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Via electronic mail and online submission

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European Commission

Mr. Martin Spolc
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European Commission

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Re: Consultation on a Renewed Sustainable Finance Strategy

Dear Mr. Berrigan, Mr. Spolc:

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry ("industry"), appreciate the opportunity to provide high-level comments to the European Commission (EC) on its public consultation on a Renewed Sustainable Finance Strategy (RSFS). The IIF is a global association, with close to 450 members from 70 countries, including commercial and investment banks, asset managers, and insurance companies. The comments in this letter have been informed by discussions of the IIF Sustainable Finance Working Group (SFWG), under the leadership of Chair Daniel Klier (Group Head of Strategy and Global Head of Sustainable Finance, HSBC) and Vice-Chair Judson Berkey (Managing Director and Group Head of Sustainability Regulatory Strategy, UBS).

General Comments

Over the past 24 months, the EC has made significant progress in developing new frameworks and instruments to support the transition to sustainable finance. We strongly support the work of the EC on the sustainable finance agenda, including under the auspices of the 2018 Action Plan on Sustainable Finance. We congratulate the EC and other European Authorities on the adoption of the EU Taxonomy Regulation, and appreciate the efforts of other European authorities to develop related guidelines and supervisory expectations. We welcome the ambition of the EC to formulate a RSFS, which will set the groundwork for future measures to rapidly scale-up sustainable finance in support of a green recovery.

We believe that certain elements of the existing sustainable finance policy framework in Europe may benefit from consolidation. This is especially true in areas such as disclosure and reporting of non-financial information relevant to Environmental, Social and Governance (ESG) factors (hereafter referred to as "ESG Disclosure"). Close alignment of EU ESG disclosure initiatives – including the Non-Financial Reporting Directive (NFRD), the Disclosures Regulation, and the Taxonomy Regulation – is critical. We therefore encourage the EC to use the materials gathered via this consultation to reflect on how the broad dispersion of

formal requirements, expectations, and guidelines on sustainable finance can be effectively harmonized.

Future sustainable finance measures should aim to maximize the potential of the financial sector as a driver and catalyst of the low-carbon transition – but also must recognize the limits of the financial sector's role. The capacity for sustainable finance to drive outcomes in the real economy is fundamentally contingent on, and may be constrained by, the broader policy environment effecting economic agents. Due to varying structures and design characteristics, different types of financial products have varying ability to allocate capital to sustainable economic activities, motivate transition in the real economy, or influence impacts or outcomes relevant to specific environmental or social objectives. Clear, robust, and binding policy frameworks which create incentives for sustainability-oriented choices in the real economy (like a transparent, credible, and meaningful carbon price) are equally, if not more important, than measures affecting financing decisions, capital markets, or risk management.

In this context, we believe that interventions targeting the greening of the financial system must be designed with near-term real economy outcomes as their core objective. The IEA has recently set out a roadmap of real economy investments that could be made over the period 2021-23 to fund a sustainable recovery[1]. We would encourage the EC to focus on enabling these types of investment outcomes through the design and implementation of clear incentives and stable policy frameworks. The financial system continues to respond strongly to the sustainable finance imperative, including through the COVID-19 crisis. Going forward, the industry will continue to develop new and innovative products to support transition towards a green economy across the widest possible range of client groups.

Weighing the potential benefits of a more structured and stringent sustainable finance framework against current implementation and compliance challenges for financial institutions is an important priority. The consultation suggests that the EC may consider introducing new instruments in a wide range of areas, as well as expanding the scope of application of existing frameworks, leading to new requirements for financial institutions. We would stress the need to conduct evidence-based assessments of whether new or additional regulation are likely to be beneficial (e.g. by addressing market failures or the supporting transition to net neutral economy), recognizing that many elements of the existing framework put forward under the 2018 Action Plan on Sustainable Finance remain under development.

