Response to the Consultation on possible legal or alternative measures to strengthen the contribution of financial institutions to the climate transition

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Reclaim Finance

Question 1:

During the 2019-2024 mandate, MEPs contributed to the European Green Deal, which set ambitious climate targets for the EU. However, developing solutions to meet these goals does not come cheap. The European Commission estimates that an additional €620 billion will be needed each year until 2030, where the European Court of Auditors gives a less conservative figure, advocating for a yearly additional €1000 billion. To fill the gap, both public and private finance will have to be heavily mobilized. Nonetheless, according to data from the International Energy Agency (IAE), and supported by the EU Commission, between 80 and 85% of the money needed for the EU transition must come from the private sector.

But today, financial institutions are not on track to reach our climate goals. Since 2015, the European banks have poured over $767 billion USD on fossil fuels. Unless private finance rapidly changes trajectory, it will be unable to mobilize the capital needed to achieve European climate objectives. Instead, private financial institutions will continue to exacerbate climate change despite their stated ambitions. In so doing, the finance sector will increase the risk of financial crises, the costs of which are likely to be borne by member states and their citizens. Indeed, the fossil fuels supported by private finance represent a huge reservoir of assets that could–and should–depreciate during the transition. Beyond the fossil fuel sector, many sectors and activities must also decarbonize rapidly and could be deeply affected (transport, steel production, cement, etc.).

In this context, new measures are urgently needed to ensure that financial institutions align with climate goals. These new measures include:

1. The mandatory adoption of robust transition plans and their enforcement (see: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf).
2. The mainstreaming of the use of the do no significant harm (dnsh) principle.
3. The integration of the high risk linked to fossil fuel assets in prudential frameworks.
4. The establishment of a mandatory ratio to boost the financing of sustainable energy.

These measures are notably explained in Reclaim Finance's note on the EU Elections 2024: https://reclaimfinance.org/site/en/2023/08/30/eu-elections-our-four-key-proposals-for-private-finance/

Question 2:

As underlined in our answer to Question 1, additional legislation is needed to ensure financial institutions contribute to the transition. It is essential to progressively align all financial services provided by institutions with climate goals, starting with ending financial services that are especially detrimental to these goals (for example services provided to new fossil fuel projects and/or the companies that develop them) and ramping up support to key sustainable activities (for example solar, wind energy and grid investment).

As explained in Question 1, new legislation can notably build on EU rules with:

1. The mandatory adoption of robust transition plans and their enforcement.
2. The mainstreaming of the use of the do no significant harm (dnsh) principle.
3. The integration of the high risk linked to fossil fuel assets in prudential frameworks.
4. The establishment of a mandatory ratio to boost the financing of sustainable energy.

These legislations should:

- Apply to all financial institutions (banks, asset owners and asset managers, insurers, private equity). While specific measures can be adopted to facilitate the journey for SMEs, this is largely irrelevant to financial institution.
- Focus on support provided to activities that play a significant role in the climate crisis (fossil fuel, heavy industry, agriculture..) and activities that could significantly contribute to mitigate it.

Question 3:

We do not see any objections to introducing new legislation. We underline such legislation can notably build on a significant body of: 1) National commitments and policies; 2) EU rules on climate and finance.

Question 4:

Since the Paris Agreement was adopted, many financial institutions took voluntary pledges on climate. Alliances - such as those united under the Glasgow Financial Alliance for Net-Zero (GFANZ) - where launched, making the headlines, and promising to align financial institutions with climate goals. In parallel, the offer of so-called "green" or "sustainable" financial products increased, with an increasing number of funds making climate-related claims and a growth of green bonds (and other types of sustainable bond) issuance.

After years of following this trend, it is evident that all these voluntary initiatives and offering changes are not sufficient:

- The financial institutions that took "net-zero" commitments and are members of alliances are yet to change their practices. They are instead continuing to fuel the climate crisis (see the report: https://reclaimfinance.org/site/en/2023/01/17/throwing-fuel-on-the-fire-gfanz-members-provide-billions-in-finance-for-fossil-fuel-expansion/).
  The ECB himself noted in a recent report that EU banks are not aligning with climate goals, despite many of them having made commitments (see: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.bankingsectoralignmentreport202401~49c6513e71.en.pdf)
- The development of so-called "sustainable finance" does not change the fact that the majority of financial products and services remain out of this scope. What is needed is a transition of all the financial sector, and not the only the emergence of a category of relatively less harmful financial products. Furthermore, the "sustainable" characteristic of these products and offering is often not substantiated, with many studies showing that ESG/sustainable or even labeled funds contain some of the worst companies from a climate perspective.

It is therefore crucial to shift from a logic where financial institutions are expected to voluntarily transition, to one where they have an obligation to do so.

Question 7:

European frameworks provide a useful basis to align financial services with climate goals but are insufficient to do so, notably because they focus on transparency. More precisely:

- The EU CSRD and CSDDD mean that climate transition plans should be adopted by financial institutions and companies. However, the content of these transition plan is not precisely defined, and the related enforcement mechanism are yet to be discussed. Similarly, CRR/CRD and Solvency II contain a mention of prudential transition plans but the definition of such plans is not clear at this stage and will depend on the opinion of European Supervisory Authorities (ESAs). On this topic, see Reclaim Finance's report: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf
- "Do no significant harm" (DNSH) has been established as a key principle in EU financial regulation and in other frameworks (including around the use of recovery funds). But the principle remains loosely defined, and its application changes from one framework to another. It is notably not reflected in funds commercialized in the EU, where only a few transparency indicators - the PAI of SFDR - are related to it.
- If it is now clear that some assets are especially risky from a climate perspective - including those tied to fossil fuel development - discussions on prudential requirements are yet to led to increased capital requirements. Additional capital requirements (pillar I) have been discussed at the EU level but rejected from CRR/CRD.
- Several measures adopted at the EU level on transparency fall short of their objective: 1) The SFDR is widely criticized for failing to clarify the environmental contribution of funds with its classification system and providing relevant information on their content; 2) The EU green bond standard is a voluntary one and does not tackle the issue of the sustainability of the issuer (and not only the "use of proceeds"); 3) The development of the EU Ecolabel has been paused and even if it were to be finalized would remain a voluntary tool, much like other labels. This shows that new reform on to help citizens better access information on financial products are still needed, notably to ensure any product making a "sustainability" claim respect some minimum criteria (including not containing any asset from a company developing fossil fuels).

