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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

Setting the scene

By adopting the Paris Agreement[1] on climate change and the UN 2030 Agenda for Sustainable Development[2] in 2015, governments from around the world chose a more sustainable path for our planet and our economy. The UN 2030 Agenda has at its core 17 Sustainable Development Goals (SDGs). Over the next 15 years, these goals will guide us in preparing for a future that ensures stability, a healthy planet, fair, inclusive and resilient societies and prosperous economies. The Paris Agreement, signed in December 2015 by 195 countries, is the first-ever universal, global climate deal to adapt and build resilience to climate change and to limit global warming to well below 2°C.

Sustainability and the transition to a low-carbon, more resource-efficient and circular economy are key in ensuring long-term competitiveness of the EU economy. Sustainability has long been at the heart of the European Union project and the EU Treaties give recognition to its social and environmental dimensions.[3] The EU is committed to development that meets the needs of present and future generations, while opening up new employment and investment opportunities and ensuring economic growth. Many of the Commission's priorities[4] for 2014-2020 feed into the Union's energy and climate goals and work towards implementing the UN 2030 Agenda for Sustainable Development.The Commission is also working on a Reflection Paper 'Towards a Sustainable Europe by 2030' and has launched a multi-stakeholder platform to exchange best practices on SDG implementation.

As we are increasingly faced with the catastrophic and unpredictable consequences of climate change and resource depletion, urgent action is needed to adapt public policies to this new reality. The financial system has a key role to play here. The financial system is being reformed to address the lessons of the financial crisis, and in this context it can be part of the solution towards a greener and more sustainable economy. Reorienting private capital to more sustainable investments requires a comprehensive shift in how the financial system works. This is necessary if the EU is to develop more sustainable economic growth, ensure the stability of the financial system, and foster more transparency and long-termism in the economy. Such thinking is also at the core of the EU's Capital Markets Union (CMU) project.[5]

At the end of 2016, the Commission appointed a High-Level Expert Group on sustainable finance. On 31 January 2018, the expert group published its final report[6] offering a comprehensive vision on how to build a sustainable finance strategy for the EU. The Report argues that sustainable finance is about two urgent imperatives: (1) improving the contribution of finance to sustainable and inclusive growth by funding society's long-term needs; (2) strengthening financial stability by incorporating environmental, social and governance (ESG) factors into investment decision-making. The Report proposes eight key recommendations, several cross-cutting recommendations and actions targeted at specific sectors of the financial system. This Action Plan builds upon the group's recommendations to set out an EU strategy for sustainable finance.

1 See conclusions agreed in December 2015 at http://unfccc.int/paris_agreement/items/9485.php

2 https://sustainabledevelopment.un.org/post2015/transformingourworld

3 See, among others, art. 3.3 of the Treaty on the European Union (TEU) and the role of environmental and social issues in international cooperation (art. 21 TEU).

4 These priorities include the Clean Air Policy Package (http://ec.europa.eu/environment/air/clean_air/index.htm), the Circular Economy Package (http://ec.europa.eu/environment/circular-economy/implementation_report.pdf), the Energy Union Strategy (http://eur-lex.europa.eu/resource.html?uri=cellar:1bd46c90-bdd4-11e4-bbe1-01aa75ed71a1.0001.03/DOC_1&format=PDF) including the Clean Energy for All Europeans Package, the EU Strategy on Adaptation to Climate Change (https://ec.europa.eu/clima/policies/adaptation/what_en), the New Skills Agenda for Europe (http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0381&from=EN), the European Pillar of Social Rights (https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights/european-pillar-social-rights-20-principles_en), the development of "blue economy financing principles" and the Investment Plan for Europe (https://ec.europa.eu/commission/priorities/jobs-growth-and-investment/investment-plan-europe-juncker-plan_en).

5 https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en

6 https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en

1 Finance for a more sustainable world

Finance supports the economy by providing funding for economic activities and ultimately jobs and growth. Investment decisions are typically based on several factors, but those related to environmental and social considerations are often not sufficiently taken into account, since such risks are likely to materialise over a longer time horizon. It is important to recognise that taking longer-term sustainability interests into account makes economic sense and does not necessarily lead to lower returns for investors.