We recognize that there are certain areas where additional policy guidance may be necessary to strengthen the foundations for sustainable finance. Data remains a critical challenge. We would encourage the EC to consider a wide range of levers to facilitate a shift towards more comprehensive, comparable, and relevant ESG data, including, very importantly, through disclosure requirements on non-financial corporates. One critical aspect is how financial institutions and non-financial corporates firms can effectively communicate a forward-looking view of alignment of a firm's strategy and business model with a net-zero economy. Within the financial sector, we would recommend that any new instruments focus on progress (e.g. improvements on specific indicators) rather than a snapshot of performance.

European innovation on sustainable finance policy and regulatory frameworks and instruments is inspiring developments in other jurisdictions. Given the EC's vanguard role, it can be expected that future action will influence developments in other jurisdictions. The uncoordinated development of multiple, highly granular frameworks for sustainable finance policy in different jurisdictions is already resulting in regulatory fragmentation. Any new efforts

[1] IEA 2020 "Sustainable Recovery: World Energy Outlook Special Report" (June 2020)

in this area should build on those already gaining traction rather than add to the confusion by diverging from what is already in the market.

Risks of regulatory fragmentation are set to increase unless concerted action is taken to evaluate equivalency across national and regional-level frameworks, standards, and requirements. Climate risks are global in nature, and require globally coordinated supervisory and regulatory responses, ideally in the form of global standards. We would stress the need to identify the core 'building blocks' of this evolving agenda to ensure coherence as other jurisdictions gradually take action. While we recognize that the formation of global standards is currently on a slow pace, we encourage the Commission to formulate its agenda in close coordination with other jurisdictions.

1. Ensuring the existing EU Sustainable Finance agenda is complete and coherent

1.1 Data & Disclosure from non-financial corporates

Industry efforts to scale up sustainable finance require consistent and high-quality data on a wide range of ESG issues in order to inform decision-making[2]. As is widely recognized, including by the EC, there are pervasive data challenges in the sustainable finance sphere, many of which stem from the independent and uncoordinated evolution of different frameworks of ESG information[3]. The landscape of ESG disclosures by corporates is inconsistent and fragmented. While ESG disclosure is improving, progress is uneven. The levels and quality of disclosure vary significantly across industries and geographies. This has been addressed in various periodic studies, including by the TCFD Secretariat (June 2019),[4] EFRAG (February 2020)[5] and IIF/EBF (January 2020).[6]

High-quality ESG disclosures by financial institutions will necessitate similarly high-quality disclosures by non-financial corporate counterparties. Interventions to address data challenges relevant for sustainable finance market practice (e.g. managing risks and evaluating opportunities) must consider the root causes of data gaps – for instance, the lack incentives or requirements for coherent measurement of environmental externalities within the real economy. We therefore welcome the broad scope of application that the EU authorities take on the topic of ESG disclosures, and suggest that any future disclosure-related initiatives or actions focus on disclosures by non-financial corporates.

We support the proposal to develop a 'common, publicly accessible, free-of-cost environmental data space for companies' ESG information' (hereafter referred to as 'ESG data repository'). We recommend that the private sector have an active role in shaping the design of the ESG data repository platform, to ensure that data collected is made available in a consistent format readily applicable for financial institution disclosures. To ensure the relevance of such a data space, it would also be important to ensure that the data collected is consistent with data required under existing reporting requirements in the EU, such as the Non-Financial Reporting Directive, as well as other commonly used frameworks and/or metrics. Acknowledging that different types of financial institutions require different data from counterparties in order to satisfy disclosure requirements, we would suggest that there a specific platform be developed within the ESG data repository to capture data from firms not subject to NFRD requirements,

[2] IIF 2020 "Back to Basics: The Sustainable Finance Pyramid" (February 2020)
[3] IIF 2020, "Building a Global ESG Disclosure Framework: a Path Forward" (June 2020).
[4] TCFD 2019 "2019 Status Report" (June 2019),
[5] EFRAG 2020, "How to improve climate-related reporting," (February 2020)
[6] IIF-EBF 2020 "Global Climate Finance Survey: A Look At How Financial Firms Are Approaching Climate Risk Analysis, Measurement and Disclosure" (January 2020)

including SMEs, while respecting proportionality. More broadly, the proposed ESG data repository could serve as the basis for specific initiatives to strengthen the digitization and automation of ESG data provision across supply chains, including through the use of mainstream IT infrastructure. Going forward, it would be valuable to clarify how this effort may connect with other jurisdictional or international efforts to provide 'public good' data on ESG issues, including potential work within the planned NGFS work stream on data issues. The IIF would be pleased to contribute perspectives on this where helpful.

