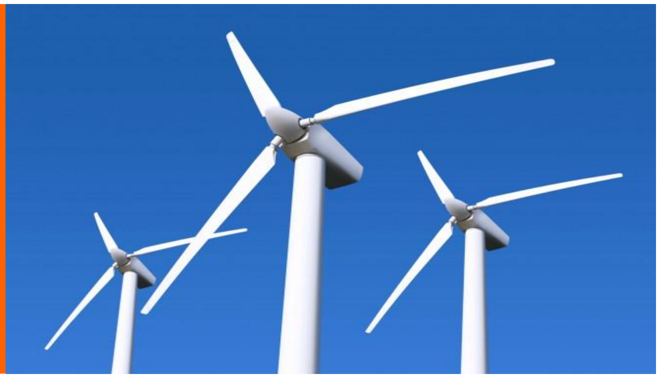
ING VIEWPOINT
March 2018

Sustainable finance:

Empowering businesses to reach the EU's sustainability goals



"Sustainability forms an integral part of a bank's corporate strategy as it is fundamental to its license to operate and the promise to its customers. Sustainability is one of the major focal points of ING's strategy, and we strongly welcome the EU's recent push to move forward on this agenda. We fully support Europe's strong commitment to the COP21 Paris Agreement.

In the very near future, the competitiveness of companies will be determined by their sustainability performance. Companies that take appropriate actions to mitigate the risks of a high carbon footprint will be valued higher than companies that don't, all other things being equal.

The EU can be a crucial catalyst in making our economies more sustainable. We believe this should be a joint effort from businesses, the financial sector and governments alike. Industries, banks and policy makers need to work together to make this happen."

Isabel Fernandez

Head of Wholesale Banking
ING Group

Introduction and summary

The European Commission's High-Level Expert Group on Sustainable Finance (HLEG) published its final report 'Financing a Sustainable European Economy' on 31 January 2018, which fed into the European Commission's action plan on sustainable finance. As the main providers of capital and credit in Europe, banks have the responsibility to play a pivotal role in this. Banks cannot do this alone. To further boost sustainable finance in Europe we need a comprehensive set of measures that should be picked up by a wide variety of stakeholders. In this Viewpoint we identify a number of aspects that can further stimulate industries, banks and policy makers to take action in making our economies more sustainable.

We encourage specifically:

- **Enhancement of data disclosures by banks and industry alike.** This will facilitate the development of a sustainability taxonomy, green bond standards and improve sustainability ratings
- **The development and implementation of ambitious bank strategies.** As main providers of finance they have an essential role to play
- **Robust and stable government policies.** A central element of this should be to ensure that carbon emissions are appropriately priced

Enhancement of data disclosures will facilitate the development of a sustainability taxonomy, green bond standards and improve sustainability ratings

While there is an abundance of financial data from all sectors, the availability of data on sustainability performance still lags. Like the HLEG report, we believe that the strong, principle-based reporting framework developed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) would significantly improve the level of harmonisation, quantity and quality of relevant climate-related data available to banks and other investors. As a significant share of the technologies and projects that are needed to realise the COP21 targets comes from smaller, innovative non-listed companies, the scope of the implementation of the TCFD recommendations should ideally be extended to those companies as well. Proportionality should be applied to take impact and size into consideration. In this way there would be no disproportionate reporting burden, while incentivising the continuous adaption to, and understanding of, climate-related risk. If industry-led implementation does not move fast enough or does not deliver the right level of consistency, a mandatory approach should be considered. In line with HLEG recommendations, using the Non-Financial Reporting Directive (NFRD) review would provide the momentum to consider this. The experience gained from the "comply or explain" approach in France should be taken on board. The enhancement of available data underpins the development of a sustainability taxonomy for green assets, the engineering of Green Bond Standards and the improvement and wider use of sustainability ratings. These steps should be developed in close conjunction with the development of the disclosure requirements to align definitions and labels as much as possible.