'Sustainable finance' generally refers to the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities. More specifically, environmental considerations refer to climate change mitigation and adaptation, as well as the environment more broadly[7] and related risks (e.g. natural disasters[8]). Social considerations may refer to issues of inequality, inclusiveness, labour relations, investment in human capital and communities. Environmental and social considerations are often intertwined, as especially climate change can exacerbate existing systems of inequality. The governance of public and private institutions, including management structures, employee relations and executive remuneration, plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.[9]

This Action Plan on sustainable finance is part of broader efforts to connect finance with the specific needs of the European and global economy for the benefit of the planet and our society. Specifically, this Action Plan aims to:

1. reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
2. manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. foster transparency and long-termism in financial and economic activity.

1.1 Reorienting capital flows towards a more sustainable economy

Current levels of investment are not sufficient to support an environmentally and socially sustainable economic system. Europe has to close a yearly investment gap of almost EUR 180 billion to achieve EU climate and energy targets by 2030.[10] According to estimates from the European Investment Bank (EIB), the overall investment gap in transport, energy and resource management infrastructure has reached an astounding yearly figure of EUR 270 billion.[11] A lack of clarity among investors regarding what constitutes a sustainable investment is a contributing factor behind this investment gap and also an obstacle to financing the social infrastructure that is needed to address inequality and inclusiveness issues.

Transforming Europe's economy into a greener, more resilient and circular system will not just reduce our environmental footprint on the planet and address existing inequalities. It will also boost competitiveness by improving the efficiency of production processes and reducing the costs of accessing and managing resources.

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7 e.g. covering air and water pollution, resource depletion, and biodiversity loss.

8 One of the four priorities for action under the Sendai Framework for Disaster Risk Reduction focuses on investing in disaster risk reduction for resilience.

9 Governance is a tool to integrate environmental and social objectives in public and private investment decisions. For instance, executive compensation rules or incentives to protect shareholders' rights from managers are tools to ensure equality between the different stakeholders of a firm, i.e. managers, workers, shareholders and so on. In this case, in fighting inequality within a firm, governance performs a social goal.

10 The estimate is an yearly average investment gap for the period 2021 to 2030, based on PRIMES model projections used by the European Commission in the Impact Assessment of the Proposal of the Energy Efficiency Directive (2016), http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1483696687107&uri=CELEX:52016SC0405.

11 See EIB, 'Restoring EU competitiveness', 2016. The estimate, until 2020, include investments in modernising transportation and logistics, upgrading energy networks, increasing energy savings, renewables, improving resource management, including water and waste.

The EU is committed to this transition and has pledged to make at least 20% of its budget directly climate-relevant.[12] For instance, already in 2017, almost one third of investments mobilised by the European Fund for Strategic Investments (EFSI) were channelled into energy, environment and resource efficiency projects and social infrastructure. The EFSI 2.0 extends the fund until 2020 and raises investment targets to EUR 500 billion, with at least 40% of EFSI financing for infrastructure and innovation to support climate action projects. But clearly further steps are needed to channel even more investment into sustainable sectors.

1.2 Mainstreaming sustainability in risk management

Including environmental and social goals in financial decision-making aims to limit the financial impact of environmental and social risks. For example, an increase in the world's temperature of 2 degrees Celsius could have destabilising effects on Europe's economy and financial system.

Environmental and climate risks are currently not always adequately taken into account by the financial sector. The increase in weather-related natural disasters means that insurance companies need to prepare for higher costs. Banks will also be exposed to greater losses due to the lower profitability of companies most exposed to climate change or highly dependent on dwindling natural resources. Between 2000 and 2016, annual weather-related disasters worldwide rose by 46%[13] and between 2007 and 2016, economic losses from extreme weather worldwide rose by 86% (EUR 117 billion in 2016).[14] This is a worrying trend, since close to 50% of the exposure of Euro area banks to risk is directly or indirectly linked to risks stemming from climate change.[15] Other environmental issues are increasingly acknowledged to threaten current business models.[16]

