Summary Report of the High-Level Conference on Sustainable Finance 22 February 2018 in Berlin

The final report by the EU high-level expert group on sustainable finance (HLEG) was delivered on 31 January, the Commission, in the meantime, "responded" with an action plan on 8 March and the March European Council will need to take a stance on it as well. More than 2 years after the "Paris Climate Deal" and the entry into force of the "Sustainable Development Goals", is Europe ready to take sustainable finance to the next level, making finance work for sustainable development and for protecting our climate?

This and other questions were discussed at the high-level conference on sustainable finance, organized by DIW Berlin and the European Commission's Representation in Germany in co-operation with the German Hub for Sustainable Finance on 22 February 2018 from 12 pm till 6 pm.

I. Introduction and key note speeches

The conference was opened by **Karsten Neuhoff**, Head of the Climate Policy Department at the German Institute for Economic Research (DIW Berlin). The Representative of the European Commission in Germany, **Richard N. Kühnel,** delivered the welcome note to the participants of the conference.

Around 200 experts from German and European politics, ministries, the financial sector, NGOs, academia, and business associations took part in the all-afternoon conference at the European House in Berlin. The event was organised jointly by the European Commission, DIW Berlin and the Hub for Sustainable Finance Germany (H4SF).

Valdis Dombrovskis, the Vice-President of the European Commission, explained in his opening keynote speech the Commission's thinking about sustainable finance: „There is an increasing realisation that we need to re-orient our financial system towards sustainability and enable it to better channel funds towards green investments". This, he emphasized, was not only a moral imperative but also justified from a risk perspective. In 2017, the amount of catastrophe-related losses covered by insurance reached an all-time high. "Finally, and perhaps most importantly, it is an economic opportunity that we cannot afford to miss," Mr. Dombrovskis said. Climate policy was an opportunity for Europe to become a magnet for green investment and technological development.

According to Vice-President Dombrovskis, reducing carbon emissions by 40 percent until 2030 in Europe will require additional investment of 180 billion euros per year, much more than the public sector's capacity. To fund the transition to a low carbon economy, private investment was needed. The Commission had called for the High Level Group's report to elaborate proposals for mobilising green investment and integrating sustainability into all aspects of the financial system.

To follow up on the report, the Commission's first priority was to establish an EU classification system ("taxonomy") for sustainable assets and activities, Mr. Dombrovskis said. "The taxonomy will be a living document in order to keep pace with change on green and sustainable investment." Building on this classification, the Commission was also looking into introducing a "green supporting factor" to lower capital requirements for some climate-friendly investments.

The second key note speech was given by **Michael Meister**, Parliamentary State Secretary at the Federal Ministry of Finance. He welcomed the Commission's initiative on sustainable finance and commended the report of the High Level Group as the probably most ambitious blueprint for sustainable finance existing. In implementing the very valuable recommendations, he also called for realism. E.g., for taxonomy to provide reliable guidance to markets over time, it needed to remain flexible to be able to deal with dynamic change and possible conflicts between climate and other environmental goals. "We don't need a fixed check list," Mr. Meister said. "We need a consistent meta-framework as an evolving tool." Mr. Meister was sceptical towards the idea of a green supporting factor "just because an investment is labelled green but does not have a lower risk".

II. Opening debate: the policy context

The first speaker in the opening debate was **Christian Thimann**, Senior Executive of AXA, who had chaired the High Level Expert Group on Sustainable Finance. A year of intense work had gone into the report published on January 31, he said. There were three questions that the group had tried to address, and the recommendations in the report could be mapped to these questions:

1. How can we reorient capital streams within the financial system?
2. How do we orient the financial system better towards long term?
3. How do we better manage risks, whether related to the climate, environment, social etc?

With this background, the participants of the opening debate – Vice-President Dombrovskis, Mr. Thimann, **Marcel Fratzscher**, President of the German Institute for Economic Research, the principal initiator and organiser of the conference, and **Joachim Wuermeling**, Member of the Executive Board of the Deutsche Bundesbank – started into a lively debate moderated by **Kristina Jeromin** of Deutsche Börse Group. Here is an overview of the most important issues discussed:

On taxonomy:

In response to Mr. Meister's suggestions, Mr. Dombrovskis pointed out that taxonomy would evolve over time. It would start with the effects on climate as this was relatively simple because carbon emissions could be quantified, but would over time include other environmental aspects. "We need to set up a governance structure on these issues that will work," he added. "What we consider sustainable today may not be considered sustainable tomorrow, but we do have to start somewhere." Taxonomy was urgently needed as a base for further action – for instance for creating EU eco labels and green funds.

On the "green supporting factor":

The vice-president described the proposed green supporting factor as "a limited reduction in capital requirements responding to certain policy goals." He admitted that this was very controversial. Yet it had been done for SMEs, and that wasn't free of risk, either. If the EU wanted banks to support more green investment, this kind of regulation would help. The European Parliament, he added, had voiced the same idea. "But we are open to discussion with member states."

