

Sustainable finance and the EU transition: An overview

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Table of Contents

- I. Sustainable development and climate risk
- II. The role of sustainable finance
- III. The SF transition in the EU



I. Sustainable development and climate risks



Sustainable development

What is sustainability?

- Sustainability in its core definition **goes much beyond** the financial investment universe
 - ***“sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs”*** – UN World Commission on Environment and Development
- *Sustainable development* means that current and future generations have the resources needed, such as food, water, healthcare and energy, without stressing the Earth system processes



Sustainable development Concept

- Sustainable development is an integrated concept with three aspects: economic, social and environmental.
 - **Environmental challenges:** climate change, land-use change, biodiversity loss and depletion of natural resources
 - **Social challenges:** poverty, hunger and lack of healthcare show that many people live below minimum social standards
 - **Economic challenges:** our economic models were developed in an empty world with an abundance of goods and services produced by nature



Sustainable development 2015 COP21 and 2030 Agenda

- Paris Agreement (COP21) of 2015, adopted by 196 countries, is the **first universal and legally binding agreement on a global action plan**
- Globally, Paris Agreement (2015) commits signatories to:
 - **Climate change mitigation:** Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 C (art. 2(1)(a))
 - **Climate change adaptation:** Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience (art. (2)(1)(b))
 - **Sustainable finance:** Reorienting investment flows consistently with these climate change mitigation and adaptation objectives (art. (2)(1)(c))
 - **The financing gap**



Sustainable development 2015 COP21 and 2030 Agenda

To guide the transition towards a sustainable and inclusive economy, the United Nations has developed the **2030 Agenda for Sustainable Development** (UN, 2015); 17 high level goals are specified in 169 targets



Global Strategy

Government policy

Technological change



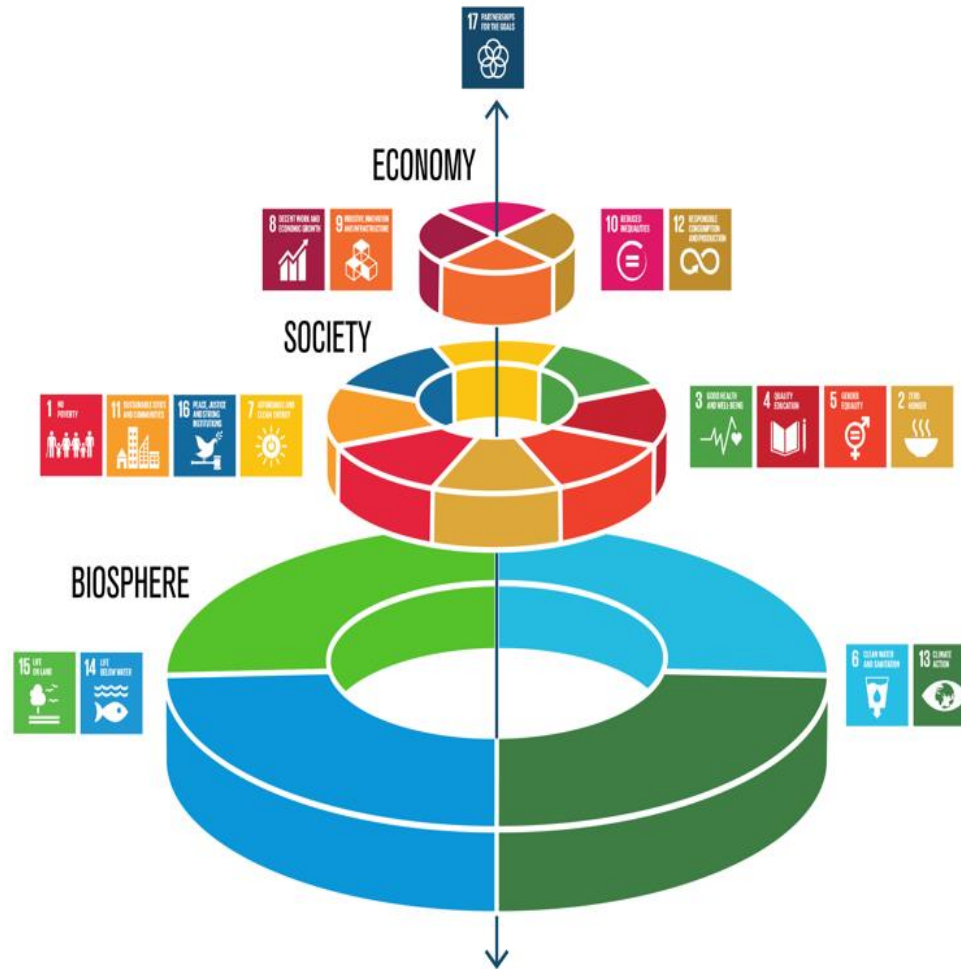
Sustainable development

UN Sustainable Development Goals (UN SDGs)



