FESE Position Paper on the EU Strategy for Financing the Transition to a Sustainable Economy

Brussels, 23rd September 2021

FESE welcomes the Commission's renewed Sustainable Finance Strategy and its multiple planned actions to ensure that the financial system fully supports the transition of the economy towards sustainability. We believe that the different measures would contribute significantly to reorienting capital flows to sustainable investments and, as a result, to easing the path in the transition to a carbon-neutral, inclusive and resilient economy by 2050.

FESE supports developing a long-term sustainable finance vision that ensures a level playing field between public and private markets, is built on a solid understanding of the role of financial markets and how these can facilitate the transition towards a low-carbon future, and does not lead to unintended consequences for market players in terms of risk management. A transparent and consistent approach, in line with ESG aspects, by the real economy, financial industry and regulators holds great opportunities for international and European capital markets. It is important, however, to keep in mind that financial markets reflect developments in other parts of the economy and the sustainable finance agenda cannot, by itself, realise the goals of the Paris Agreement. Real change could be achieved by adopting sector-specific regulations and tax incentives to promote the fight against climate change.

With the firm commitment to contribute to the EU's Sustainable Finance agenda, we would like to draw attention to certain aspects that are worth considering in the development and implementation of the Strategy.

Need to embrace on transition

FESE strongly believes that the EU should focus on having an inclusive approach, targeting transition and not only steering investments to already green activities. As we are transitioning to a more sustainable economy, it is important that companies' best efforts are recognised and that companies that are implementing changes to become ESG compliant are not excluded from related initiatives or funding opportunities. In this regard, we would second the Commission's suggestion to extend the EU Taxonomy framework to better recognise these transition efforts and mobilise investments for intermediary steps on a credible pathway towards sustainability.

Moreover, the transition towards a climate-neutral economy might have socio-economic impacts as well. Therefore, and looking forward, the inclusion of social objectives in the Taxonomy would be desirable. Having said this, we would like to highlight the need to adopt gradually sustainability measures. These should be regularly reviewed, and their effects assessed in terms of efficiency, the competitiveness of Europe, market quality, depth of liquidity and participation of investors in the market.

Foster sustainable finance across asset classes

As more and more asset owners incorporate ESG approaches into their portfolios, asset managers have the duty and challenge of presenting strategies and products that meet their clients' criteria. In this context, ESG indices are key to enhancing access to ESG strategies with liquidity and appropriate portfolio diversification. Passive ESG investment represents an important and powerful tool, especially in light of the need to redirect capital flows towards the financing needs of the transition of Europe's economy. It is therefore important to avoid overlapping and diverging legislation and that the upcoming benchmark-related regulation is aligned with the other sectoral legislation and developments of the underlying market. Furthermore, demand for listed ESG derivatives has emerged over the last few years, with mainly the asset-management industry seeking flexible solutions to align their ESG investment mandates, trade longer-dated maturities and manage the granularity of clients' risk exposure while reducing trading costs. FESE wants to highlight that ESG derivatives are increasingly playing a role in channelling more capital into sustainable investments, and hence should not be treated inconsistently or discriminated against under the regulatory frameworks in order to avoid fragmentation of and unintended negative effects within this market.

An EU transition alignment methodology

We would suggest the creation of a transition alignment methodology for companies created or endorsed by the EU. Right now, Transition Pathway Initiative (TPI)[1] and Science Based Targets initiative (SBTi)[2] are the most known ones, but shall a methodology be framed or/and endorsed by public authorities, in particular at EU level, would gain traction and have a pivotal role on a transition economy. This suggestion is aligned with ongoing discussions and analysis provided by market participants, for instance, the joint Climate Bonds Initiative and Credit Suisse whitepaper, "How to ensure the transition label has impact"[3].

Need to empower retail investors and SME

As reflected in both the Sustainable Finance and the CMU Agendas, we should foster a more inclusive sustainable finance framework that provides SMEs with more financing opportunities and encourages retail investors' participation in capital markets. It should be recalled that European capital markets have a clear disadvantage compared to their US and Asian counterparts in terms of retail participation. In the green capital market, this deficiency risks undermining the financial sector's efforts towards the green transition. Europe needs to empower retail investors by making investment practices simple, less costly, transparent, and by taking steps to prevent conflicts of interest. Similarly, with SMEs standing as the backbone and engine of the European economy, it is also vital to facilitate their access to more sustainable finance opportunities.

