POSITION PAPER

febea

EUROPEAN FEDERATION OF ETHICAL AND ALTERNATIVE BANKS AND FINANCIERS

June 2021

FOR A TRULY SUSTAINABLE FINANCE

THAT COMBATS CLIMATE CHANGE AND INEQUALITY

8 PROPOSALS FOR THE NEW EU SUSTAINABLE FINANCE STRATEGY FROM THE EUROPEAN ETHICAL FINANCE MOVEMENT

Recommendations (1/2)

To be effective, the EU sustainable finance agenda should:

Foster the assessment of the benefits for people and the planet, along with economic ones, of all financial activities, with a specific focus on the impact on climate change

Be strongly linked to the real economy and stimulate long-term commitments, promote and foster financial activities supporting the social economy and financial inclusion of disadvantaged groups, to foster social cohesion and an inclusive growth

Ensure coherence of all the financial activities of the financial organisation, and not just the sustainability of a single product

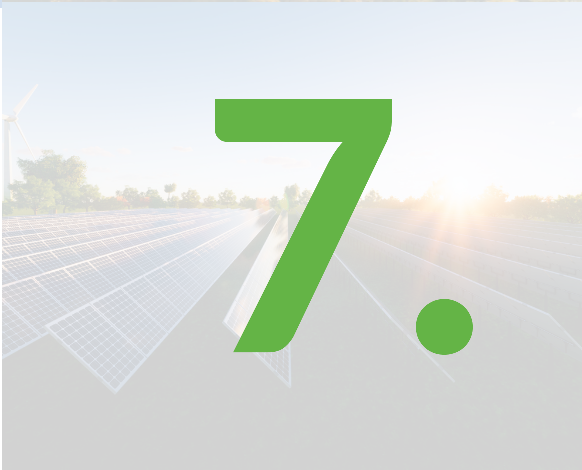
Include an obligation of transparency and adoption of specific criteria on all the activities of the financial intermediaries, including their governance, destination of profits, remunerations policies

Recommendations (2/2)

To be effective, the EU sustainable finance agenda should:

Move towards "sustainability" understood at 360°, including the definition of unsustainable activities and clearly defining a social taxonomy

Include representatives of small, community rooted, ethical banks and financial institutions among the stakeholders being consulted for the development of the sustainable finance strategy



Clearly state activities and approaches of financial intermediaries that are not compatible with the sustainable finance definition

Promote transparency and clear communication on what is sustainable finance towards consumers, to facilitate the mobilisation of citizens savings that can help finance the ecological transition

Introduction

The financial system consolidated in recent decades has proven clearly reluctant to joining the coalition of financial and civil society institutions fighting for sustainable development. For many citizens, this financial system has been simply unable to act in the wider interest of society and the planet.

Facing this systemic failure, the European Union's Sustainable Finance Agenda (see box n.1) is more than welcome. The new orientation of the EU recognizes the un-sustainability of a large part of the current financial system and aims to frame and develop a possible alternative, including among its objectives the redirection of financial flows towards sustainability. The new European agenda focuses the analysis on the impact of finance on the environment and climate change: an understandable and widely accepted choice. **Climate change is in fact an important and urgent issue that requires immediate action; the current financial system has an enormous responsibility in the devastation of the planet and the climate; the impact of financial choices on climate change are quite easily measurable with specific indicators and the political moment is favourable to take action in this regard.**

Today there is no shared standard of what is meant by "sustainability" in financial investments, which allows each bank or fund manager to adopt their own definitions, often rather weak and tailored to their needs. The EU intends to overcome this deficit by providing a precise definition of sustainable investment.

Pursuant to Reg. 2088, a sustainable investment must take place in an economic activity that contributes to an environmental objective measured through key resource efficiency indicators (concerning the use of energy, the use of renewable energy, the use of raw materials, water resources and land, waste generation, greenhouse gas emissions as well as the impact on biodiversity and the circular economy) or an investment in an economic activity that contributes to a social objective (in particular an investment that contributes to the fight against inequality; or that promotes social cohesion, social integration and proper industrial relations; or an investment in human capital or in economically or socially disadvantaged communities) - provided that such investments do not cause damage to any of the overall climate objectives and that the companies benefiting from such investments adhere to good governance practices. **These are all elements of enormous importance to provide clear and univocal definitions that establish a level playing field for all.**