Sustainable development

Sustainable Development *Goals* (UN SDGs)



✓ Reference to investment as driver of sustainable development

Climate risks

- Climate change driven by **greenhouse gas emissions** is a top issue on the policy agenda
- Can financial markets **price** the financial risk descending from climate change?



Climate risks

- *“Financial risks posed by the exposure of financial institutions to physical or transition risks caused by or related to climate change, for example, damage caused by extreme weather events or a decline in asset value in carbon-intensive sectors” (NGFS)*
- **Physical risks** arise from the physical effects of climate change and environmental degradation (e.g. weather-related hazards)
- **Transition risks** arise from the transition to a low-carbon economy through three main drivers: policy, technology and preferences
- These risks interact: physical risk can give rise to transition risk, while transition risk mitigation can help reduce physical risk



II. The role of sustainable finance



What is sustainable finance?

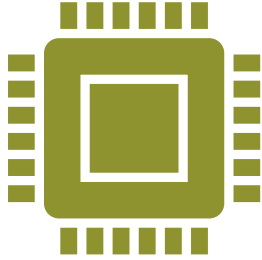
- As mentioned, there is a big financing gap to be addressed
- **Sustainable finance generally refers to the process of taking due account of environmental, social and governance (ESG) considerations when making investment decisions in the financial sector, leading to increased longer-term investments into sustainable economic activities and projects. (EC)**

ESG as investment parameters for sustainable finance

- **Environmental considerations** *may refer to climate change mitigation and adaptation, as well as the environment more broadly, such as the preservation of biodiversity, pollution prevention and circular economy*
- **Social considerations** *may refer to issues of inequality, inclusiveness, labour relations, investment in human capital and communities, as well as human rights issues*
- The **governance** *of public and private institutions, including management structures, employee relations and executive remuneration, plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process*

Sustainable finance

The role of finance



Levine (2005) lists the following functions of the financial system:

Produce information ex ante about possible investments and **allocate capital**;

Monitor investments and **exert corporate governance** after providing finance;

Facilitate the trading, diversification, and management of **risk**;

Mobilise and pool **savings**;

Ease the **exchange** of goods and services.



Finance can play a role by allocating funding to its most productive use and in a sustainable manner



To sustainable corporates and projects and thus accelerate the transition to a low carbon economy



Framework for sustainable finance

Sustainable Finance Typology	Value created	Ranking of factors	Optimisation	Horizon
Finance-as-usual	Shareholder value	F	Max F	Short term
Sustainable Finance 1.0	Refined shareholder value	$F \gg S \text{ and } E$	Max F subject to S and E	Short term
Sustainable Finance 2.0	Stakeholder value (triple bottom line)	$I = F + S + E$	Optimise I	Medium term
Sustainable Finance 3.0	Common good value	$S \text{ and } E > F$	Optimise S and E subject to F	Long term

Note: F = financial value; S = social impact; E = environmental impact; I = integrated value. At Sustainable Finance 1.0, the maximisation of F is subject to minor S and E constraints.