Social factors, such as poor working conditions and growing inequalities can have concrete consequences for financial institutions including legal risks. Companies that, for example, do not adhere to international labour standards will find their reputation damaged. Legal and reputational damage may well ultimately lead to financial losses. Similarly, growing income inequality can hamper long-term, stable growth: research by the IMF has shown that rising inequality and fragile growth are linked.[17]

1.3 Fostering transparency and long-termism

Transparency of market participants' activities is essential to a well-functioning financial system. Corporate transparency on sustainability issues is a prerequisite to enable financial market actors to properly assess the long-term value creation of companies and their management of sustainability risks. Corporate reporting is ineffective when longer-term risks are not fully transparent and thus cannot be taken into account. Corporate transparency on sustainability will not only inform market participants, but also help to steer companies in a more sustainable and long-term direction.

Increased transparency, underpinned by innovative technologies, empowers citizens to compare the sustainability performance of companies and allows retail investors to make informed investment decisions. In this context, the Commission welcomes and encourages private initiatives on disclosure that promote easily accessible information on sustainable finance.

Sustainability and long-termism go hand in hand. Long-termism describes the practice of making decisions that have long-term objectives or consequences. Investments into environmental and social objectives require a long-term orientation. However, current market practices often focus on producing high returns over a short timeframe. Therefore, a central focus of the sustainability agenda

12 European Commission, Climate Action, https://ec.europa.eu/clima/policies/budget_en

13 Lancet Report 2017, p.7.

14 $ 129 billion, as for Lancet Report 2017; 14b Ostry et al, 2014: https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

15 Battiston, S., A. Mandel, I. Monasterolo, F. Schutze, and G. Visentin, "A climate stresstest of the financial system," Nat. Clim. Chang., vol. 7, no. 4, pp. 283–288, Apr. 2017.

16 Both biodiversity loss and ecosystem collapse, and water scarcity, have been listed among the top ten global risks by World Economic Forum's 2018 Global Risks Report.

17 Ostry et al, 2014: https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf

is to reduce the undue pressure for short-term performance in financial and economic decision-making, notably by increased transparency, so that investors, whether corporate or retail, can take better informed and more responsible investment decisions.

2 Reorienting capital flows towards a more sustainable economy

2.1 A unified classification system for sustainable activities

A shift of capital flows towards more sustainable economic activities has to be underpinned by a shared understanding of what 'sustainable' means. A unified EU classification system - or taxonomy - will provide clarity on which activities can be considered 'sustainable'. It is at this stage the most important and urgent action of this Action Plan. Clear guidance on activities qualifying as contributing to climate change mitigation and adaptation, environmental and social objectives will help inform investors. It will provide detailed information on the relevant sectors and activities, based on screening criteria, thresholds and metrics. This is an essential step in supporting the flow of capital into sustainable sectors in need of financing. An EU taxonomy will be gradually integrated into EU legislation to provide more legal certainty.

Due to the complexity and highly technical nature of developing such a classification system, it will take time to arrive at a fully-fledged EU sustainability taxonomy, covering climate, environment and social aspects. Furthermore, ongoing monitoring will be necessary in light of evolving EU policy objectives and other aspects, such as market, environmental and technological developments. Therefore, the Commission proposes to proceed with a step-by-step approach, starting with a taxonomy on climate change mitigation and adaptation activities and some environmental activities. As a second step, the taxonomy will cover remaining environmental and social activities, recognising that one aspect of sustainability must not be detrimental to other related risks or objectives.

Action 1: Establishing an EU classification system for sustainable activities

1. Subject to the outcome of its impact assessment, **the Commission will table a legislative proposal in Q2 2018 that will ensure the progressive development of an EU taxonomy** for climate change, environmentally and socially sustainable activities, building on existing work, where relevant. The aim is to embed the future EU sustainability taxonomy in EU law and provide the basis for using such a classification system in different areas (e.g. standards, labels, green-supporting factor for prudential requirements, sustainability benchmarks). The proposal will include tools allowing such a classification system to be established and regularly updated.

2. In addition, and as a first intermediate step, **the Commission will set up a technical expert group on sustainable finance**. The group will be asked, on the basis of broad consultation of all relevant stakeholders, to publish a report providing a first **taxonomy with a particular focus on climate change mitigation activities by Q1 2019**. This is to be extended to **climate change adaptation and other environmental activities by Q2 2019.** These reports will be a building block in the Commission's progressive development of the EU sustainability taxonomy and will in the meantime be an initial point of reference for investment in climate change-related and environmental activities.