Introduction

Many of these elements - while they are new for most financial intermediaries - are part of the daily work of [Ethical Finance] organisations. Ethical finance - as understood and practiced for decades by many organisations in Europe and on an international scale - is based on the idea that every financial decision has significant social and environmental consequences. **Ethical Finance organisations have been applying this approach both in regards to defining their vision of society and their organisational mission as well as in daily practice in the past decades, achieving [significant results] and going well beyond the current definition of "sustainable" finance.**

With this document, we want to highlight the gaps in the current proposition of "sustainable finance" as framed by the EU, proposing to integrate some of the practices and approaches linked to Ethical Finance, as understood by dozens of financial institutions active in Europe for at least the last two decades.

Box 1. What is the EU Sustainable Finance Agenda

On the 8 March 2018 the EU Commission published the Action Plan for sustainable finance.
The Plan has the objective of re-orienting private capital flows towards sustainable and inclusive growth; managing the financial risks deriving from climate change and its social impacts; and promoting a more transparent finance aimed at long-term investments to support the "European Green Deal".

The main actions envisaged by the EU in this path concern:

- The introduction of a Taxonomy for sustainable economic activities, i.e. a system of shared definition and classification of sustainable products and services;
- The introduction of a standard for Green Bonds, to promote their effectiveness, transparency, comparability and encourage their issuance and negotiation;
- The definition of guidelines for companies on the publication of information relating to the impacts that their activities have on the climate and that climate change has on their activities;
- An improvement in the transparency of benchmark methodology to promote methodological standards for EU low carbon benchmarks;
- Introduction of new transparency obligations and publication of information for investors by financial intermediaries and financial advisors;
- The creation of an international platform on sustainable finance.

Main regulations already issued:

- Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on the disclosure on sustainability in the financial services sector;
- Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework that favours sustainable investments and amending regulation (EU) 2019/2088.

8 proposals for a truly sustainable finance

1) FOSTER THE ASSESSMENT OF THE BENEFITS FOR PEOPLE AND THE PLANET, ALONG WITH ECONOMIC ONES, OF ALL FINANCIAL ACTIVITIES, WITH A SPECIFIC FOCUS ON THE IMPACT ON CLIMATE CHANGE.

For most financial intermediaries, **their main organisational goal is to maximize profit and the value of their shares, regardless of the consequences on the society and the environment.** According to this approach adopted by many organisations, sustainability is at best a secondary objective functional to the achievement of the main one, a competitive factor to be taken into consideration to respond to the growing market demand for sustainable products, or even a marketing tool to reduce their reputational risks and obtain a "cleaner" public image.

If the EU regulation on sustainable finance fails to provide clear and specific parameters, the risk is that many intermediaries will try to achieve the maximum benefit (in terms of image) with the minimum effort (in terms of changing their operating model) with "greenwashing" risks already highlighted by various independent international organizations (see for example WWF and FinanceWatch).

Today, important movements of opinion and young people all over the world are advocating for greater commitment to safeguarding the planet, but if sustainability in finance will remain perceived as a market niche to be addressed by showcasing some products and advertising them on the sustainability reports, there will not be an effective and concrete response to these societal demands.

Economic profit should obviously be pursued, but because it is functional to the main objective of **maximizing the benefits for people and for the planet.** Even if we wanted to limit the analysis to the environmental dimension only, the exasperated search for maximum profit in the shortest possible time represents the main engine that pushes companies not to consider environmental impacts, as well as social, fiscal or labour rights. Instead they are pushed to pursue the returns imposed by the financial markets.

We suggest using a standard Ethical Finance practice, which consist in including the assessment of the non-economic impacts and repercussions of the economic action, as the compass that guides every operational decision. This approach reflects the transition from shareholders interest (acting in the exclusive interest of shareholders) to stakeholders interest in its broadest sense (acting by evaluating the impacts on all the actors bringing value).

2) BE STRONGLY LINKED TO THE REAL ECONOMY AND STIMULATE LONG-TERM COMMITMENTS, PROMOTE AND FOSTER FINANCIAL ACTIVITIES SUPPORTING THE SOCIAL ECONOMY AND FINANCIAL INCLUSION OF DISADVANTAGED GROUPS, TO FOSTER SOCIAL COHESION AND AN INCLUSIVE GROWTH.

