to products that are already on the market, must support a high degree of predictability and transparency for all involved stakeholders and companies.

Also, taxonomy eligibility criteria should be predictable and finite ex ante. For example, considering the taxonomy on construction and real estate activities: A bank funding the loan for instance by issuing a green bond must when granting the loan ex ante for the construction of a new home or a renovation of an existing home be able to rely on a predictable measure regarding the taxonomy. Otherwise, investors incur taxonomy eligibility risk in connection with the green bond funding the loan behind a construction or renovation.

The assets owners' transition to more sustainable activities relies on the access to funding. The taxonomy is therefore not only relevant for investors, but also relevant for the asset owners, for instance homeowners. The taxonomy should therefore encourage and incentivise assets owners to improve sustainability irrespective of current levels of energy efficiency.

The considerations above must also be seen in connection with the aim of extending the taxonomy to apply to bank lending. Finance Denmark finds it important that the EU standards do not hamper the transition of the real economy - more specifically when financing the individual companies and/or, for example, building owners. Financing of companies (in particular SMEs) often takes place on the basis of a holistic view of the company's activities - some activities will thus be green, cf. the taxonomy, while other activities (yet) do not meet the taxonomy. Thus, it should be possible to calculate the relative proportion by which the company is green.

It is also important to ensure that the taxonomy can be applied to covered bonds by the same methodology as described for equity portfolios in TEG's final recommendations. Covered bonds are one of the largest asset classes in Europe and have the capacity to fund a lion's share of the green transition. Issuers might choose to issue covered bonds, where only a percentage of assets backing the bond are taxonomy eligible. Issuers should disclose the split between taxonomy eligible and non-eligible assets backing the bond. Issuance of bonds, which fund both taxonomy eligible and non-eligible assets, allows the issuance of large bond series, which are more attractive to investors. Generally, large bond series are more liquid, which reduces costs for borrowers, due to limited liquidity risk. An investor buying such bonds, must be able to calculate the greenness of the bonds, when calculating the taxonomy alignment of her portfolio.

To ensure that transparency and stability for consumers and investors purchasing 'green' or 'sustainable' products is upheld, all bonds should maintain their 'taxonomy eligibility' until maturity using the grandfathering clause proposed in the report on an EU Green Bond Standard from June 2019.

It is important to ensure alignment in governance of the taxonomy technical screening criteria, the reporting requirements in the Disclosure Regulation, as well as, the Non-Financial Reporting Directive (NFRD) (see also below, point 6).

Finance Denmark's recommendations:

- *Develop a transparent and predictable governance system for updating and maintaining the taxonomy, e.g. with a predefined regime for updating the taxonomy criteria and the further development of the scope (in terms of activities). The governance and maintenance of other global standards and infrastructures such as ISO and SWIFT as well as versioning of the technical criteria could inspire this.*
- *The usability of the taxonomy in bank lending must be designed to fit the typical holistic assessment approach when financing corporates – in particular not to hamper the sustainable transition of SMEs.*
- *Ensure that existing and future bonds are subject to a grandfathering clause, in line with what is recommended by the TEG regarding an EU Green Bond Standard in June 2019.*
- *Ensure that the taxonomy can be applied to covered bonds, i.e. that an issuer can issue covered bonds where only a percentage of assets backing the bond are taxonomy eligible, and that an investor can include the greenness of the bond when calculating the taxonomy alignment of her portfolio.*
- *Align the reporting criteria on sustainability and ESG for all relevant companies (cf. the Disclosure regulation and the NFRD) with the taxonomy (see below for standardisation of data).*
- *Ensure that the ongoing work on especially the taxonomy as well as other relevant sustainable finance initiatives, a broad representation from all sides of the economy must be ensured in the EU's Sustainable Finance Platform.*
- *Assist the sector in implementing the many new requirements under the Taxonomy Regulation, the Sustainable Disclosure Regulation (SFDR) and the Non-Financial Reporting Directive (NFRD) by developing an overview of all the related dates of application.*

4. *Put in place EU standards and labels that increase transparency for consumers*

Finance Denmark supports the development of standards and labels to increase transparency and stability for consumers on sustainability. It is important that such labels and standards also help drive forward an effective transition of the economy to a carbon-neutral society and sustainable development. Therefore, they should not only apply to products that are strictly low carbon but also underpin transition and enabling activities to promote a faster, broader and more effective transition.