2.2 Standards and labels for sustainable financial products

Building on the future EU sustainability taxonomy, EU standards and labels for sustainable financial products would protect the integrity of and trust in the sustainable financial market, as well as enable easier access for investors seeking those products. For instance, green bonds allow entities (companies, banks, governmental organisations, etc.) to borrow money from investors in order to finance or re-finance 'green' projects, assets or business activities. While the green bond market is expanding rapidly, it still accounts for less than 1% of total bonds outstanding worldwide.[18] Drawing on current best practices, an EU standard accessible to market participants would facilitate channelling more investments into green projects and would constitute a basis for the development of reliable labelling of financial products.

Labelling schemes can be particularly useful for retail investors who would like to express their investment preferences on sustainable activities. They could facilitate retail investors' choice by gradually being integrated in tools, like comparison websites or financial planning services, currently developed in the context of the Commission's Consumer Financial Services Action Plan. Surveys suggest that retail investors increasingly want their investments to take into account climate, environmental and social considerations.[19] However, the lack of labelled financial products may prevent investors from directly channelling their funds into sustainable investments. The Commission sees the potential merit in the use of the EU Ecolabel Regulation to create a voluntary EU-wide labelling scheme. Criteria would have to be identified for specific financial products offered to retail investors (such as Packaged Retail Investment and Insurance Products). The Commission will also consider the merits of a labelling scheme for socially responsible financial products, such as SRI,[20] building on the experience of the European Social Entrepreneurship Funds.

Action 2: Creating standards and labels for green financial products

1. As a first step, **the Commission's technical expert group on sustainable finance** will be responsible, on the basis of the results of a public consultation, for preparing **a report on an EU green bond standard by Q2 2019, building on current best practices.**

2. Within the framework of the Prospectus Regulation, **the Commission will specify by Q2 2019 the content of the prospectus for green bond issuances** to provide potential investors with additional information.

3. T**he Commission will explore the use of the EU Ecolabel framework for certain financial products**, to be applied once the EU sustainability taxonomy is adopted.

2.3 Fostering investment in sustainable projects

Mobilising private capital for sustainable projects, especially for infrastructure, is a prerequisite for the transition to a more sustainable economic model. According to the OECD, infrastructure contributes to about 60% of greenhouse gas emissions.[21] Given the needs for sustainable infrastructure investment, continued progress in developing appropriate frameworks to leverage private investment alongside public funds is key.

The capacity to develop and implement projects, however, varies widely across the EU and between sectors. Greater advisory and technical assistance would contribute to a larger pipeline of sustainable projects. Beyond large-scale infrastructure projects, the clean energy transition also requires adequate finance available for smaller-scale, distributed projects.[22]

In addition to grants,[23] as part of the Investment Plan for Europe, the Commission has significantly boosted its financial and technical support for sustainable infrastructure investment, in particular through the EFSI and the European Investment Advisory Hub. The EFSI has proven to be

18 G20 Green Finance Study Group, G20 Green Finance Synthesis Report, 2016.

19 Such as the French and SRI: Results of the 8th National Survey run by Ipsos for Vigeo Eiris and the FIR; Natixis Gobal Asset Management, “Mind Shift – Getting past the screens of responsible investing”, 2017; and Schroders, “Global perspectives on sustainable investing”, 2017.

20 Socially responsible investment funds or Sustainable and responsible investment funds are funds integrating environmental, social and governance factors in their investment decision making process.

21 OECD, Investing in Climate, Investing and Growth, 2017.

22 This concerns particularly energy efficiency improvements, for example in buildings, and deployment of renewable energy. The Commission has proposed actions that stimulate such investments as part of the Clean Energy for all Europeans package.