Mainstream finance today is characterized by an unscrupulous use of speculative instruments and tax havens, a continuous creation of bubbles and instability, a wide use of derivatives as well as speculative bets - more than half of the operations on financial markets are linked to high-frequency trading -, a shadow banking system that escapes scrutiny and regulation, and the list goes on. These activities, even if they have no direct consequence on the environment, are the very definition of an unsustainable activity.

The new European legislation should include an obligation, at least, "not to harm the community and the real economy". Sustainable finance should not be intended as a self-addressed goal to "make money from money", but on the contrary as a tool at the service of the economy and society as a whole. As a tool, it adapts to try to answer the questions and challenges that arise from society. As a concrete example, in 2018 the % of loans granted on total assets for the real economy was over 76% for sustainable banks, while just 39% for mainstream European banks, and with a significantly lower NPL rate. Ethical finance organisations in 2019 granted 78% of their loans to the real economy. In addition, the timing of investments and operations was much more long term oriented. In contrast, the mainstream financial system is more and more obsessed with very short-term horizons. Also, access to credit and the financial inclusion of disadvantaged groups should be pursued. This is a central issue in the current context, characterised on the one hand by an excess of liquidity but on the other by a growing inequality and financial exclusion of many people and companies in Europe.

In addition to this, the financial support to the social economy sector should be promoted via dedicated tools and regulations.

One exceptional tool to foster social and green economy could be a green / social supporting factor. Banks's capital requirements for any loan they provide are currently based only on their financial risk. Taking into account the overall environmental and social impact of a loan, thus lowering capital requirements for loans with positive impacts and possibly raising them for "unsustainable" ones would mean that the loans to green/social firms and projects would become cheaper, while those to polluting / impacting activities would become more expensive. Thus, it would be a major factor to promote social, green and circular economy, and towards a real sustainable finance.

Box 2. EXAMPLE
The securitization of subprime mortgages - which was at the origin of the disastrous financial crisis of 2008 - had no particular environmental impact. Should it therefore be considered an example of sustainable finance?

3) ENSURE COHERENCE OF ALL THE FINANCIAL ACTIVITIES OF THE FINANCIAL ORGANISATION, AND NOT JUST THE SUSTAINABILITY OF A SINGLE PRODUCT.

The approach to sustainable finance should not be limited to the specific financial product, but instead it should apply to all the activities proposed by a banking group, including the provision of credit and other banking activities.

We propose to apply the Ethical Finance approach, for which the idea of a bank offering its customers just some sustainable products - while other products are not sustainable at all - is simply unacceptable. Every ethical finance organisation must apply the principles of transparency and fairness as detailed in the ethical finance charter, which apply also beyond the products and services it offers. For this reason, the analysis of each financial product offered to customers must go hand in hand with an overall evaluation of the related project.

We understand that we are at the beginning of the road towards sustainable finance and the product-oriented approach is the simplest way to start, but it creates a great temptation for many financial institutions to apply camouflage and simply promote one or more "good" sustainable products, while continuing its remaining activities according to old business models. This may be especially true of the last two letters in the abbreviation ESG, i.e. social and governance elements.

4) INCLUDE AN OBLIGATION OF TRANSPARENCY AND ADOPTION OF SPECIFIC CRITERIA ON ALL THE ACTIVITIES OF THE FINANCIAL INTERMEDIARIES, INCLUDING THEIR GOVERNANCE, DESTINATION OF PROFITS, REMUNERATIONS POLICIES.

Recent regulations (2019/2088 and 2020/852) address issues related to transparency, but they only address the single products and not the overall behaviour of the financial intermediary. There are proposals on a national scale that go in this direction. One of them is the definition of "ethical and sustainable finance" included in Italian legislation with Article 111 bis of the TUB. This legislation provides a series of criteria that financial operators who want to define themselves as ethical and sustainable must meet. These criteria concern the overall behaviour of the organisation, and not the specific product: transparency on loans, re-investment of profits in development of ethical finance activities, internal remuneration system and others.