1.2 ESG ratings, analytics & data providers

Financial institutions are increasing reliant on a diverse group of ESG ratings agencies, analytics firms and data providers, whose inconsistent and incompatible products have a significant influence on risk management and capital allocation decisions. While competition amongst providers is currently fairly lively, it is uneven across different parts of the service provider landscape. Large mainstream data providers and credit ratings agencies have increased acquisitions and expansions. There is a small group of niche providers delivering bespoke solutions relevant to specific policy and regulatory interests, e.g. scenario analysis and portfolio warming potential (see section 1.3). Beyond market concentration, vertical integration across ESG data, research and provision of other services appears to be increasing.

The quality, comprehensiveness, and comparability of offerings of ESG ratings varies significantly, presenting challenges for financial institutions that must rely on such ratings in order to inform investment decisions and develop financial products. Studies have found that there is substantial divergence between ratings methodologies[7]. Though there is hope that correlation will increase as more firms begin to disclose,[8] findings suggest that more ESG disclosure might lead to greater discrepancies between ESG ratings firms[9]. Key issues include:

- **Divergent understanding as to what ESG ratings should measure.** Some providers seek to measure the impacts of a company on society and the environment, others also seek to measure how ESG considerations affect the company's financial performance.
- **Subjective elements of methodologies**. A providers' choice of risk and performance indicators, variables underlying those indicators, and the relative weight of each indicator are instrumental in determining a company's or portfolio's overall ESG rating.
- **Opaque assumptions**: Ratings methodologies are based on different choices, assumptions, and proxies, which are commercially sensitive and therefore non-transparent. a lack of transparency means that end-users are not readily able to compare the results of competing models without insight into those assumptions.
- **Data sources and their treatment**: Providers use a range of resources to formulate data products, including public disclosures and surveys, which may create biases towards certain types of firms, sectors or geographies.

The EC should reflect on where harmonization may be required across the ESG ratings, analytics, and data provider landscape, and which segments are naturally divergent. While significant divergence in approaches can constrain comparability, it is without

[7] Bender et al., "A Blueprint for Integrating ESG into Equity Portfolios" *JOIM*, January 2018.
[8] Carbone, Guizio, and Mikkonen, "Climate risk-related disclosures of banks and insurers and their market impact" in European Central Bank *Financial Stability Review,* Nov. 2019, p. 64-67.
[9] Christensen, Serafeim, Sikochi, "Why is Corporate Virtue in the Eye of the Beholder? The Case of ESG Ratings," *Harvard Business School Working Paper 20-084*, September 2019.

doubt that a degree of heterogeneity in ESG ratings can add value. Differences in ESG ratings can stimulate internal discussion and leave flexibility for financial institutions to make better choices.

Considering these challenges, contemplated regulatory action of ESG service providers should aim to both support consistency while ensuring strong competition. Specifically, we recommend that:

- **The EC should consider addressing root causes of the current fragmentation of the service provision landscape**, including the range of voluntary standards for disclosure and reporting of ESG information by corporates, which service providers then use to develop ratings and data products.
- **If pursuing regulatory action, the EC should examine whether potential unintended consequences could arise**, including where harmonization could constrain the potential for innovation, or potentially create concentration risks. Potential concentration risks and/or risks of herding behavior could result if a significant share of the market using similar ratings and market insights to inform core risk management and capital allocation decisions, especially where significant uncertainties and data gaps exist. There is also a risk of over-regulation of the green/sustainable finance market which could lead to disincentivizing further innovation in this market segment, instead of encouraging its growth.
- **There should not be any undue discrimination against service providers domiciled outside the EU wishing to participate in European markets, nor should undue burden be placed on EU-domiciled providers**. It is worthwhile to consider that a fairly open approach in recent years has led to a profusion of innovation, including by EU-domiciled entities, which are now globally competitive.
- **Considering the global nature of ESG data, the EC and other EU authorities should engage proactively at the global level, including through IOSCO**, to ensure that a global approach is taken to this challenge.