23 Such as the Connecting Europe Facility

instrumental in crowding in private investment for strategic projects across the EU, mobilising almost EUR 265 billion in total investments.[24] Following its successful first years of operation, the EFSI has been recently extended until 2020 (EFSI 2.0) and its investment target has been raised to half a trillion euros. In addition, the EFSI 2.0 will focus even more on sustainable projects, with at least 40% of EFSI financing for infrastructure and innovation to support climate action projects. The European Investment Advisory Hub, the EU's gateway for investment support, will also provide greater advisory capacity at regional and local level to promote projects with a climate, environmental and social impact.

In parallel, the roll-out of the EU External Investment Plan (EIP) will encourage sustainable investments in partner countries, starting from Africa and the EU Neighbourhood. The EIP is expected to leverage more than €44 billion of investments by 2020, by mobilising public and private finance through the European Fund for Sustainable Development (EFSD), providing technical assistance on investment projects, and fostering a favourable investment climate and business environment. Sustainable development is integrated into the design of the instrument and all projects will have a clear sustainability dimension, for example by supporting sustainable agriculture and connectivity, as well as the creation of decent jobs.

For the post-2020 multiannual financial framework, the Commission has come forward with the idea of establishing a single investment fund integrating all EU market-based instruments to further increase the efficiency of EU investment support for discussion by the European Union's Leaders.[25] Building on the successful roll-out of the EFSI, such a fund could provide financial support and related technical assistance to crowd in private investment, including for sustainable infrastructure. Backed by an EU budgetary guarantee, a single investment fund could support investment priorities and simplify interaction between investors, beneficiaries, the EU Commission, implementing partners, like the EIB and national promotional banks, and potential new partners, such as foundations and philanthropic organisations. As a continuation of the European Investment Advisory Hub, such support could also include a project development assistance component to continue to build more capacity for developing sustainable projects.

Action 3: Fostering investment in sustainable projects

Building on the ongoing efforts to **reinforce advisory capacity**, including for **developing sustainable infrastructure projects**, the Commission will take **further measures** that will improve the efficiency and impact of instruments aiming at sustainable investment support in the EU and in partner countries.

2.4 Sustainability considerations in financial advice

By providing advice, investment firms and insurance distributors can play a central role in reorienting the financial system towards sustainability. Prior to the advisory process, these intermediaries are required to assess clients' investment objectives and risk tolerance in order to recommend suitable financial instruments or insurance products. However, investors' and beneficiaries' preferences as regards sustainability are often not sufficiently taken into account when advice is given.

The Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) require investment firms and insurance distributors to offer 'suitable' products to meet their clients' needs, when offering advice. For this reason, those firms should ask about their clients' preferences (such as environmental, social and governance factors) and take them into account when

24 As of February 2018.

25 Communication from the Commission "A new, modern Multiannual Financial Framework for a European Union that delivers efficiently on its priorities post-2020" - The European Commission's contribution to the Informal Leaders' meeting on 23 February 2018.

assessing the range of financial instruments and insurance products to be recommended, i.e. in the product selection process and suitability assessment.

Action 4: Incorporating sustainability when providing financial advice

Subject to the outcome of its impact assessment**, the Commission will amend the MiFID II and IDD delegated acts in Q2 2018** to ensure that sustainability preferences are taken into account in the suitability assessment. Based on these delegated acts, **the Commission will invite the European Securities Markets Authority (ESMA) to include provisions on sustainability preferences in its guidelines on the suitability assessment** to be updated by Q4 2018.

2.5 Sustainability benchmarks

Benchmarks are indices that play a central role in the price formation of financial instruments and other relevant assets in the financial system. Benchmarks are useful instruments for investors, as they allow to track and measure performance and allocate assets accordingly.

Traditional benchmarks reflect the status quo and their methodologies, as a result, reflect sustainability goals only to a limited degree. As such, they are not appropriate to measure the performance of sustainable investments. In response, index providers have been developing ESG benchmarks to capture sustainability goals, but the lack of transparency regarding their methodologies has affected their reliability. More transparent and sounder sustainable indices' methodologies are needed to reduce greenwashing risks.[26] For instance, a sound methodology for low carbon indices should reflect compatibility with the objectives of the Paris Agreement, in order to improve the performance assessment of low-carbon funds.