Box 3.EXAMPLE

A "too big to fail" bank could channel large sums to investments labelled as "green" by the EU and at the same time maintain equally large, if not greater, investments in harmful sectors such as fossil fuels or armaments. The ranking of sustainability ratings assigned by the "Standard Ethics" agency was reported on MF on 29 December 2020: the podium is occupied by BNP Paribas, Finecobank and Unicredit. Yet, according to the "Banking on Climate Change" report edited by a network of international organizations for the protection of the environment, BNP Paribas is the first European financier of fossil fuels.

5) MOVE TOWARDS "SUSTAINABILITY" UNDERSTOOD AT 360°, INCLUDING THE DEFINITION OF UNSUSTAINABLE ACTIVITIES AND CLEARLY DEFINING A SOCIAL TAXONOMY.

Sustainability is often defined almost exclusively by looking at the environmental component. However, an appropriately and strictly used ESG framework, as applied by Ethical Finance, **must take into consideration every environmental, social and governance aspect in the traditional ESG analysis, including their respective interrelations**, and more generally any economic and non-economic impact generated.

The model defined at European level is based on the definition of a specific "green" taxonomy, which lists sustainable activities, but this vision - from the truly sustainable finance perspective - **must be complemented by a clear definition of unsustainable activities**, to define which activities absolutely cannot fall within the concept of sustainable finance.

It is a positive sign that these issues are being discussed (see for example the public consultation on sustainable corporate governance), and that there are signs regarding the creation of a "social taxonomy".

However, the current vision for a social taxonomy is too broad – taking as an initial standpoint the respect of basic human rights - and could lead to easily lead to social washing practices.

Box 4.EXAMPLE

The analysis of the environmental dimension alone could lead to a positive evaluation of projects, in the energy field or in other sectors, with highly negative impacts. An emblematic case is that of the large dams. Huge infrastructure projects in the name of renewable energy that can, however, have devastating impacts from a social point of view, such as the forced displacement of entire populations. The struggles waged in past decades, such as those against dams in the Narmada Valley in India, have brought these issues to light. One response was the drafting of guidelines, under the aegis of the World Commission on Dams, which would hold together the environmental, social and economic aspects of these projects.

6) INCLUDE REPRESENTATIVES OF SMALL, COMMUNITY ROOTED, ETHICAL BANKS AND FINANCIAL INSTITUTIONS AMONG THE STAKEHOLDERS BEING CONSULTED FOR THE DEVELOPMENT OF THE SUSTAINABLE FINANCE STRATEGY.

In Ethical Finance, cultural, training and financial information activities go hand in hand with the operational ones, trying to explain the current distortions of the financial system and asking for the introduction of specific regulations to solve them. The organisations of ethical finance are in the forefront to demand the introduction of a tax on financial transactions, a separation between commercial and investment banks, a serious fight against tax havens, a limit on the use of derivatives and many more. These are proposals that - unlike those made by mainstream finance which want to preserve the status quo of the financial industry - are not inspired to produce an advantage for the operators of ethical finance, but instead to promote a reform of finance in the interest of all.

On the other hand, the lobbying activity carried out by the mainstream financial sector argues for ever less regulation and controls. An approach that unfortunately did not even spare the discussions on sustainable finance, with strong pressures to dilute the notion of sustainability. Although the sustainability definition is already weak and limited to the environmental dimension only, it has even been asked to include nuclear power or some investments in fossil fuels among the activities to be considered as "sustainable" (hypothesis still being examined by regulators).

Box 5. EXAMPLE
Particularly worrying is the choice of the EU Commission to assign to the giant BlackRock the consultancy service to assess how to include ESG risks in banking regulations and supervision and to integrate sustainability objectives in banking activities. A letter signed by more than ninety organizations asks the Commission to cancel this consultancy contract, citing the conflicts of interest of the largest financial manager in the world; its lack of credibility in this area; its efforts in lobbying against the taxonomy; BlackRock's stake in the share capital of many European banks that heavily finance fossil fuels and its direct stake in coal or oil companies.

While we appreciate the merits, experience and relevance of the individual experts selected so far to consult the Commission on this issue, we would like to highlight that the organizations they represent are not always involved in sustainable finance practices (see for example Banking on Climate change; Banca Armada; Banktrack; Nuclearbanks).

It is therefore extremely important to include representatives of small, community rooted, ethical banks and financial institutions among the stakeholders being consulted for the definition of the EU sustainable finance agenda - which unfortunately is not the case for the moment. Their know-how and expertise would bring additional value and legitimacy to the work carried out by the EU and would ensure that the issue of proportionality is taken into account in the different regulations and criteria to be developed.