1.3 Disclosure by financial institutions

Regulatory processes currently underway at the EU level are likely to result in an increasing volume and complexity of disclosure obligations, in terms of sustainability issues considered, materiality perspectives and granularity[10]. The current review of the EU Non-Financial Reporting Directive (NFRD), and the RSFS, represent an important opportunity to streamline and harmonize the evolving EU regime for disclosures of ESG information by financial institutions and corporates in Europe and beyond.

Contemplated requirements on institutional investors and credit institutions to estimate and disclose which temperature scenario their portfolios are financing ("portfolio warming potential") are likely to be premature. While we acknowledge the appeal of such an indicator, and would support more consistent disclosure of such information, there are several challenges that must be addressed before regulatory requirements are introduced. These include:

- **Standardization and harmonization of methods:** There is currently no standardized method for evaluating portfolio warming potential. Financial institutions currently rely on a small number of specialized service providers to evaluate warming potential, on the basis of a divergent and non-standardized climate scenarios. There is

[10] IIF 2020, "Building a Global ESG Disclosure Framework: a Path Forward" (June).

significant disagreement within leadership coalitions on whether or not different approaches to evaluating portfolio warming potential are robust. These challenges are compounded by a lack of credible and comparable emissions data.

- **Data gaps:** The absence of credible and timely data remains a key barrier to properly estimating and disclosing which temperature scenario their portfolios are financing. Emissions data disclosed by corporates in the real economy is inconsistent, requiring extensive use of proxies. Greater consistency in the data landscape, either through regulation or the introduction of an ESG data repository, could potentially support this objective – and therefore should be the primary priority at this stage.
- **Clarification of objectives:** The objectives of introducing such a disclosure requirement are not clear. If this information is desired from a supervisory perspective, action should be considered within the context of evolving risk management requirements pertaining to climate change risks (e.g. ECB proposals).
- **Perverse outcomes:** Without standardization and clarification of objectives, new requirements on portfolio warming potential could lead to unintended consequences and potentially perverse outcomes. There is a risk of oversimplification of the relationship between a firm's portfolio holdings and outcomes in the real economy, creating a risk of greenwashing if such temperature values were taken up in marketing of retail financial products. Over-emphasis on portfolio warming potential could influence choices to divest from high-carbon sectors in order to lower warming potential, ultimately constraining the potential for investor stewardship to motivate transition in high-carbon industries (and thereby reduce emissions).

The development of a common EU-wide methodology could address issues of inconsistency in approaches, and lay the groundwork for future requirements. We would encourage that any approach developed at the EU level should be aligned wherever possible with action at the global level (e.g. future work via the BCBS, IAIS, IOSCO, NGFS).

1.4 Managing prudential risks & ensuring financial stability

Sustainable finance needs a harmonized and sound policy and regulatory framework that ensures clarity of purpose, protects consumers, supports market development, and facilitates transition in key economic sectors. Climate and environmental risks and broader sustainability issues should be incorporated into the existing general prudential framework for banks, insurers and investment firms in a considered manner given that they can potentially materialize as financial risks (credit, market, operational) for individual firms, which can in turn affect firm viability (relevant for microprudential regulation) and system-wide stability (relevant for macroprudential regulation).

We believe it is critical to ensure that prudential treatment and capital requirements remains risk sensitive, especially where climate and environmental risks and opportunities are concerned. In this context, we recognize that while some central banks and supervisors are exploring the potential to use prudential tools to influence market behavior (e.g. through introduction of 'green supporting factors' or 'brown penalizing factors'), there is no consistency across the supervisory community on the merits of such an approach[11]. As summarized by the Chair of the Supervisory Board of the ECB, "any capital relief for green assets must be based on clear evidence that they are less risky than non-green assets."[12]

[11] OMFIF-Mazars 2020 'Tackling Climate Change' (February). For example, see Figure 7.
[12] ECB 2019. "Regulation, proportionality and the sustainability of banking", speech by Andrea Enria.