Finance Denmark's recommendations:

- *An EU Ecolabel for financial products should underpin low carbon, transition and enabling activities in the taxonomy and the label should be extended to deposits.*
- *Seek to avoid that the EU Ecolabel becomes too narrow, thereby rendering only very few financial products eligible. This would run the risk of turning the Ecolabel into a niche label, rather than helping investors channel private capital to transition activities, which is essential in financing the transition to a carbon-neutral society and sustainable development.*
- *Include a minimum social safeguard in the EU Ecolabel, in line in line with the taxonomy criteria.*
- *Ensure that subsequent changes to the EU taxonomy will not apply to outstanding EU Green Bonds, i.e. grandfathering, as proposed by the TEG in June 2019.*

5. *Develop an EU model for measuring carbon footprint on investments and lending*

Finance Denmark believes that a need for a common approach for measuring carbon emissions is important in order to ensure comparable and transparent communication about the carbon footprint of the economic activities that are financed or invested in.

Therefore, we suggest that the Commission sets up a Task Force to develop a common model for measuring carbon footprint on investments and lending at EU level as part of the next steps in accelerating the Sustainable Finance Agenda. Creating a voluntary EU model for measuring the carbon footprint would be useful for setting reduction targets by the sector, and thereby accelerating green investments (and lending) and would help reduce market fragmentation.

Different methods and disclosures already exist such as the 2-degree investment project's Paris Agreement Capital Transition Assessment (PACTA) Project, the Dutch sector initiative Partnership for Carbon Accounting Financials (PCAF) and the recommendations of the FSB's Task Force on Climate-related Disclosure (TCFD).

Finance Denmark has initiated the work to develop such a model for the Danish sector. A first version of the model focusing on major activities in the sectors of particular relevance to carbon emissions will be ready by 2021. To support its efforts in this matter, we would be more than happy to share our experience with the EU Commission

Finance Denmark welcomes the aim of the Commission to develop standardised natural capital accounting practices within the EU and internationally. This is essential to the further development and implementation of the taxonomy to cover all six environmental objectives. In this relation, Finance Denmark finds it important to look at existing ESG-data and -approaches in this area (e.g. TrueCost and Life Cycle Analysis, LCA).

Finance Denmark recommends:

- *That the Commission set up a task force to develop a common model for measuring carbon footprint on investments and bank lending at EU level.*

- *That the Commission's task force looks into developing a set of guidelines regarding how to make a carbon footprint on different asset classes.*

- *That the task force on developing draws on experience and expertise from the financial sector (e.g. PCAF). Finance Denmark would be happy to contribute to this work.*

- *That the task force is combined with the Commission's stated aim to develop standardised natural capital accounting practices within the EU and internationally.*

6. *Ensure access to standardised and digitalised sustainability data to increase transparency*

Ensuring access to and availability of digital, standardised and reliable environmental and sustainability data is critical for a sustainable financial system, and a prerequisite for transparency and for avoiding issues such as so-called 'green bubbles'. Therefore, codification, i.e. making sure that the taxonomy is usable for digital processing and automized processes, is crucial for an efficient sustainability reporting ecosystem to develop.

Redirecting private capital to sustainable investments naturally requires financial companies to improve their reporting on ESG risks and opportunities in investment and lending decisions. Therefore, this information must be made available and the flow of data between companies, issuers, investors should be as seamless as possible across the EU.

The biggest challenges to the transparency and usability of the sustainable financial system thus relate to the availability of affordable and comparable data of a certain quality. Small investors, banks and other relevant parts of the society have difficulties to access the data because of high collection costs and are thereby dependent on third parties. Moreover, the new reporting obligations for institutional investors, asset managers and other financial institutions need to be backed by more sophisticated and comparable sustainability data concerning the financed companies and projects.

