Technical Expert Group on Sustainable Finance (TEG)

- State-of-play, July 2018 –

On 5 July 2018, the members of the newly-created Technical Expert Group on Sustainable Finance kicked off the work on four key actions outlined in the Commission's Action Plan on Financing Sustainable Growth.

The recently established Technical Expert Group on Sustainable Finance (TEG) has had two plenary and two sub group meetings for each of its four workstreams since its inception in early July. These meetings focused on the mandate and deliverables of the group as well as the key questions surrounding the group's four tasks, which are to assist the Commission in developing:

- an EU classification system – the so-called **taxonomy** – to determine whether an economic activity is environmentally sustainable;
- an **EU Green Bond Standard**;
- **benchmarks** for low-carbon investment strategies; and
- **guidance** to improve corporate disclosure of climate-related information.

The TEG will continuously consult with the European Commission on existing and future environmental and climate policy developments, to ensure proposals that are dynamic and synchronised with technology and policy innovation. The sub groups will also be mindful of other non-EU developments in sustainable finance. Each task and product of the TEG is meant to provide a strong contribution to the EU's competitiveness as it transitions to a low-carbon, sustainable economy.

Taxonomy

To encourage sustainable growth, industry, investors and governments need a clear understanding about which economic activities are environmentally sustainable. Currently, no classification system exists at EU-level and market-led initiatives of recent years are not comprehensive enough to sufficiently reflect all EU environmental and broader sustainability priorities. An EU taxonomy, commencing with definitions of environmentally sustainable activities will build on similar, existing market-led and Member State-based initiatives. The aim of such a system is to facilitate the achievement of the EU's mid- and long-term GHG emissions targets and environmental policy objectives by encouraging capital flows to environmentally sustainable economic activities. The taxonomy will serve as the basis for the future establishment of standards and labels for sustainable financial products that provide sustainable capital flows.

In May 2018, a proposal for a regulation on the establishment of a framework to facilitate sustainable investment was put forward by the Commission. The proposed regulation provides the framework for the taxonomy work of the TEG.

The proposed regulation is expected to be discussed and negotiated by the European Parliament and Member States over the course of 2018 and 2019. Once adopted, the legal text should empower the Commission to adopt delegated acts containing a list of environmentally sustainable activities, together with their technical screening criteria. This would be based on the report provided by the TEG in June 2019, which would also include an explanation of how the sectors were selected, the determination of technical screening criteria in compliance with the taxonomy proposal, as well as an analysis of the potential economic, financial and environmental impacts.

Progress achieved

With a view to building on existing initiatives, the group members focused the first two meetings in July on reviewing the work carried out in 2017 and 2018 by the Commission's High-Level Expert Group on Sustainable Finance (HLEG) (in particular the climate change mitigation taxonomy publicly available here) together with commercially available taxonomies (e.g. Climate Bond Initiative). The group also discussed using existing EU statistical classifications of economic activities and products (NACE and CPA), as well as EU environmental classifications (e.g. CREMA and CEPA), for developing the taxonomy.

The group members will work during the summer on mapping the existing classifications and proposing a sector framework that would best serve the main users of the taxonomy (financial market participants), as well as facilitate the future tracking of financial flows to sustainable investments. Further preparatory work over the summer includes:

- gathering and synthesising available information on mitigation and adaptation-related economic activities (e.g. first two environmental objectives);
- developing knowledge on dealing with trade-offs between environmental outcomes and thresholds (i.e. 'not significantly harming' principle);
- devising a strategy on obtaining expert input and stakeholder feedback.

EU Green Bond Standard

Green bonds allow issuers to seek funding from investors in order to finance or re-finance 'green' projects, assets or business activities. Building on the EU sustainability taxonomy and drawing on current best practices, an EU Green Bond Standard can protect the integrity of and trust in the green bond market, by giving guidance to issuers as well as enabling easier access for investors seeking such a product.

Progress achieved

The members of the subgroup on the EU Green Bond Standard (GBS) have started the work on the guiding principles that could form the basis for such a standard, based on approaches that are currently present in the market. Experts deliberated some of the potential issues that will need to be addressed, such as external review and verification processes and reporting.

It was agreed that the EU GBS would draw on the EU taxonomy to be developed by the taxonomy subgroup with an external verification process envisaged, as is common practice for green bonds in the EU market already today. Discussions regarding the granularity of requirements placed upon the verification process and the scope of the EU GBS are ongoing. Given the relatively well-developed EU market for green bonds, the EU GBS could focus on maintaining and reinforcing market integrity and establishing the basis for a recognised international standard.

The group decided that their report would encompass the following three thematic sections (i) purpose of green bond standard; (ii) main features of the standard; and (iii) external reviews and reporting. Links to other frameworks, actions and working groups will be taken into account. Topics like additionality and incentives for issuing green bonds will be subject to further evaluation.

Benchmarks

Benchmarks play a central role in the price formation of financial instruments and provide a useful tool for investors, as they allow tracking and measuring performance and allocating assets accordingly. Traditional benchmarks reflect the status quo and their methodologies, as a result, reflect sustainability goals only to a limited degree. Existing ESG benchmarks lack transparency with regards to their methodologies and fund managers pursuing a low-carbon or Paris-aligned investment strategy lack a reliable index to benchmark their performance against.

<u>Progress achieved</u>

The subgroup has started discussing selection criteria, data needs, and weighting methods for underlying assets of such benchmarks. This includes determining the key elements of minimum standards for low-carbon and positive carbon impact benchmarks.

The importance of ensuring the comparability and reliability of data used for the construction of these benchmarks is clear. In this context, the experts have started deliberations on the various greenhouse gas emission scopes (1, 2 and 3) to develop the positive carbon impact benchmark. As part of that, clear definitions of the benchmark objectives have been identified as success parameters: The low-carbon benchmark (LCB) would be used for risk diversification and positive carbon impact benchmark (PCIB) for investing with impact.

Climate-related disclosures

In the context of the update of the non-binding guidelines of the Non-Financial Reporting Directive (NFRD), the TEG has started to work on the question of how to improve climate-related disclosures.

The aim of the work is to help investors make sound investment decisions. This can be achieved by improving transparency and comparability of climate-related information that is provided by market actors. Ideally, clear and transparent climate-related disclosure leads to more insight into how climate risks and opportunities may influence return on investment. As such, it will also help investors to make better investment decisions while understanding their impact on climate change.

<u>Progress achieved</u>

The findings of the group will feed into a report on climate-related disclosures, which may include additional information. For example, the different ways in which disclosed data can be used by the investment community may be relevant to be included in the TEG's report as well.

Starting points for the work are the existing guidelines to the NFRD and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The work of the group will build on and further develop the TCFD recommendations. For example, the group has also taken up the challenge of identifying disclosure metrics that could give meaningful information about the impact a company has on climate change. Both climate change mitigation and adaptation are part of the scope.