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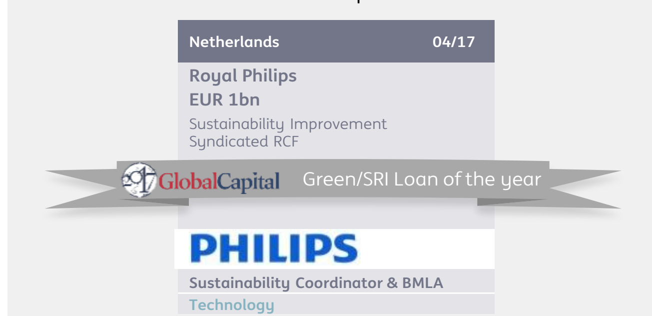
The emergence of independent sustainability rating agencies will add to the appropriate valuation of how companies are performing on sustainability. By addressing the data challenge mentioned it would be substantially easier for banks to use this type of ratings (see Box 1). Firstly, the quality of existing ratings for large listed companies would improve as the data quality increases. Secondly, widening the scope of data disclosure will facilitate the provision of sustainability ratings particularly for non-listed innovative firms. To increase the reliability and credibility of sustainability ratings, there is merit for the EU to set minimum standards for sustainability rating providers.

Box 1

Philips in 2017 signed a €1 billion syndicated loan where the interest rate is coupled to the company's sustainability rating. ING acted as sustainability coordinator. For these types of loans to develop, it is crucial that external ratings are as accurate and credible as possible.



Banks will have to pursue ambitious sustainability strategies.

Banks can facilitate and finance society's transition. To play their part, banks need to make concrete commitments and set targets to facilitate the transition to a low-carbon and self-reliant society. For example, ING has the ambition to become the industry leader in sustainable finance and has set the target to double our Sustainable Finance portfolio by 2022 compared to 2017. At the same time, ING aims to reduce exposure to coal-fired power generation to near zero by 2025, and of phasing out direct loans to coal-fired power plants altogether by the end of 2025. Further, banks should integrate external and independent sustainability assessments into investment and lending decisions. They should develop a strategy to identify clients and business opportunities that contribute to this and commit budget for investments to support sustainable projects (for example "scale-ups" in specific areas like the circular economy and energy transition).

Governments should provide for a robust and reliable transition path

A stable and well-calibrated regulatory and policy environment is a prerequisite for continued investment in sustainable projects and assets. This applies equally to tax rules, government support programmes and investments (including retail investments), as well as to prudential regulation for financial institutions and accounting standards. However, we believe the introduction of a 'green support factor' or a 'brown penalisation factor' will not move the needle. Capital requirements are meant to safeguard financial stability and be a reflection of the risks involved and should not be used to further political goals. Moreover, financing costs make up only a small part of the total operating expenses of so-called 'brown' assets. Increasing these costs by applying a penalty would not make a significant difference. In the absence of a clear definition as yet of what should be considered a 'green' or 'brown' asset, the introduction of such a measure lacks practical application. Lastly, there is an increasing supply of alternative funding from entities not subject to these requirements, such as loan funds and other non-bank institutional investors. A more effective way to ease the transition is to use the economic signal of carbon pricing to stimulate investment in clean technology and market innovation.

A well-calibrated carbon price captures the full societal costs of greenhouse gas emissions and ties them to their sources. This would level the playing field for low-carbon investments and would pave the way for the necessary significant growth in both debt and equity financing of sustainable projects. It is estimated that carbon price levels of US$ 40–80/tonne CO_2 by 2020 and US$ 50–100/tonne CO_2 by 2030 are required to meet the COP21 Paris Agreement temperature goal, supported by a strong policy environment (*Report of the High-Level Commission on Carbon Prices, 2017 - the "Stiglitz-Stern report"*-). The average price of carbon emission rights in the European Union Emission Trading Scheme (EU ETS) has hovered around € 5/tonne CO_2 over the last 5 years. A carbon price that fully reflects the societal costs of greenhouse gas emissions encourages polluting industries to reduce their emissions and invest in clean energy and commit to low-carbon growth. Time is of the essence because the longer the delay in making the necessary investments, the higher the future costs of meeting the COP21 Paris Agreement temperature goal will be.

Conclusion

We need meaningful, reliable and harmonised disclosure by companies to improve the assessment of their sustainability performance. As a result, banks will be better placed to mainstream sustainability targets within their portfolios. This goes hand-in-hand with a robust and reliable regulatory environment that the markets can rely on, and which will make a material difference in setting the right incentives for a transition to a sustainable economy.

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