On introducing a "brown penalising factor" as an alternative to the green supporting factor:

Mr. Dombrovskis said that while both were possible, the Commission was leaning towards the green supporting factor. Mr. Thimann added that AXA had disinvested from coal without any green incentive, a decision that was based on corporate responsibility as well as investment considerations. Mr. Fratzscher disagreed: penalising was the wrong word, he said. With coal, it was known that companies transferred costs and risks to the society as a whole. "A functioning market means that those who take risks need to carry the costs."

On the role of incentives:

Mr. Fratzscher emphasized the importance of setting the right incentives for players in the financial sector. "Companies and financial institutions have very different risk preferences from society as a whole which looks much more at the long term," Mr. Fratzscher said. "So we need to set the right incentives for financial and non-financial institutions to take into account externalities."

On the green sector in banking:

Not just the government, but also Germany's Bundesbank supports sustainable finance because it is responsible for the resilience of the banking sector, Mr. Wuermeling said. For now, the market for green investment instruments was simply neither deep enough nor broad enough. Yet the green sector had an enormous dynamic. From a low base, the volume of green bonds had risen by 60 percent in 2017 and might go up another 70 percent this year

On short termism:

Mr. Dombrovskis suggested that reviewing the fiduciary duty in order to include non-financial disclosure could help. Mr. Wuermeling added that financial risks having to do with climate change were already covered by banking supervision.

On creating a pipeline of green projects:

There was no lack of private or public money for investment in infrastructure, Mr. Thimann said. What was lacking was technical development expertise. If the EU could set up a group of specialists to help develop sustainable infrastructure projects, this could create a pipeline of green projects.

To wrap up the discussion, Mr. Thimann pointed to three pitfalls that need to be avoided in the transformation towards sustainable finance: falling into a "planned economy" spirit and underestimating the potential of technological innovation in this area complexifying further financial and other regulation and thereby stifling business development and investment; and impacting a level playing field with other large constituencies in advanced and emerging economies. Mr. Wuermeling emphasised that great care was needed not to harm the functioning of markets. “Green finance is not nice to have, but an essential contribution to stability,” the Bundesbank official said. Mr. Fratzscher set the same tone: “Set the right incentives and trust that market will function and come to the right conclusions.”

III. Session A: Finance for sustainability – the demand for sustainable finance from firms, households and the public sector

The participants of this panel were **Berthold Goeke**, Head of the Climate Policy Division at the Federal Ministry for the Environment, **Gerhard Schick**, Member of the Bundestag and expert for fiscal policy for the Greens, and Karsten Neuhoff, head of the Climate Policy Department at DIW Berlin. Sustainable finance, Mr. Goeke explained, had two main aspects: securing the stability of the financial system by systematically integrating risks; and mobilising the necessary financial means towards sustainable goals. The debate was moderated by **Karsten Loeffler** of UNEP.

On creating a more long-term approach in the markets:

“We need a long-term environmental strategy in order to create certainty among market participants,” Mr. Goeke said. From a legislator’s perspective, Mr. Schick pointed out that some uncertainty about future regulation was inevitable due to technological developments or political changes. Nevertheless, governments and parliaments could try to create more trust. For instance, there should be clear phasing-out agreements for coal.

On the role of public banks:

“In Germany, we have a public finance system that is not bound by the short term,” Mr. Schick said. “About a third of our finance system – for instance the Sparkassen and Landesbanken – could behave differently from private institutions, but currently, they don’t. We need an overall public finance system strategy towards sustainability.”

On the Emission Trading System (ETS):

Mr. Goeke admitted that the current ETS price was not high enough to achieve the shift to lower carbon emissions. There would have to be a discussion about further instruments for carbon pricing, including a debate with France over carbon tax. “Other sectors than energy will have to be integrated into the efforts of finding a price, too,” Mr. Goeke said.

On scenario development:

Mr. Schick recommended developing a shadow carbon price and using it as an instrument in supervision. “It would help companies recognize that they might get into difficulty if the carbon price rises beyond a certain level. In that sense, it would be a good stress test.” Mr. Neuhoff agreed that scenarios based on different carbon prices would push companies into green investments.

On the Climate Policy Act:

Mr. Goeke and Mr. Schick both spoke out in favour of setting clear targets in legislation – effectively a Climate Policy Act, even if the name might be different. “I don’t understand why the Commission focusses so much on voluntary recommendations,” Mr. Schick said. “Politics is there to set rules.” Berlin should coordinate its climate legislation with Paris.

IV. Session B: The firm level

The next panel, moderated by DIW’s Karsten Neuhoff, brought together experts from associations and private companies: **Michael Schmidt**, Managing Director at Deka Investment GmbH, Alexander Bassen of the German Sustainability Council, **Mirjam Wolfrum**, Head of Policy Public Affairs at CDP Europe and **Steffen Schwarz-Hoefler**, Senior Manager Sustainability Strategy, Reporting and Ratings, at ThyssenKrupp AG.

On disclosure and ratings:

Over the last ten years, as ThyssenKrupp was trying to improve its rating with CDP, disclosure had become part of its core business, Mr. Schwarz-Hoefler said. During this time, the company learnt that climate-related data could not be left out of its management reports. Figures, however, could be very past-oriented. ThyssenKrupp had greatly reduced its carbon emissions over the past two years. Yet this had happened not because of cleaner technology, but through divestment.