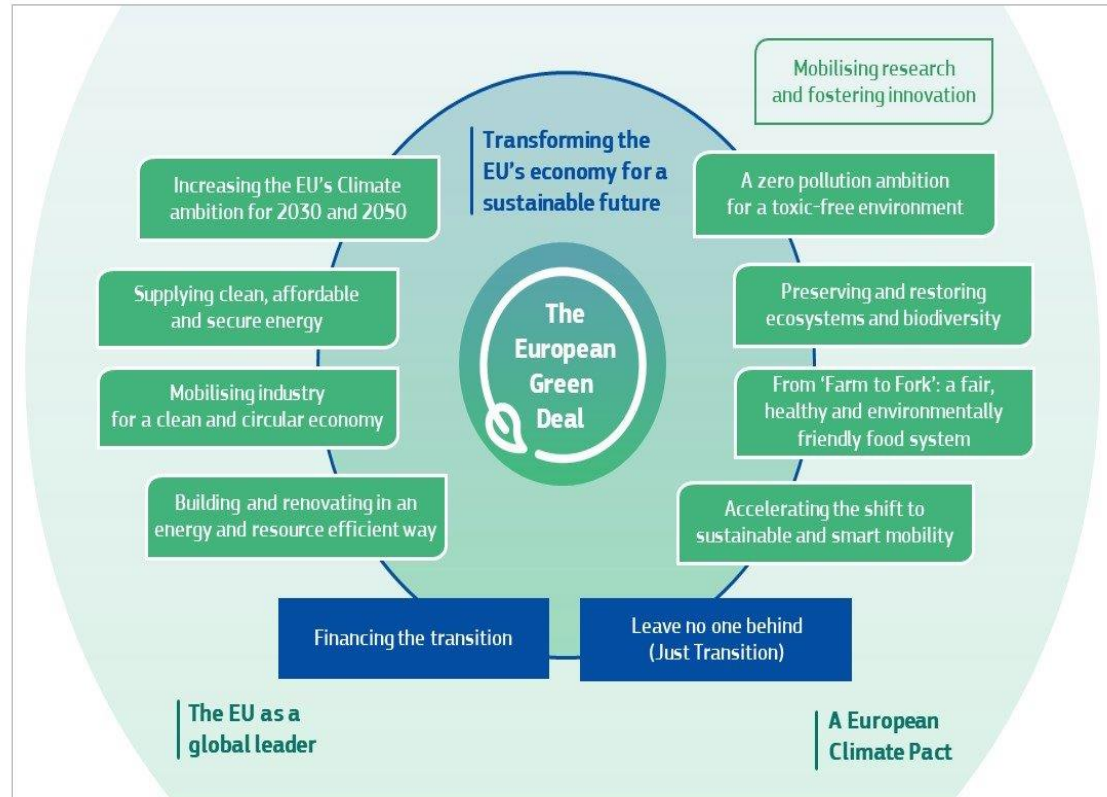
Source: Schoenmaker (2017).

