Disclaimer: The English version is translated from German, in case of missing clarity the German version is to be consulted

Joint statement on the Final Report of the EU High-Level Expert Group on Sustainable Finance (HLEG)

The recommendations are an important step towards making use of the financial markets' leverage on climate change, and they send a strong signal to the German coalition talks and the EU Commission's action plan. Still, some aspects need to be improved in the implementation phase.

We welcome the recommendations of the EU Commission's High Level Expert Group on Sustainable Finance (HLEG). The HLEG's final report represents hitherto the most comprehensive plan to systematically integrate sustainability aspects into the financial system of the European Union.

The Recommendations have the potential to substantially contribute to solve the so-called tragedy of the horizon and to make use of the financial sector's leverage potential to achieve the climate and development goals.

At the same time, when implementing the recommendations, some points need further improvement. Besides the so-called key recommendations, we expect the other "cross-cutting recommendations", such as the integration of sustainability aspects into indices and benchmarks, to be further elaborated and implemented by the EU Commission and the member states.

Furthermore, it is crucial to apply a far-sighted perspective across all areas of activity, as well as to ensure that the recommendations are effective to making substantial progress towards achieving the climate and development goals.

The recommendations pick up two important dimensions of sustainable finance: First, to secure the stability of the financial system by systematically integrating sustainability criteria into the regulation of financial markets. Second, to mobilize additional financial means to achieve the climate and devlopment goals.

The HLEG was right to base its work on both dimensions. In consequence, the report provides valuable recommendations for targeted further action at the EU-level and in Germany:

- **Inclusion of sustainability in the supervisory mandate of the European Supervisory Authorities (ESAs).** Some first action has already been initiated by the EU Commission in this area, which we highly welcome. Still, there is further action required. The corresponding recommendations now have to be implemented consistently. This holds as well for the national supervisory authorities (in Germany especially by the Bundesbank and BaFin), which should address sustainability risks in their systemic risk assessments.

- **Disclosure of (long-term) sustainability risks across the entire investment and lending chain**. To build upon the results of existing initiatives for increased transparency on climate risks, as recommended, is a straightforward way to go. For this purpose, the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which has been established by the FSB (Financial Stability Board of the G20), as well as the experience with article 173 of the French Energy Transition Law, are to be taken as a starting point. The EU Commission and the German government should – as recommended for the review of the Non-financial Reporting Directive – engage with the necessary improvements of the hitherto insufficient disclosure practice.

- **Consideration of sustainability aspects as a key element of investor duties.** The German government should take up and implement this recommendation as quick as possible. This should be done in close interaction with the EU Commission, and it should include the results of the Commission's most recent consultation on this topic. Sustainability risks as well as the beneficaries' individual preferences regarding the environmental and societal impact of their investments.

- **Establishment of a sustainability taxonomy and development of European sustainability standards and labels.** A common sustainability taxonomy for all asset classes as well as a Green Bonds Standard (EU GBS), which over time should evolve into a sustainability standard, have long been necessary and are in principle highly welcomed. However, in addition to the question in how far green bonds actually mobilize additional investments into green or sustainable projects or support other sustainability effects, the risk of entrenching sustainable bonds in a niche becomes apparent. Thus, any standard or label for sustainable and green bonds has to be established with the specific goal to target and transform the "mainstream" bond market.

The EU Commission and the member states are now asked to implement the recommendations. In the German context, the coalition contract, which is currently under negotiation, will serve as a guideline for the coming legislative period. It is important that when taking the next steps, the Commission and the member states still need to take additional action to close remaining gaps and improve on some aspects of the recommendations:

- **Introduce mandatory sustainability risks disclosure as soon as possible.** Building on voluntary disclosure, the recommendations fall short of sufficiently highlighting the necessity of mandatory disclosure for all financial market actors. Voluntary approaches have very rarely induced transformative change across large parts of the markets. Therefore, it is not plausible that comprehensive disclosure, in terms of risks addressed and the degree of market actor coverage, can be achieved voluntarily. Only if all actors disclose their risks and the opportunities of a sustainable, climate-compatible transformation, the market failure caused by imperfect information could be eliminated and a level playing field could arise.

- **Consider sustainability risks in capital requirements.** A "brown-penalising factor" was not included in the key recommendations, it is only marginally discussed towards the end of the final report. Yet, with the Paris Agreement being in force, emission-intensive projects and technologies exhibit increased risks, such as the risk of becoming stranded assets as soon as the required climate policies are implemented. A brown penalising factor for financing CO2-intensive and therefore potentially high-risk projects or business models would only consequently adapt the already established regulatory approaches to the new developments. This should be considered when implementing the recommendations.

- **Target passive market activities.** A substantial part of investments is channelled through indices. The main indices such as the MSCI World, DAX30, FTSE 350, S&P 500, DJIA and others are, if at all, only partially and at most accidentally designed in an adequate manner in terms of relevant sustainability factors. This given, however, no measure that addresses passive market activities is included in the key recommendations. These are only mentioned among the other cross-cutting recommendations, despite the fact that mainstream indices exert massive leverage in the markets. They have to be urgently addressed by policy makers, as the market to date did not develop the necessary dynamics in this field by itself.

- **Systematically implement forward-looking perspectivea.** In order to induce the sustainable transformation of the economy and to manage related opportunities and risks, a paradigm change from observations of the past towards forward-looking analyses is necessary. This includes, amongst others, the area of risk assessment, where a forward-looking approach could have been mentioned in a more explicit, operationalised manner. The proposed sustainability taxonomy does not seem to display a dynamic transformation perspective, either. The backward-looking proposed figure of reduced greenhouse-gas emissions is not a sensible indicator to assess future contributions to the decarbonisation of the real economy until 2050. As a part of disclosure provisions, all market actors should report in the context of scenario analyses how they adapt to effective, raising CO2-Prices and to achieving the middle- and long-term climate goals.

Such information should, where appropriate, be incorporated into the sustainability taxonomies of certain asset classes.

- **Systematically account for the actual contribution of investments and capital allocation decisions to achieving the societal goals.** So far, no respective systematic evaluation exists to this end. The current practice could induce investments in areas of societal goals, which are partly arbitrary or even irrelevant. In consequence, the goals are insufficiently implemented. The contribution to societal goals should particularly be included into reporting obligations. Article 2.1.c of the Paris Climate Agreement asks all member states to align all financial flows with the goals of the agreement. There is an urgent need to develop solutions for this obligation.

Overall, the report sends **an important signal to the German coalition talks**. Regardless of the various initiatives for a more sustainable financial system in Germany, amongst others from the German financial sector itself, the results of the pre-coalition talks among CDU/CSU and the SPD entirely missed aspects on the systematic integration of sustainability aspects in the financial sector. The recommendations clearly show that immediate action is required. German policy makers have so far closed their eyes on this issue, while other countries – such as France – have moved ahead. In the context of the planned new Elysée treaty, both countries should agree on specific measures to lead the way together.

CDU, CSU and SPD, based on the recommendations of the HLEG and beyond, must **enshrine comprehensive measures to systematically integrate climate and sustainability aspects in the financial sector on a German and European level in the coalition treaty.** The new federal government will immediately and within short time be confronted with different respective fields of action: On the one hand through EU Directives requiring implementation, such as the IOPR II Directive and the review of the Non-financial Reporting Directive; and on the other hand when dealing with the recommendation's next steps at national and European level, most importantly the Commission Action Plan on Sustainable Finance.