As a key measure to this end, Finance Denmark welcomes the planned review of the Non-Financial Disclosure Directive (NFRD), which currently regulates inter alia how large companies disclose information on the way they operate and manage social and environmental challenges in their annual reports. The scope of application and disclosure requirements on sustainability in the NFRD need to be aligned with the Taxonomy Regulation, the Technical Screening Criteria as well as the reporting requirements in the Disclosure Regulation. Applying a minimum disclosure data set for companies that mirrors the metrics in the Taxonomy would greatly facilitate the operability as well as transparency in ESG reporting across sectors, and to this end, the Commission should closely consider the benefits of turning the NFRD into a Regulation.

To this end, Finance Denmark supports the idea of creating a central 'EU sustainability data register' that would facilitate ESG disclosure and access to relevant and reliable data at the EU level. Importantly, Finance Denmark is of the opinion that sustainability data should be viewed as a public good. Therefore, the EU Commission should put in place infrastructures to periodically collect existing sustainability data of companies published in non-financial statements, as well as other relevant information such as information related to physical climate risk. An open access approach to digitalised, standardised information (incl. from public authorities), would help to ensure transparency and a level-playing field in access to this information, incl. for SMEs.

Sustainability data also needs to be comparable and to be able to flow sectors and countries. In other words, the data that is reported by companies on their sustainability performance should be standardized and digitally compatible with the taxonomy and the sustainability reporting requirements for financial market participants. Therefore, the Commission should apply a 'digital-by-default' principle.

As the sustainable data will only continue to grow in scope and importance, more and more economic actors will be dependent on a well-governed and predictable 'data system'. Predictability in the governance and updates of data standards/criteria, such as the taxonomy TSC, and the reporting requirements for companies and financial market participants, are key to making the sustainable finance 'data system' work in practice. This could be inspired by other global standards and infrastructures such as ISO and SWIFT.

Finally, it is important that new technology, innovation and alternative sustainable solutions are encouraged. SMEs – financial as well as non-financial companies – play an important role and should be encouraged to provide solutions that underpin the sustainable transition. Due consideration to proportionality should be taken in applying reporting obligations for SMEs.

Finance Denmark's recommendations:

- *Ensuring access to and availability of standardized, digital sustainability data is key for the sustainable finance system.*

- *Standardization of data and alignment of reporting requirements can be promoted by broadening the scope of application and requirements of NFRD to align companies' non-financial reporting requirements on* sustainability *with the taxonomy Technical Screening Criteria as well as the reporting requirements in the Disclosure Regulation.*

- *The potential benefits to this end of turning the NFRD into a Regulation should be explored, including with a view to require a minimum disclosure data set for enterprises that mirrors the metrics in the Taxonomy taking proportionality into account.*

- *The creation of a central 'EU sustainability data register' would facilitate the building of* sustainability *disclosures and ensuring access to relevant and reliable data at the EU level. Such a database as well as the collection of existing* sustainability *data, including information related to physical risk, could be administered by the Commission.*

- *Ensure predictability in the governance and updates of data standards, such as the taxonomy TSC, and the reporting requirements for companies and financial market participants. Governance structures could be inspired by other global standards and infrastructures such as ISO and SWIFT.*

- *New reporting obligations should be applied in a proportional manner for SMEs – financial as well as non-financial companies.*

7. Create clear guidelines for prudential requirements on sustainable finance

Climate change and the sustainable transition are altering the risk landscape of society in general and of the financial sector. Banks and other participants in the financial sector need to adapt their business and risk management activities to this new reality.

Finance Denmark finds that integrating ESG risks in banks' risk management, whenever possible, is part of a sound and prudent management. Furthermore, the development of solutions and products enabling the climate change transition is a key factor of growth and development. Including climate-related risk in the general risk management represents material challenges, in terms of methodology (e.g. time horizon, risk materialisation, scenario(s)), data granularity or risk governance. The measures will require major adjustments to banks' business strategies, risk management, credit management, corporate culture and the way banks communicate, collect, process and analyse data with significant investments in the resources, processes and IT systems. Relevant, reliable and comparable data on a rather granular level are also necessary to ensure compliance with the envisaged regulation and to have adequate risk management and credit policy.