- From shareholder value to stakeholder value

III. The SF transition in the EU



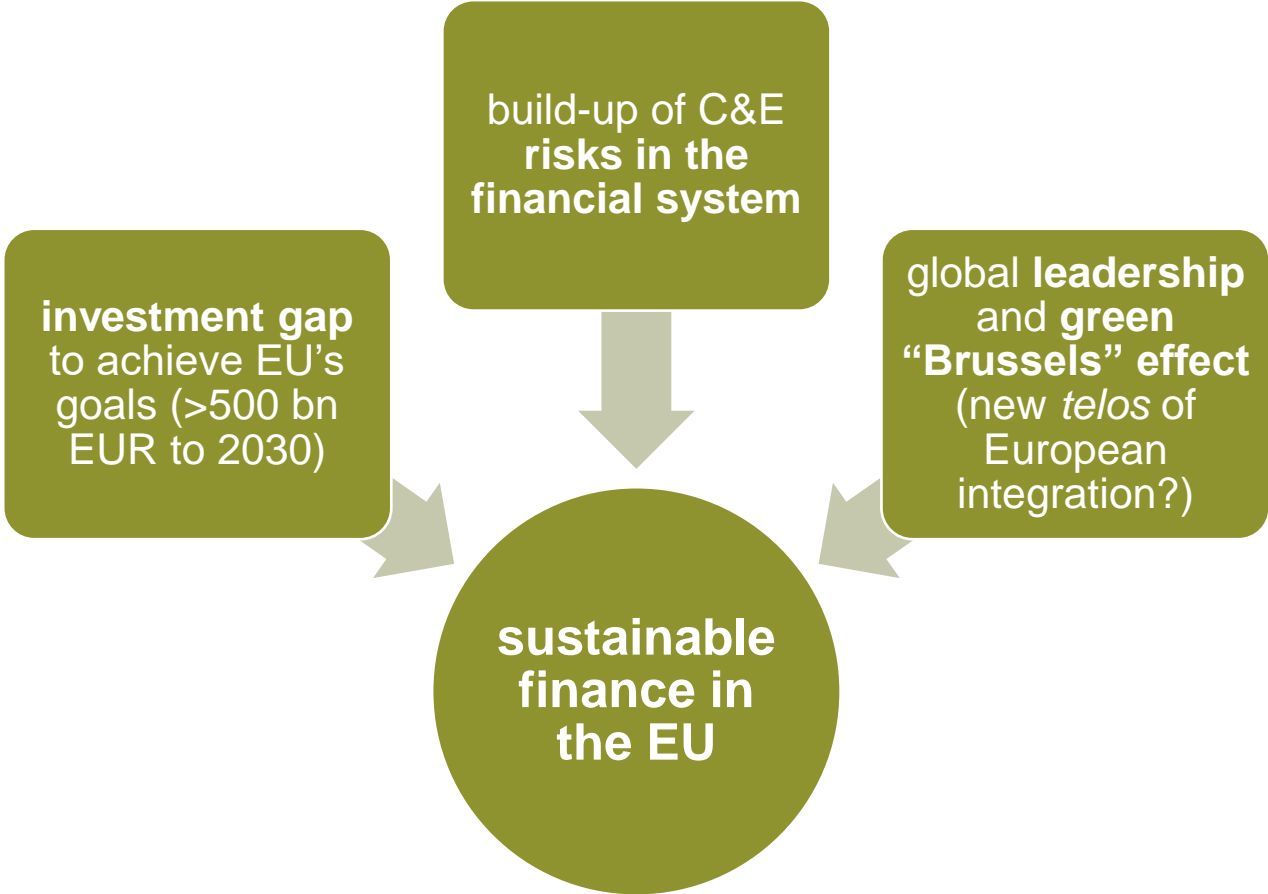
The EU transition: legal basis



- **EU Treaties** already provide for high level of environmental protection (Art. 3(3) TEU, Art. 11 TFEU)
- **2020 European Green Deal** makes sustainability transition part of EU's industrial policy tackling both sectoral and systemic transformation
- **2021 European Climate Law** enshrines the goal of reduction of 55% emission reduction as compared to 1990s as a **mandatory requirement for EU institutions/Member States** (cf. Zilioli/ Ioannidis, 2022) → fit for 55 package