More evidence and analysis are needed to make clear judgements on the use of prudential tools to stimulate green investment. There is evidence suggesting that capital markets are not adequately 'pricing in' climate-related transition risks, particularly in the context of financial securities issued by high carbon sectors[13]. Similarly, it is unlikely that markets are accurately reflecting the risk profile of green assets, especially in jurisdictions where such investments are contingent on policy support. Recent research by the NGFS has concluded that due to a lack of consistency in definitions, classifications and taxonomies, a material risk differential between green, non-green and brown assets could not be conclusively determined[14]. To address this knowledge gap, we would encourage further engagement with the industry – through the global channel – to conduct targeted research on risk differentials. This could be done on the basis of consistent industry definitions for green vs. non-green assets, a topic on which the IIF intends to conduct further work, building on our recent work on sustainable investment terminology[15].

Considering that uncoordinated national actions could lead to fragmentation, any practical steps forward in this area should be taken at the international level. This is necessary to ensure coherence across markets, as well as to maintain clear connectivity between any potential climate-related measures (or considerations) to core prudential architecture. BCBS, FSB, IAIS, and ISOCO, which have the necessary mandates, should lead activity in this area, ideally through the formulation of a coordinated inter-agency task force. It is also fundamental that prudential standards for capital and liquidity remain appropriately risk-sensitive and focused on their primary objective of financial system resilience.

Finally, it is necessary to reflect on the wider range of policy measures that will affect the capacity of the financial sector to support the transition. Broader climate objectives need to be addressed consistently by EU institutions, and wherever possible, interventions should be complementary and not overlap. For instance, the EC should consider how potential policy measures pertaining to prudential factors correspond to activities from EU financial regulators including the ECB, which has released its own consultation on environmental risk management guidelines. There are likely to be areas where action by the EC can help close gaps – including in exposures to physical climate risks. In this context, action by the EC to facilitate the provision of climate-related physical risk data (e.g. natural disasters) would be a valuable public good.

2. Broadening and deepening the EU Sustainable Finance agenda

2.1 Addressing new and emerging ESG issues

Sustainable finance measures should consider a wide range of emerging and interlinked ESG issues, but must recognize complexity in quantifying, assessing, and measuring risks and impacts. The RSFS Consultation Document makes several references to the need to better account for a wider range of emerging ESG issues in the context of sustainable finance measures, including biodiversity loss. **We strongly support the consideration of biodiversity loss in the context of future EC work on sustainable finance**, considering the foundational significance of biodiversity for the functioning of ecosystems upon which all economies rely. However, we recognize that the frameworks, tools and methodologies currently available for assessing, quantifying and disclosing a broader suite of

[13] IMF 2020 "Global Financial Stability Report – Chapter 5: Climate Change: Physical Risk and Equity Prices" (May 2020)
[14] NGFS 2020. "Status report on financial institutions' practices with respect to risk differential between green, non-green and brown financial assets and a potential risk differential."
[15] IIF 2019 "The case for simplifying sustainable investment terminology."

environmental risks and opportunities, including biodiversity and natural capital, are less mature than those available for climate-related risks. Any future regulatory expectations should account for this. Going forward, we fully support the development of such frameworks, tools and methodologies at the global level.

The COVID-19 crisis has brought a wider of ESG issues into the spotlight. Social issues such as employee treatment (e.g. paid sick leave), contractual arrangements, and management of suppliers are now under the spotlight. Corporate behaviour to mitigate risk of virus transmission has created new reputational risks. Recognizing the complexity of our current era, we would encourage the EC to wherever possible align priorities of the RSFS with this new reality.