On non-financial information: accounting on environmental, social, and governance (ESG) issues:

Mr. Bassen pointed out that for most companies, there was a positive link between financial performance and performance in terms of sustainability. Ms. Wolfrum added that non-financial information was often highly relevant in financial terms as well. Therefore it should be integrated into the financial reporting. Mr. Schmidt also said that too much different information in too many different reports could be confusing. But while Mr. Schmidt called for standard key ESG data to be included in the financial reporting, Mr. Schwarz-Hoefler said the relevant data differed too much from one company to another to allow for a unified list of criteria.

On the use of forward scenarios:

Mr. Schmidt pointed out how important it was for companies to analyse their business model under different scenarios. “Forward scenario management is about pathways we can see: Do you need to transform now, so that you still have a business in ten years?” Thinking in terms of scenarios was also necessary to identify what could end up as stranded assets.

V. Session C: Financial policy and markets

How ambitious should policy be? This was the key question debated by **Silvia Kreibiehl** of the UNEP Collaborating Centre for Climate & Sustainable Energy Finance at Frankfurt School of Finance & Management, **Katharina Latif**, Head of Corporate Responsibility at Allianz SE, and **Gerald Podobnik**, Global Head of Capital Solutions & Sustainable Financing at Deutsche Bank. The Head of Sustainable Finance at WWF Germany, Matthias Kopp, moderated the panel.

On the importance of taxonomy and rules:

Mr. Podobnik said there was enormous interest in green finance, but taxonomy needed to be clear. "As banks we can be enablers to move capital streams, but we need to know the regulatory environment because everything we do is regulated," Mr. Podobnik said. This thought was echoed by Ms. Latif: From the perspective of a large asset owner like Allianz, taxonomy was the most important issue. If regulators got that right, the financial markets would be very happy to make use of it.

On mainstreaming green investments:

According to Mr. Podobnik, greenness is beginning to show in some market segments, but only in terms of a few basis points. "We see this as a start," he said. "I think it will become meaningful in the next three to four years." Ms. Latif said, so far only niche investors were favouring green bonds over conventional bonds. Ms. Kreibiehl added that it was difficult to measure the spread as no mainstream private sector institutions had yet issued both green and ordinary bonds.

Other suggestions:

- Set up indices to include ESG, Ms. Latif said. "This could be one of the little tools that could have a huge effect on the market."
- Regulation of the financial sector needs to go hand in hand with real economy regulation to maximise its efficiency, Ms. Kreibiehl said.
- Create a rule book with specific, tangible rules that every bank in Europa can follow if it wants to green itself, Mr. Podobnik suggested.

VI. Closing Debate – the outlook

The closing debate, moderated by Germanwatch CEO **Christoph Bals**, focused on the crucial next steps, with contributions from **Olivier Guersent**, Director General of the European Commission's DG FISMA, **Levin Holle**, Director General for Financial Policy at the Federal Ministry of Finance, **Chris Barrett** from the European Climate Foundation and **Kristina Jeronim**, Head of Group Sustainability for the Deutsche Börse Group.

Mr. Guersent emphasised that the Commission will be very ambitious and quick with its proposals on sustainable finance. The action plan will be presented in March. "We will take on board most, if not all recommendations of the High Level Group," Mr. Guersent promised. "We will also come quickly with the first deliverables." Because of the European Parliament elections in 2019, any measures needing legislation will have to be passed until March 2019. In line with Mr. Dombrovskis, Mr. Guersent also spoke of taxonomy as the first priority, followed by legislation on fiduciary duties.

Mr. Holle of the German Finance Ministry welcomed the Comission's leadership and reiterated the Germany's commitment to make relevant progress and intergarte sustainable finace into the entire financial system. In order to achieve as much progress as possible, he pointed to the management challenges involved, including the tight time frame. “There are some elements that are technically not that easy, and some that can become politically challenging” he warned. Also against this backdrop in some instances it might be conducive to success to consider where government prescription was necessary and the most effective, and where it would be better to rely on a more market-driven approach.

On a policy level, things were moving quickly Mr. Barrett said. “The Paris agreement is the world’s greatest example of regulatory overhang: governments have promised to act, and when they do, there will be significant reaction,” he predicted. Change was also being driven by the dramatic fall in cost of renewable technologies and by changes in consumer demand.

“We need more transparency, so we need to modify the non-financial reporting guidelines,” Ms. Jeronim concluded. “We need people to understand which kind of company they are investing in. Then we will not only see the niche of green products growing but change in the system as a whole.”

Links:

The full conference programme and this report can be downloaded from

http://www.diw.de/en/diw_01.c.579716.en/research_advice/sustainability/climate_policy/events/high_level_conference_on_sustainable_finance.html

The final report by the EU high-level expert group on sustainable finance (HLEG) can be downloaded from

https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

Sustainable finance: Commission's Action Plan for a greener and cleaner economy can be found here

http://europa.eu/rapid/press-release_IP-18-1404_en.htm