7) CLEARLY STATE ACTIVITIES AND APPROACHES OF FINANCIAL INTERMEDIARIES THAT ARE NOT COMPATIBLE WITH THE SUSTAINABLE FINANCE DEFINITION.

Ethical Finance promotes a vision of finance and the economy as tools for active participation and change.
One of the crucial objectives of ethical finance is to contribute to changing the behaviour of companies that produce negative impacts on a large scale through engagement or active shareholding. Through ethical mutual funds or in partnership with non-governmental organizations, other financial institutions, associations, etc. ethical finance is committed to becoming an active interlocutor of large corporations, publicly denouncing behaviours that are harmful to people and the environment and aiming, through dialogue, to put pressure on management and governance practices to be improved.

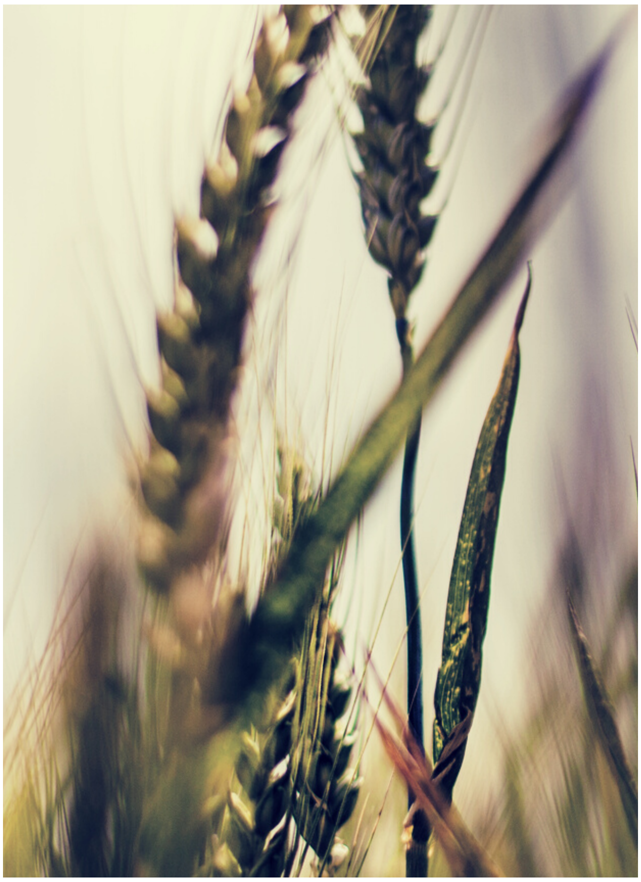
In this perspective, the issue of sustainable finance products should not be compatible with the use of tax havens, with the offer of other products that are completely inconsistent with those defined as sustainable, or with the adoption of governance and internal management policies that are poorly oriented towards equity and environmental protection.

For a truly sustainable finance, that can foster a real change in the conduct of all economic actors towards environmentally and socially impactful activities, the presence of these contradictions is inadmissible.

8) PROMOTE TRANSPARENCY AND CLEAR COMMUNICATION ON WHAT IS SUSTAINABLE FINANCE TOWARDS CONSUMERS, TO FACILITATE THE MOBILISATION OF CITIZENS SAVINGS THAT CAN HELP FINANCE THE ECOLOGICAL TRANSITION.

Ethical finance is based on a high degree of citizens’ engagement and participation in the allocation of resources. The deposits and the equity of an ethical finance organisation come from savings of its customers, which are created through activities in the real economy.

Transparency and clear, effective communication on what is sustainable finance could facilitate citizens' engagement and participation towards the ecological transition.



About Ethical Finance

Ethical Finance was born to give back to the people the control over the use of their money. By choosing an Ethical Finance organisation to manage their savings, investments, pensions funds, insurances, people can chose to support local, social economy and sustainable development.