2.2 Extending the scope of frameworks and instruments

The RSFS Consultation Document discusses the potential development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts ('brown taxonomy'). **We would not encourage the EC to pursue development of a 'brown taxonomy' at present.** There are a range of costs and benefits associated with the development of an additional taxonomy instrument, considering the time, human resources, and political capital required. Other key issues include:

- **Limited experience with implementation:** We recognize that there is a need for clear definitions for financing and investment in terms of green credentials. The taxonomy for green economic activities provides one element of this. However, even the most ambitious financial institutions have very limited experience in implementing the taxonomy and integrating it into everyday financial decision-making. This experience would be valuable and instructive for the EC in its decision to pursue the development of a specific brown taxonomy, which is likely to be time consuming and resource intensive.
- **Clarification of objectives:** The objectives of developing a brown taxonomy are not clear, specifically in terms of its application in the context of disclosures, or as a way to gather information on the risk performance of high-carbon assets. On the former, a relatively simple classification would suffice, building on other instruments setting out frameworks for assessing sectors exposed to transition risks (e.g. TCFD Frameworks). On the latter, other approaches (e.g. targeted studies engaging a small group of firms to report risk performance information against a consistent set of definitions) are likely to be more efficient and yield more robust results. While there might be merit in developing a brown taxonomy for disclosure and reporting purposes, we consider it premature to develop and use such a taxonomy for prudential and/or wider risk management purposes, as such a use might discourage investments in transition activities.
- **Other ESG issues are more pressing.** More robust accounting of carbon sinks and natural capital might be a better use of limited resources, considering that less work has been done in the space. Under current trajectories, biodiversity and natural capital losses (e.g. large-scale deforestation) may prove to be more significant for the global carbon budget over coming decades than marginal decarbonization of high-emitting industries where transition opportunities exist (e.g. power generation).

2.3 Further regulation and development of new standards or guidance

The RSFS Consultation Document discusses the potential for development of new standards for sustainable finance products. For emerging product segments, including those where sustainability benefits, improvements or outcomes are challenging to measure or otherwise demonstrate, it is evident that clear frameworks and guidelines are necessary to guard

against risk of greenwashing. The key question is whether or not such frameworks should be developed by the market, or mandated through policy, and the costs and benefits of such approaches in an international capital market context.

Market institutions have been successful in coalescing around key outcome-based and operational standards for financial products' green credentials, including on the basis of classification of use of proceeds. The evolution of green bond markets, which were able to grow on the basis of market-led principles, is instructive in this regard. Sustainability-linked loans and bonds, which are general-purpose products with financial conditions are linked to corporate performance, are developing rapidly. New frameworks for sustainability-linked products, including those released by ICMA, are an important contribution that can help underlie strong market discipline.

We think it makes sense to for the EC to allow time for a monitoring period how these relatively new market solutions are working. This will allow time for markets to continue to adapt in a self-regulatory way if necessary before intervening with further external regulation. Similarly, we do not think there is a need to provide additional detailed guidance on how private clients are asked about sustainability preferences. As with the introduction of new regulatory frameworks that are EU-specific, development of an EU-level standard may constrain future harmonization across jurisdictions.

3. Strengthening international coordination and alignment

3.1 Assessment of current level of coordination

Given the global nature of the climate change agenda, globally coordinated supervisory and regulatory responses are essential to encourage the development of well-aligned and considered frameworks across jurisdictions. However, signs of fragmentation are already evident in areas such as prudential regulation and supervision, market and conduct regulation, taxonomy and disclosure[16]. It is for this reason that we would highlight the importance of EU engagement in a broad range of coalition efforts, including those working beyond the financial sector (e.g. the Coalition of Finance Ministers for Climate Action), to ensure that all countries develop net zero transition plans and financing strategies, as the EU has done with its green deal.

3.2 Priorities for international coordination and harmonization of policy instruments

We would encourage the EC to considering the following priorities for harmonization and standardization at the global level:

- **ESG Disclosure**: Steps should be taken to develop a harmonized cross-sectoral framework for ESG disclosure across jurisdictions. In the longer term, a durable solution could be the emergence of a generally accepted international non-financial reporting standard for corporates and financial institutions. There are indications that the EC has already commenced initial work to develop an EU-level non-financial reporting standard, even though public consultation on the NFRD (which addressed this very issue) has only recently concluded. We believe an EU-level standard could be counterproductive to the EC's own objectives of greater global consistency and coherence in sustainable finance