Action 5: Developing sustainability benchmarks

By Q2 2018, the Commission intends to (i) adopt delegated acts, within the framework of the Benchmark Regulation, **on the transparency of the methodologies and features of benchmarks** to allow users to better assess the quality of sustainability benchmarks; and **(ii) put forward, subject to the outcome of its impact assessment, an initiative for harmonising benchmarks comprising low-carbon issuers,** based on a sound methodology to calculate their carbon impact, to be put into operation once the climate taxonomy is in place. The Commission's technical expert group will, on the basis of consultation of all relevant stakeholders, publish a report on the design and methodology of the low-carbon benchmark by Q2 2019.

3 Mainstreaming sustainability into risk management

3.1 Sustainability in market research and credit ratings

In recent years, market research providers and sustainability rating agencies have stepped up their efforts to assess companies' environmental, social and governance performance and their ability to manage sustainability risks. Such assessments contribute to a more sustainable allocation of capital and improve the information flow between issuers and investors. The lack of broadly-accepted market standards to assess companies' sustainability performance makes the transparency of the methodology used by research providers particularly important. Additionally, some stakeholders argue that the focus of sustainability research providers on very large issuers has a negative impact on the attractiveness of smaller issuers for institutional investors.

Credit ratings are also an important element of well-functioning financial markets, as they provide investors with assessments of the creditworthiness of companies and public institutions. Credit rating

26 The use of marketing to portray an organisation's products, activities or policies as environmentally friendly when they are not.

agencies operate in a highly concentrated market and adopt their credit ratings based on the relevant available information. However, it remains unclear to what extent sustainability factors are being considered. The Commission is monitoring developments in the credit rating market and acknowledges the need for greater understanding of and transparency about how credit rating agencies take sustainability factors into account. The Commission will invite ESMA to promote solutions which would ensure that credit rating agencies fully integrate sustainability and long-term risks. The Commission will also continue engaging on those issues with all relevant stakeholders, including as regards the possible emergence of new credit rating agencies that would meet this objective.

Action 6: Better integrating sustainability in ratings and market research

1. **Starting in Q2 2018, the Commission will engage with all relevant stakeholders** to explore the merits of amending the Credit Rating Agency Regulation to mandate credit rating agencies to explicitly integrate sustainability factors into their assessments in a proportionate way to preserve market access for smaller players. Commission services will report on the progress made on this by Q3 2019.
2. **The Commission invites ESMA** to: (i) assess current practices in the credit rating market by Q2 2019, analysing the extent to which environmental, social and governance considerations are taken into account; (ii) include environmental and social sustainability information in its guidelines on disclosure for credit rating agencies by Q2 2019 and consider additional guidelines or measures, where necessary.
3. **The Commission will carry out a comprehensive study on sustainability ratings and research by Q2 2019**. It will analyse methodologies and explore aspects like the market structure of sustainability ratings and market research services, the depth and breadth of sustainability research assessments and scoring, and the independence of those research/scoring providers. The study will also explore possible measures to encourage sustainability ratings and market research.

3.2 Institutional investors' and asset managers' sustainability duties

Several pieces of EU legislation[27] require institutional investors and asset managers to act in the best interest of their end-investors/beneficiaries. This is commonly referred to as 'fiduciary duty'. However, current EU rules on the duty of institutional investors and asset managers to consider sustainability factors and risks in the investment decision process are neither sufficiently clear nor consistent across sectors.

Evidence suggests that institutional investors and asset managers still do not systematically consider sustainability factors and risks in the investment process. Also, institutional investors and asset managers do not sufficiently disclose to their clients if and how they consider these sustainability factors in their decision-making. End-investors may, therefore, not receive the full information they need, should they want to take into account sustainability-related issues in their investment decisions. As a result, investors do not sufficiently take into account the impact of sustainability risks when assessing the performance of their investments over time.

Action 7: Clarifying institutional investors' and asset managers' duties

Subject to the outcome of its impact assessment, **the Commission will table a legislative proposal to clarify institutional investors' and asset managers' duties in relation to sustainability considerations by Q2 2018.** The proposal will aim to (i) explicitly require institutional investors and asset managers to integrate sustainability considerations in the investment decision-making process

27 Including Solvency II, IORP II, UCITS, AIFMD and MiFID II.

and (ii) increase transparency towards end-investors on how they integrate such sustainability factors in their investment decisions, in particular as concerns their exposure to sustainability risks.