The EU SF transition: rationale

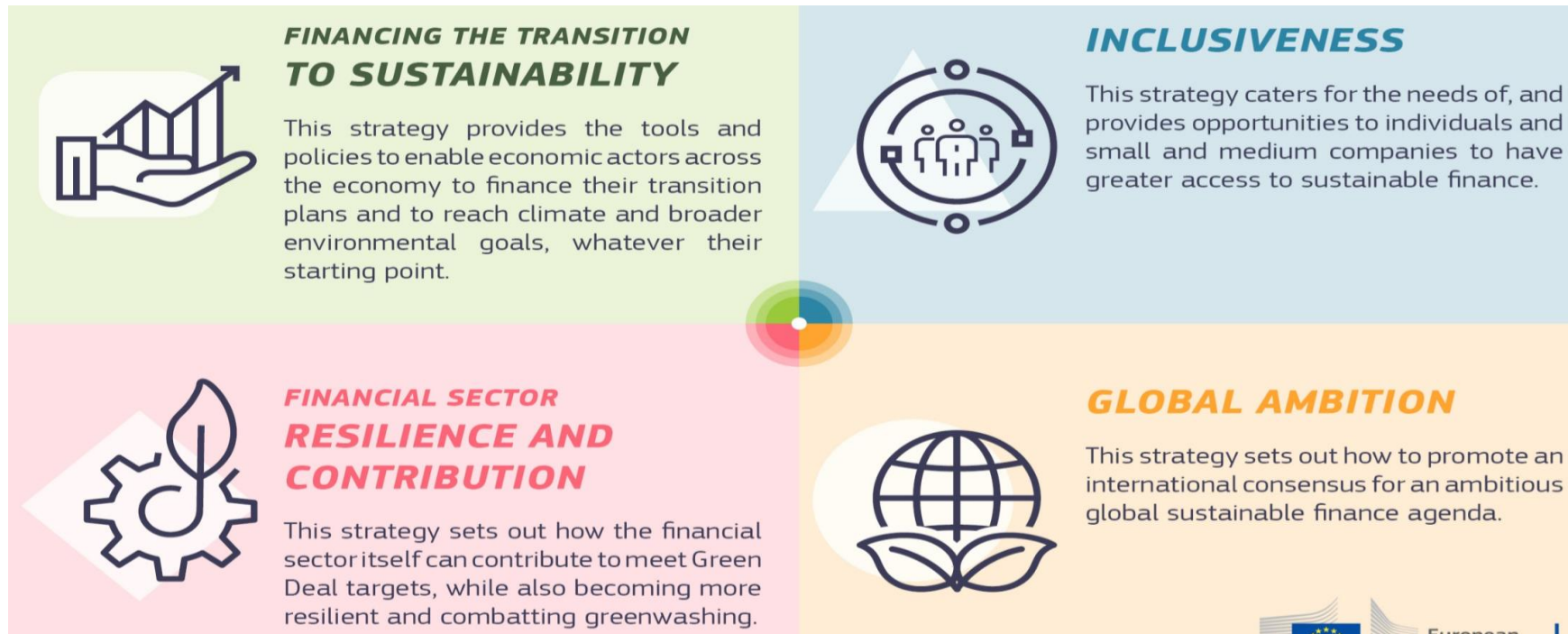


The European SF transition: milestones

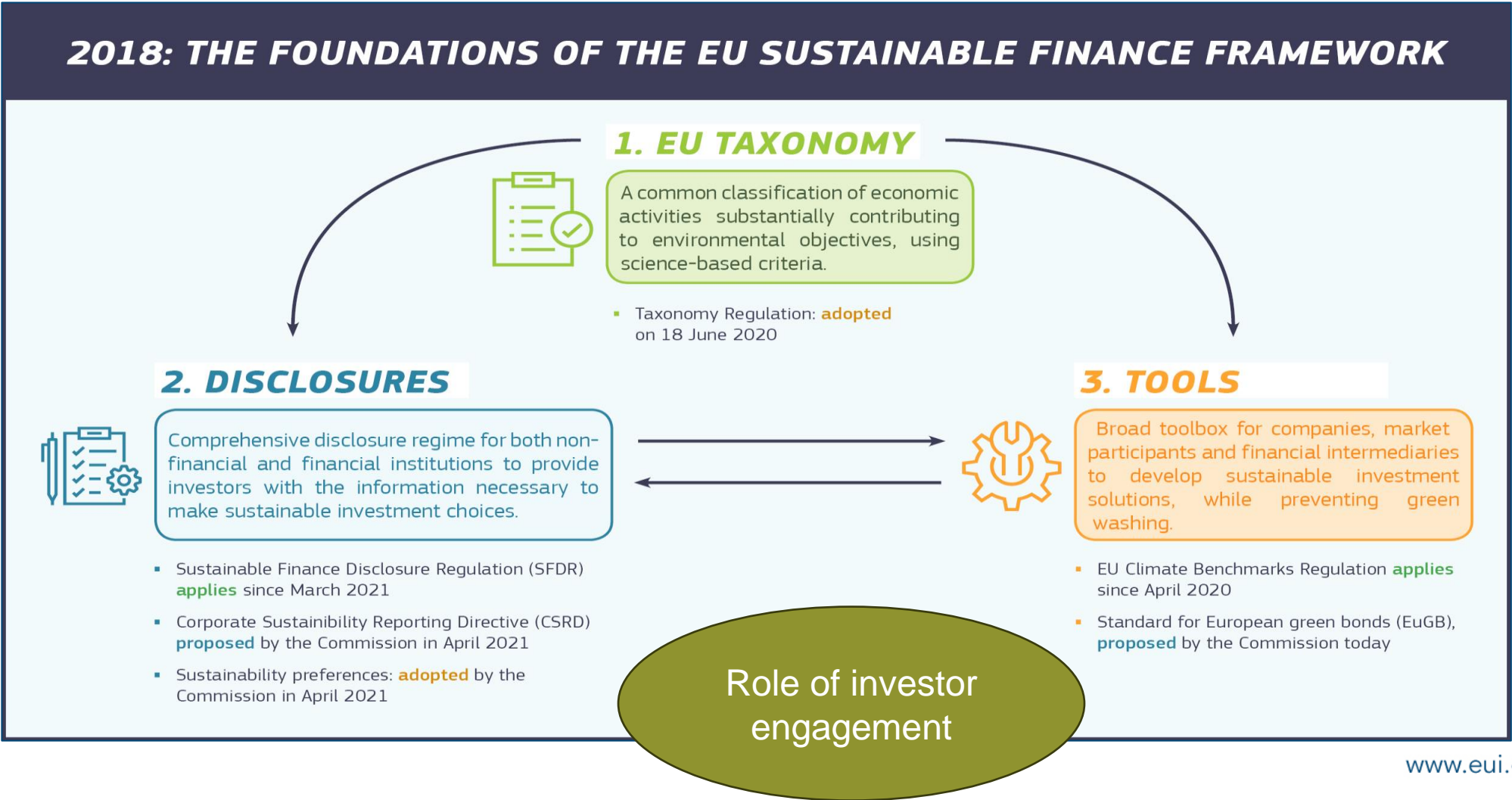


The European SF transition: the European Green Deal and ‘Renewed Sustainable Finance Strategy’