[16] Topics discussed in IIF 2020, "Sustainable Finance Policy & Regulation: The Case for Greater International Alignment" (March)

policy frameworks. The IIF would instead encourage the EC to support a coordinated effort between the G20, FSB (building on the efforts of the TCFD), accounting standard setting bodies (IASB and FASB) and those initiatives involved in the Corporate Reporting Dialogue to work within their mandates to align and consolidate ESG disclosure frameworks for financial institutions and other corporates. Given the importance to and impact on financial institutions, we would recommend that the EC also encourage relevant prudential standard setting bodies (including the BCBS, IAIS and IOSCO) to be engaged in the process to help shape the framework for financial institutions.

- **Climate-related scenario analysis exercises for supervisory purposes:** We acknowledge the thought-leadership of the EC in understanding the financial risks from climate change. However, the scope and approaches that national authorities are currently pursuing in climate-related scenario analysis differ widely. While a number of authorities have committed to base their exercises on scenarios that the NGFS released in June, scenario choice is only one design consideration that could distinguish exercises. We would urge the ECB and national-level central banks and supervisors to align their approaches as far as possible and avoid fragmentation at the European level. At a higher level, the IIF would encourage a more global approach to such analysis exercises—ideally in collaboration with industry—to cultivate a common baseline in terms of approaches and framework with a view to meaningful and comparable results. In addition, global standard-setting bodies and/or the NGFS could develop global exercises with firms, akin to the BCBS Quantitative Impact Studies (QIS) that have been performed in relation to the bank capital framework since 2001.[17]
- **Taxonomies & definitions:** Work to develop sustainable finance taxonomies continue at a national, regional and multilateral levels. While the energy behind such efforts is commendable, fragmented outcomes would hinder comparability and inhibit market and policy development. Given that the industry will need to use the taxonomies that are developed, it is important for all of the different parts of the financial sector (banks, institutional investors, insurers etc.) to understand what underlies them, how they are being developed and to work with the emerging standards to best determine how they can be integrated into existing market infrastructure. It is important to drive as far as possible towards an aligned and internationally consistent taxonomy, potentially with some national/regional variations.

The EU authorities, including the ECB, can play an important role in escalating discussion of important prudential topics to the international level through the EU's participation in the global standard setting authorities, and also through the International Platform on Sustainable Finance (IPSF). To date, there has been very limited opportunities to review progress within the IPSF, and we would urge the EC to strengthen transparency over the IPSF's activities, as well as creating a structured forum for engagement with industry. The IIF would be pleased to contribute industry perspectives into a potential dialogue on policy development and implementation, including on topics such as ESG disclosure, definitions and terminology, debt sustainability, market infrastructure, and sustainable finance in emerging markets.

3.3 Other Coordination Priorities

We would propose that the EC consider the following three key actions to facilitate global coordination of the private sector (both financial and corporate) to deliver on the goals of the Paris Agreement and the SDGs:

[17] For a history of BCBS impact studies, see https://www.bis.org/bcbs/qis/overview.htm and https://www.bis.org/bcbs/qis/.

i) Innovative solutions for sovereigns: Given high sovereign debt burdens across advanced, emerging, and frontier economies in the run-up to the pandemic and the projected sharp rise in government indebtedness as a result of fiscal stimulus spending combined with decreased tax revenue, public sectors around the world need financial instruments that will help protect them from future ESG-related crises – including those linked to climate change – while also channeling capital towards sustainable objectives. Protection includes adaptation to ESG-related risks but also rapid support in times of crisis, in contrast to some existing instruments that have not been able to deliver timely relief[18]. These financial instruments include:

- **SDG-aligned bond funds:** These funds would invest in SDG-linked debt and potentially be especially useful for emerging markets (either within the EU or beyond) seeking borrow for SDG-related projects at a lower interest rate. An SDG bond fund could achieve this with a first-loss absorbing junior tranche leveraging an international financial institution's (e.g. a regional development bank) balance sheet strength for a credit uplift. The EC's Next Generation EU budget proposal includes measures to strengthen InvestEU in order to mobilize investment across the EU in areas such as sustainable infrastructure, and also includes the creation of a new Strategic Investment Facility to invest in key value chains in the context of the green transition. Finding a way to link SDG-aligned bond funds to InvestEU and/or the Strategic Investment Facility with potential EBRD or EIB support, where necessary, could help crowd in private investment in sustainable infrastructure and green value chains.
- **Considering ESG risks in sovereign debt instruments:** Sovereign bonds and loans that include a debt re-profiling feature could provide liquidity relief in times of ESG-related crises, and help a country avoid a disorderly debt restructuring. Some Caribbean countries, like Grenada and recently Barbados, have included "hurricane clauses" in restructured bonds, which permit a temporary debt moratorium if the country were to be struck by another natural disaster. Exploring the potential for broader use of such clauses to account for impacts of pandemics, climate-related damages, or other social and environmental risks, could be worth considering.
- **Debt-for-nature swaps:** For sovereigns that enter debt distress, connecting sovereign restructuring to commitments to invest in environmental goals may be an effective instrument.

ii) Bridging the infrastructure, SDG and low-carbon investment gaps: Globally the cumulative investment gaps infrastructure, SDG and low-carbon areas stand at $100 trillion over the 2020-2040 period, highlighting the opportunities for deeper private sector engagement. In GDP terms, the gaps in Africa dwarf those in other regions of the world, though there are comparable low-carbon investment needs in Asia. The sustainability investment gap in Europe amounts to roughly €180 billion per year[19], and although the European Investment Bank already bridges part of that gap, the private sector is needed to fill in the remainder. The lack of bankable sustainable infrastructure projects remains a critical challenge. Financial institutions' allocations to infrastructure assets continue to be far below target[20], and infrastructure projects are an overweight favorite for institutional investors[21]. We would encourage the EC to explore partnerships with Emerging Market economies to support the development of project pipelines

[18] See https://www.ft.com/content/949adc20-5303-494b-9cf1-4eb4c8b6aa6b.
[19] See https://www.ebf.eu/priorities/financing-growth/sustainable-finance/. See https://www.ebf.eu/priorities/financing-growth/sustainable-finance/
[20] See https://docs.preqin.com/samples/2019-Preqin-Global-Infrastructure-Report-Sample-Pages.pdf. See https://docs.preqin.com/samples/2019-Preqin-Global-Infrastructure-Report-Sample-Pages.pdf
[21] See https://www.swfinstitute.org/news/80084/survey-sovereign-wealth-funds-and-pensions-see-quarantine-end-as-the-biggest-driver-of-equity-returns.

for sustainable investment, including through engagement at the sovereign level. Recognizing the challenges inherent in this work, and the multitude of entities seeking to achieve this objective, we would encourage the EC to identify a select set of issues which could help catalyze the development of national-level efforts across a suite of countries with similar economic conditions, financial system structures, and investment needs.

iii) Incentivizing ESG- and SDG-related instruments, including those facilitating the transition to carbon neutrality: Although more research is needed to explore the merits of a green supporting factor and/or a brown penalizing factor in capital adequacy risk weights[22], policymakers should consider designing tax incentives on ESG- and SDG-linked securities, whether for issuers, investors or both. Doing so can help increase ESG and SDG bond issuance, and attract private investment towards these ends in the process.

Concluding Remarks

On behalf of the IIF Sustainable Finance Working Group, we hope that these global industry perspectives will contribute to your efforts to formulate a Renewed Sustainable Finance Strategy and, more generally, to the EU's efforts to enhance international coordination on sustainable finance issues. We would appreciate the opportunity to discuss any of these matters further and invite you to contact Sonja Gibbs (sgibbs@iif.com) and Andrés Portilla (aportilla@iif.com) should you have questions or comments.

Sincerely,

Daniel Klier
Group Head of Strategy and Global Head of Sustainable Finance, HSBC
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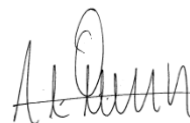

[22] See https://www.bis.org/publ/othp31.pdf. See https://www.bis.org/publ/othp31.pdf