In this context, FESE Members are devoting significant efforts to encourage capital flows to ESG projects and the listing of companies, notably SMEs, with strong ESG characteristics. Some of these actions include, for example, the launch of multiple labels and initiatives to enhance their visibility. In addition, they are also running a number of initiatives to promote sustainability and ESG reporting, and FESE has recently published the 'Introduction and Guiding Principles to ESG Reporting', an informative document to streamline ESG reporting guidelines for issuers on a European level (here).

While FESE welcomes the different workstreams envisaged in the Strategy, it would also support further actions to empower both SMEs and retail investors in green capital markets. For instance, we appreciate that, under CSRD, proportional reporting requirements are to be developed for SMEs listed on regulated markets; however, if non-listed SMEs are, by contrast, only subject to voluntary disclosure, we risk disincentivising companies from going public and increasing de-listings. In this scenario, a voluntary sustainability reporting framework for all SMEs (whether they are listed or not) would be a better option to allow them to respond to financial market participants' demands.

[1] Details here: https://www.transitionpathwayinitiative.org/.
[2] Details here: https://sciencebasedtargets.org/.
[3] Paper available here: https://www.climatebonds.net/transition-finance/fin-credible-transitions.

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Likewise, FESE supports measures that facilitate the sharing of company information and the provision of information to investors, and that give companies visibility on a European basis. By facilitating access to information about companies in other Member States or regions, more cross-border investments could potentially be encouraged. However, should such a project include ESG disclosures, it is important that submitting this type of information is voluntary and proportionate for SME issuers, and that private companies are subject to the same requirements as listed companies, so as not to create a barrier to listing and an unlevel playing field.

On another note, FESE agrees with the Commission's view on the need to improve the financial literacy and education of both investors and companies. In particular, we celebrate its call to improve the level of sustainability expertise of financial advisors to foster greater retail investors' participation. Similarly, we firmly believe that the promotion of educational programmes to incentivise sustainable companies to access capital markets, and market participants to invest in green products, would also make a valuable contribution to reaching the objectives of the Strategy.

We also welcome the Commission's proposal to provide advisory services for SMEs to report on sustainable-related information both through EU instruments and by supporting Member States in their efforts to provide capacity building and technical advice in this respect. It should be recalled that companies wishing to disclose ESG standards may face high compliance costs for their issuance of equity or bonds. Therefore, we would also see merit in the Commission partially funding the advisory or compliance services needed by SMEs for the issuance of their assets, either in the form of a loan or via a rebate mechanism. The SME would then be able to pay back its ESG related upfront costs following the issuance of its assets and the amount it could raise from public capital markets.

In addition, FESE would appreciate specific EU incentives to facilitate access to finance for SMEs engaged in sustainable activities, or for those SMEs wishing to transition. These could include, inter alia, tax incentives for issuers, which could also be extended to investors of certain green instruments, such as the European Green Bonds, to boost their demand. Moreover, EU actions to allow for Member States to provide for tax incentives (e.g. with a lock-up clause) would further enhance long-term engagement between investors and their investee companies, attracting long-term investments for companies undertaking ESG activities.

Need for global alignment

FESE believes that it is important to work on a global approach on the sustainable finance taxonomy, building on the EU framework and EU leadership within the field. There is the need for a robust international sustainable finance architecture that embraces the concept of double materiality. We should increase dialogue at the global level on non-financial reporting standards to ensure consistency and not risking putting European companies in a less favourable competitive position.

Maintain principles for corporate governance in the existing format of codes

Corporations play a vital role in sustainable development and economic growth, but it is important to recall that their interests vary depending on, for instance, the type, size and organisation of the business. Since different companies cannot be managed the same way, we support maintaining principles for corporate governance in the existing format of codes. This way, companies are provided with useful guidance on governance, while allowing shareholders to decide on the best ways forward. Besides, this would also prevent EU companies to be exposed to competitive disadvantages compared to non-EU companies.

More specifically, when it comes to developing an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues, FESE believes that it should be sufficient to ask companies to follow the existing guidelines and standards. ESG risks vary between individual companies and across industries, and differences may arise with respect to products, processes, organisational structure, business relationships and geographical location. Many companies are already engaged in processes and risk management related to supply chains and are following principles and guidance developed for this purpose. Such principles should remain ‘guidance’, i.e. not in a binding legislative framework.

One size does not fit all and, therefore, an EU legal framework should be avoided. Having said this, if any mandatory duties within sustainable corporate governance were to be implemented, SMEs and companies with limited resources should be exempted given the additional administrative burdens and costs that a mandatory regime at EU level would impose on them. When exclusion is not possible, binding measures should apply to all similar companies regardless of whether they are listed or not. As stated above, we risk otherwise disincentivising potential issuers from going public, which would be to the detriment of capital markets and the further development of the EU Single Market.

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