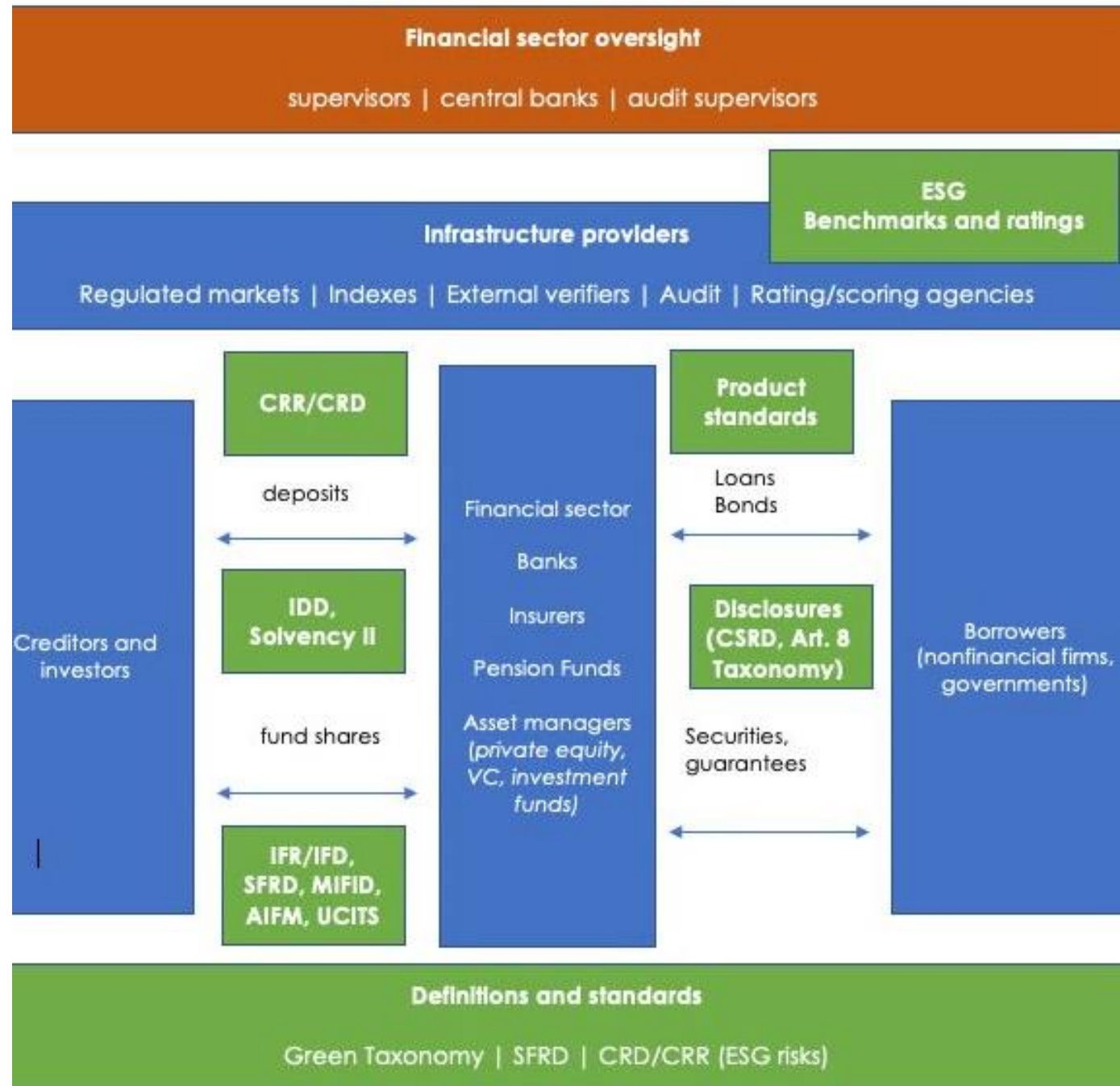
- Complete the work started under the 2018 Action Plan on Financing Sustainable Growth
- An evolved context provides need for additional measures in four key areas