In addition, customer advice will change as the financial sector must be able to offer their customers advice on how their financial situation may be affected by e.g. climate change.

Finance Denmark recommendation:

- *Any possible differentiated capital requirements on sustainability must strike the right balance between accelerating the sustainable transition through more attractive sustainable loan and investment products, on the one hand, and safeguarding financial stability, on the other hand.*

8. *Ensure quality and transparency in sustainability rating methodologies*

To ensure transparency, a common EU approach to sustainability ratings (ESG ratings) is needed. There is currently no uniform definition of what an ESG rating signifies. This not only makes it difficult to compare results, but sometimes leads to significantly diverging ratings of the same products. The lack of comparability between ratings is primarily rooted in the lack of uniformity of the rating scales, criteria and objectives as well as lack of standardized disclosure.

Finance Denmark underlines the need to review the existing rules regulating how rating agencies work with a view to ensure a high level of quality and transparency in the methodologies used in carrying out sustainability ratings. To this end, the Commission's work to examine further the best path for action is encouraged.

Finance Denmark recommendations:

- *Ensure a high level of quality and transparency in the methodologies used by the rating providers, incl. the use of uniform ESG-rating scales and -objectives.*

- *Ensure reliability of ratings and commence the work to create an EU certification of external ESG-rating agencies and auditors.*

9. *Drive forward the sustainable transition by the necessary fiscal and economic measures*

Succeeding with the sustainable transition of the European society and reaching the political objectives necessitates private investments of an unprecedented scale. This requires a transformation, not only of the way the financial sector works, but the way the economy works as a whole.

The efforts of the financial sector must be underpinned by the necessary fiscal and economic frameworks. Taxes, subsidies and guarantee funds should help promote sustainable production methods and investments and limit activities that are not compatible with a sustainable future.

The scope of the climate challenge clearly emphasises an increasing need for taxes and subsidies to reflect the macroeconomic costs and gains in terms of the climate footprint and sustainability in the broad sense. When socioeconomic gains from sustainable activities are valued and reflected in market conditions, entrepreneurs and businesses can obtain financial viability of their projects. At the same time, it will strengthen banks' capacity to fund them.

Public procurement policy is an important instrument in promoting sustainable development. Ambitious targets for public procurement of goods and services may strengthen the ability of European businesses to make a fast transition. An ambitious public procurement policy may also facilitate more private investments in products and activities that support the sustainable transition, as well as in new and small businesses that can develop new and sustainable solutions on a smaller scale.

10. Work to ensure global standards on sustainable finance

Sustainable finance is key to ensure the necessary transition of our economy to secure a climate friendly and sustainable society. A lot has been achieved at EU level since the launch of the Commission Action Plan on Financing Sustainable Growth in March 2018. Two new climate friendly benchmarks have been adopted, new ambitious disclosure rules on ESG will apply from early 2021, and we are moving fast towards a common EU framework for, what is considered "environmentally sustainable" – the so-called EU 'taxonomy'.

Finance Denmark fully supports the EU's efforts to be a regulatory front runner at a global level. In order to ensure the largest possible effect of the EU regulatory efforts, the EU's standards and approach must continuously be applied to the global financial markets through e.g. the EU International Platform on Sustainable Finance, the Coalition of Finance Ministers for Climate Action, G7/G20.

These efforts should also build on existing international frameworks to support the banking industry in contributing to sustainable development, such as the UNEP FI's Principles for Responsible Banking, which Finance Denmark along with several Danish Banks signed in September 2019.

Finance Denmark is a business association for banks, mortgage institutions, asset management, securities trading and investment funds in Denmark. Our members are mortgage institutions, banks, savings banks, cooperative savings banks, Danish branches of foreign banks, asset managers, Danish securities dealers and investment funds.