3.3 Prudential requirements for banks and insurance companies

Banks, insurance companies and pension funds are the main source of external finance for the European economy and an important channel of savings for investments. As a result, they could provide the critical mass of investments needed to close the gap for the transition to a more sustainable economy. However, banks, insurance companies and pension funds may also be exposed to risks related to unsustainable economic development. For instance, some estimates suggest that at least half of the assets of banks in the Euro area[28] are currently exposed to climate change-related risks. Such risks for financial stability have also been flagged by macro-prudential supervisors.[29]

This calls for a better reflection of risks associated with climate and other environmental factors in prudential regulation with a careful calibration that would not jeopardise the credibility and effectiveness of the current EU prudential framework and its risk-based nature. Building on the development of the EU sustainability taxonomy, the Commission will assess whether more appropriate capital requirements could be adopted to better reflect the risk of sustainable assets held by banks and insurance companies. Such a supporting factor would need to be progressively phased in, as the EU taxonomy develops. For instance, in its calibration, the Commission will consider all the available evidence on the link between energy efficiency savings and mortgage loan performance.[30]

Moreover, in its analysis of the Basel recommendations of December 2017, the Commission will pay particular attention to the possible negative impact on European bank lending, investment and other activities, which are critical for sustainable finance.

Action 8: Incorporating sustainability in prudential requirements

1. **The Commission will explore the feasibility of the inclusion of risks associated with climate and other environmental factors in institutions' risk management policies and the potential calibration of capital requirements of banks as part of the Capital Requirement Regulation and Directive.** The aim would be to take into account such factors, where this is justified from a risk perspective, to safeguard the coherence and effectiveness of the prudential framework and financial stability. Any recalibration of capital requirements, based on data and the assessment of the prudential risk of banks' exposures, would need to rely on and be coherent with the future EU taxonomy on sustainable activities (see Action 1).
2. **In Q3 2018, the Commission will invite the European Insurance and Occupational Pensions Authority (EIOPA) to provide an opinion on the impact of prudential rules for insurance companies on sustainable investments,** with a particular focus on climate change mitigation. The Commission will take this opinion into account in the report to be submitted to the European Parliament and Council by 1 January 2021 under the Solvency II Directive.[31]

4 Fostering transparency and long-termism

4.1 Disclosure and accounting

Corporate reporting on sustainability issues enables investors and stakeholders to assess companies' long-term value creation and their sustainability risk exposure. Since 2018, the EU Directive on the

28 Battiston et al.; for a more comprehensive literature review, please see ESRB (2016) Too late, too sudden: https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_6_1602.pdf.
29 ESRB (2016) Too late, too sudden: https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_6_1602.pdf.
30 Several market initiatives are starting to collect relevant data for a more thorough risk assessment of sustainable investments. E.g the EU-funded EeMAP initiative is carrying out work demonstrating a correlation between energy efficiency in buildings and mortgage performance..
31 Article 77f and 111 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance.

disclosure of Non-Financial Information (NFI) requires large public interest entities to disclose material information on key environmental, social and governance aspects and how risks stemming from them are managed.[32] The Directive allows companies to report sustainability information in a flexible manner. Going forward, an appropriate balance needs to be struck between flexibility and the standardisation of disclosure necessary to generate the data needed for investment decisions. In terms of disclosure by the financial sector, there is merit in enhancing transparency of asset managers and institutional investors, including the way in which they consider sustainability risks and their exposures to climate-related risks.

There are also growing concerns that the current accounting rules are not conducive to sustainable investment decision-making. In particular, the European Parliament's resolution on International Financial Reporting Standard (IFRS) 9, adopted on 6 October 2016,[33] raised concerns about the impact the new accounting standard on financial instruments (IFRS 9) might have on long-term investments. The Commission recognises the importance of ensuring that accounting standards do not directly or indirectly discourage sustainable and long-term investments. In this regard, consideration is needed about whether there could be more flexibility as concerns the endorsement of IFRSs wherever specific adjustments would be more conducive to long-term investment.