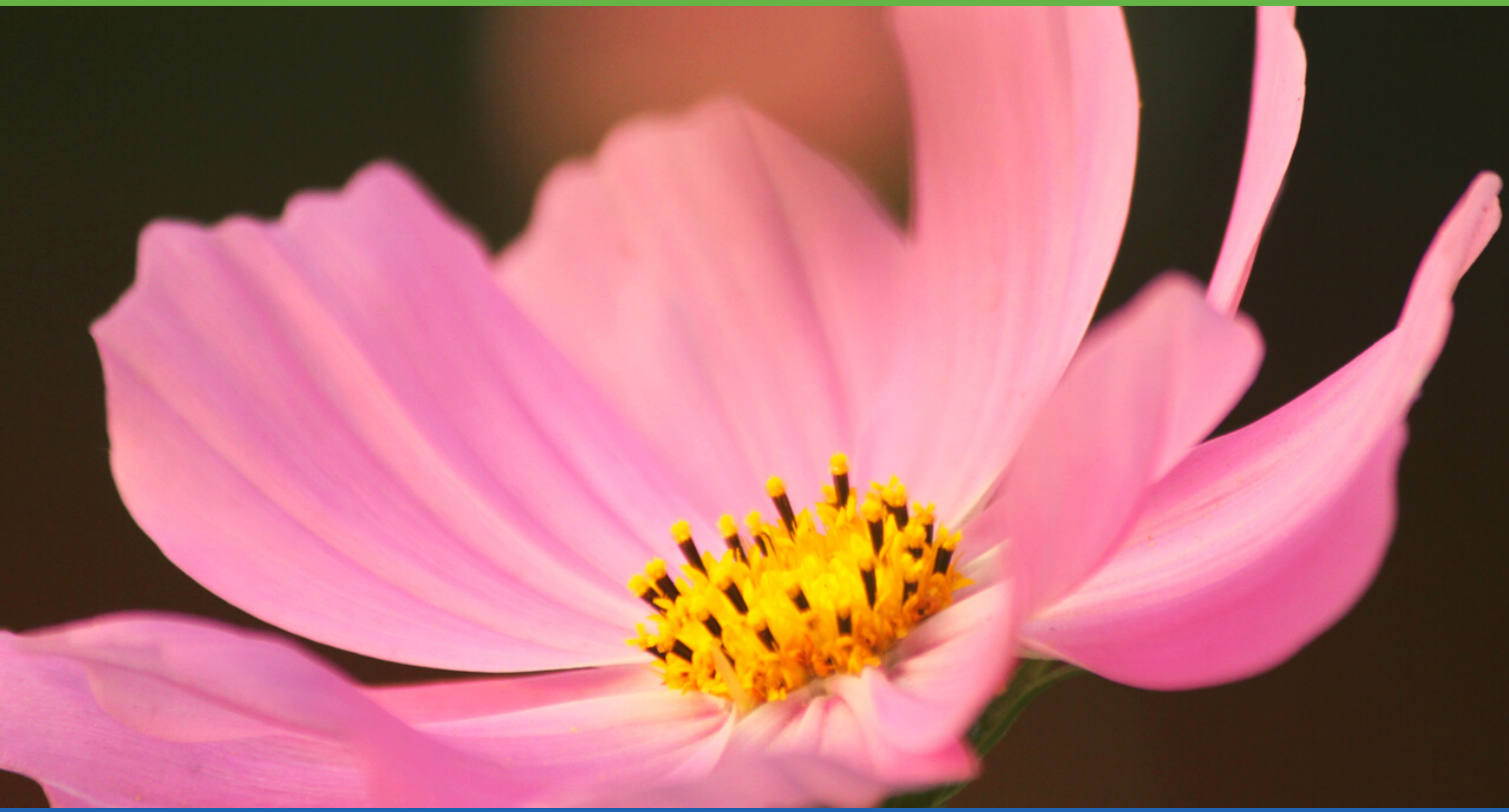
Ethical Finance organisations were created about 30 years ago all over Europe by citizens-led movements that wanted to regain control over the use of their money, to be channeled for the common good.

Learn more

About FEBEA

Founded in Brussels in 2001, FEBEA is the European Federation of Ethical and Alternative Banks and Financiers.
It brings together financial institutions from 15 European countries with the aim of developing ethical and social finance in Europe. Together, these innovative and pioneering institutions work, each in its own country, to disseminate the importance and urgency of the development of ethical and solidarity-based financial models in the European economic and political area.

Learn more



febea

Square Ambiorix n.32, box 47
1000, Brussels - Belgium

febea@febea.org
febea.org