Question 9:

Beyond decarbonization targets, financial institutions must adopt robust transition plans that include actions plans and other types of targets and metrics that highlight the contribution to the transition of the real economy. Reclaim Finance's report on transition plans provides elements on this issue: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf

A focus should be made on the energy sector that must decarbonize to enable other activities to transition. For financial institutions this include:

1. Adopting sectoral policies on fossil fuels aligned with climate goals (see the online trackers from Reclaim Finance for precise recommendations: https://oilgaspolicytracker.org/ https://coalpolicytool.org/)
2. Putting in place a mandatory ratio on sustainable energy financing (see the briefing from the Beyond Fossil Fuel Network: https://beyondfossilfuels.org/wp-content/uploads/2024/02/6-1-ratio.pdf)

Question 10

Three essential elements should be ensured for reports on sustainability to provide a better picture of the required shift in cash flows:

1. Standardizing the content of transition plans and creating an implementation mechanism (see: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf)
2. Reforming SFDR and related reporting obligations, with minimum climate requirements for all products with sustainability allegations.
3. Establishing a clear and broad definition of greenwashing, notably building on the work of the ESAs (see: https://reclaimfinance.org/site/en/2023/07/13/greenwashing-eu-supervisors-to-make-financial-institutions-accountable/)

Question 11:

Existing commitments are especially vague. Concretely, any financial institution can claim to contribute to the transition by providing some support to "green" activities, even though it is also massively supporting polluting ones. "Alignment" is much stronger in the sense that it links financial institutions' activities to a climate pathway.

Question 12:

When referencing climate goals and target, it is important to stipulate that alignment on them mean aligning with a 1.5°C no/low overshot pathway with limited reliance negative emissions (NETs) (see: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf).

Additionally, the goal to contribute to the progressive phase-out of fossil fuels - including for coal by 2030 in OECD and EU and 2040 worldwide - should be considered.

Finally, it would be important to also include biodiversity preservation - relying on national and EU priorities on the matter.

Question 13:

Being prescriptive on the indicators related to such an obligation is essential to ensure it would have an impact. Indicators should notably include: 1) Financed, facilitated and insured GHG emissions, to align with a 1.5°C no/low overshot pathway with limited reliance on negative emission technologies (NETs); 2) Targets to align financial services, notably with a ratio of fossil v sustainable energy financing (see: https://beyondfossilfuels.org/wp-content/uploads/2024/02/6-1-ratio.pdf); 3) Restrictions on financial services to fossil fuels - including an end to any service provided to new project and/or the company that develop them (see the online trackers from Reclaim Finance for precise recommendations: https://oilgaspolicytracker.org/ https://coalpolicytool.org/).

Question 15:

For financial institutions, the obligation should apply to all no matter the size.

Question 16:

Administrative law seems best suited to ensure compliance. It would notably mirror existing process for financial supervision.

Question 17:

We would favor an obligation of results. Such an obligation would put more pressure on companies to meet their targets and apply their plans, also maximizing the chances of GHG reductions being realized.

Question 18:

The obligation to adopt and "put into effect" climate transition plans should apply to all financial institutions. Financial institutions - no matter their size - provide services to all types of companies including major corporations. As such, even relatively small financial institutions have a stake in how large corporations behave regarding climate change.

It should be noted that the content of the transition plans should be further standardized, see notably Reclaim Finance's report on the topic: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf

Question 19:

To be effective, engagement must meet some quality criteria, including a clear timebound escalation strategy. Reclaim Finance published specific recommendations on this that can be leveraged: https://reclaimfinance.org/site/en/2023/08/30/climate-stewardship-a-guide-for-effective-engagement-and-voting-practices/

Engagement is also part of a robust transition plan (see: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf)

Question 23:

Our proposal to strengthen legislation are building on EU law and regulation. As such, they would ensure financial institutions from the Netherlands comply with EU rules and go beyond them in the field of climate, without requiring measures that are disconnected from their EU competitors. If robust transition plans were to be adopted, this could even provide them with a significant advantage by positioning them as leaders in the field of sustainability. It is also worth noting such obligations would drastically contribute to minimizing their exposure to potential climate-related risks. As it would increase financial institutions' contribution to the development of a greener economy in the Netherlands and EU, it could also benefit companies developing sustainable activities (including through a reduction of capital cost).

Question 24:

An additional priority would be to include some key biodiversity considerations, building on EU and national objectives. This include fighting deforestation, for which financial institutions can be mandated to adopted sectoral policies to restrict financial services to major contributors (see: https://forest500.org/).

Question 25:

As highlighted in our answer to question 1 and 2, we believe the measures needed include:

1. The mandatory adoption of robust transition plans and their enforcement (see: https://reclaimfinance.org/site/wp-content/uploads/2024/01/Report-Climate-Transition-Plan-Reclaim-Finance-January-2024.pdf).
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