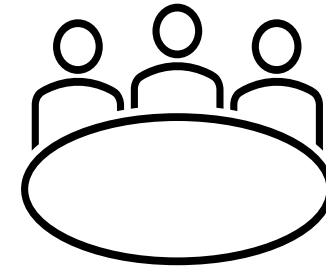
The European SF transition: the European Green Deal and 'Renewed Sustainable Finance Strategy'



The European SF transition: an helicopter view



European context: New mandate of the Platform on SF



- **Previous mandate: 2020-2022**
- **Two-year mandate:** Q1 2023 to Q4 2024.
- Three key workstreams on which the Platform support the Commission with advice and analysis on:
 - the **usability** of the Taxonomy and wider sustainable finance framework;
 - the development of recommendations for **additional Taxonomy** and on possible **revisions/updates** of criteria;
 - the implementation of the Strategy on Financing the Transition to a Sustainable Economy, esp the **monitoring of capital flows** into sustainable investments.

International outreach: International Platform on Sustainable Finance - IPSF

- Multilateral cooperation and International platform for sustainable Finance

- Late focus on social finance, transition finance and comparison of taxonomies

- Interoperability of EU and global standards (e.g. CSRD with ISSB)

19 Members

Public authorities

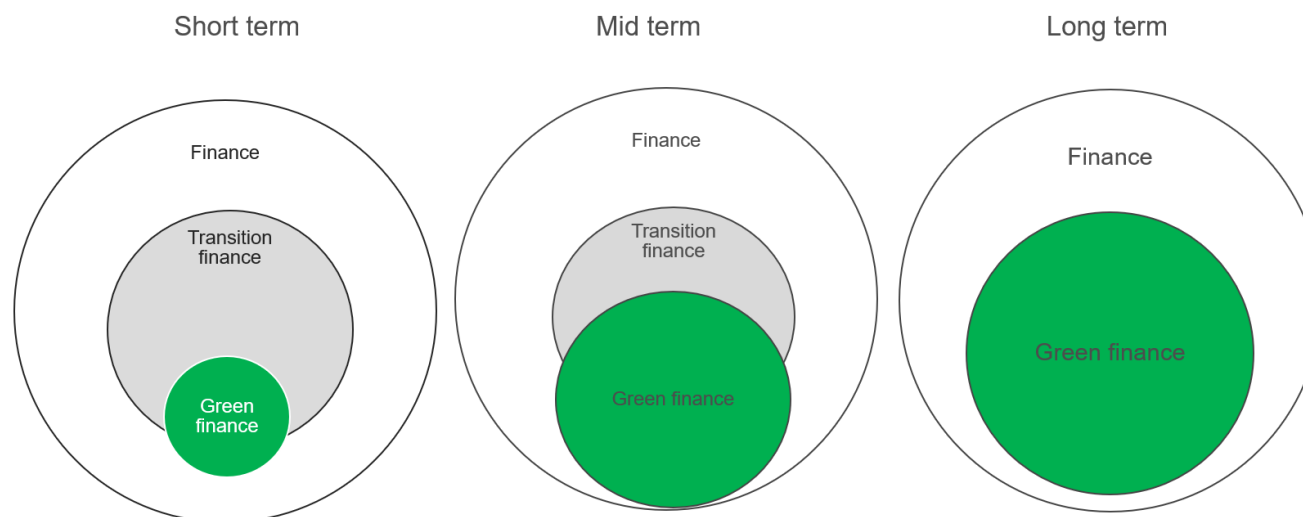
Observers



Key issues going forward

- Transition Finance: what to do with brown assets and hard-to-abate sectors
- Social taxonomy
- Usability and interoperability
- EU: Rule taker vs rule maker (cf. Eurogroup statement on CMU)

Relationship between green and transition finance today and over time



Are we going to see a political backlash??

Any questions?