Action 9: Strengthening sustainability disclosure and accounting rule-making

1. **The Commission is launching a fitness check of EU legislation on public corporate reporting, including the NFI Directive** to assess whether public reporting requirements for listed and non-listed companies are fit for purpose. It will include the evaluation of sustainability reporting requirements and the prospects for digitalised reporting. The Commission will launch a public consultation on this in Q1 2018. The conclusions of the fitness check will be published by Q2 2019 and will inform any future legislative proposals to be adopted by the Commission.
2. **By Q2 2019, the Commission will revise the guidelines on non-financial information.** Building on the metrics to be developed by the Commission technical expert group on sustainable finance, the revised guidelines should provide further guidance to companies on how to disclose climate-related information, in line with the Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD)[34] and the climate-related metrics developed under the new classification system (see Action 1). Subsequently, the guidelines will be amended to include other environmental and social factors.
3. **By Q3 2018, a European Corporate Reporting Lab will be established as part of the European Financial Reporting Advisory Group (EFRAG),** to promote innovation and the development of best practices in corporate reporting, such as environmental accounting. In this forum, companies and investors can share best practices on sustainability reporting, such as the climate-related disclosure in line with the TCFD's recommendations.
4. In terms of disclosure by asset managers and institutional investors, as part of the Commission's legislative proposal in Action 7, **they would be requested to disclose how they consider sustainability factors in their strategy and investment decision making process,** in particular for their exposures to climate change-related risks.
5. **The Commission will request EFRAG, where appropriate, to assess the impact of new or revised IFRSs on sustainable investments.**[35] The Commission will also ask EFRAG to explore potential alternative accounting treatments to fair value measurement for long-term investment portfolios of equity and equity-type instruments. In Q4 2018, the Commission will report, taking into account EFRAG current work, on the impact of IFRS 9 on long-term investments and explore improvements to the standard for the treatment of equity instruments.

32 Based on the 2017 financial year of large companies with more than 500 employees listed on a regulated market as well as non-listed banks and insurance companies.

33 http://www.europarl.europa.eu/oeil-mobile/fiche-procedure/2016/2898(RSP)

34 https://www.fsb-tcfd.org/

35 This will be done as part of EFRAG analysis of the European public good criterion.

6. Within the fitness check of EU legislation on public corporate reporting, **the Commission will also evaluate relevant aspects of the International Accounting Standards Regulation**. It will in particular **explore how the adoption process of IFRSs** can allow for specific adjustments to standards where they are not conducive to the European public good, e.g. where the standards could pose an obstacle to long-term investment objectives.

4.2 Corporate governance and undue capital market short-termism

Corporate governance can significantly contribute to a more sustainable economy, allowing companies to take the strategic steps necessary to develop new technologies, to strengthen business models and to improve performance. This would in turn improve their risk management practices and competitiveness, thus creating jobs and spurring innovation. Many companies have corporate governance strategies to this end, even if they are not always easily comparable.

Despite the efforts made by several European companies, undue short-term market pressures may make it difficult to lengthen the time horizon in corporate decision-making. Corporate managers may become overly focused on short-term financial performance and disregard opportunities and risks stemming from environmental and social sustainability considerations. As a consequence, the interactions between capital market pressures and corporate incentives may lead to unnecessary exposure in the long-term to sustainability risks. The Commission will engage with all relevant stakeholders to analyse this issue more closely.

Action 10: Fostering sustainable corporate governance and attenuating short-termism in capital markets

1. To promote corporate governance that is more conducive to sustainable investments, by Q2 2019, the Commission will carry out analytical and consultative work with relevant stakeholders to assess: (i) **the possible need to require corporate boards to develop and disclose a sustainability strategy,** including appropriate due diligence throughout the supply chain, **and measurable sustainability targets**; and (ii) **the possible need to clarify the rules according to which directors are expected to act in the company's long-term interest**.
2. **The Commission invites the ESAs to collect evidence of undue short-term pressure** from capital markets on corporations and consider, if necessary, further steps based on such evidence by Q1 2019. More specifically, the Commission invites ESMA to collect information on undue short-termism in capital markets, including: (i) portfolio turnover and equity holding periods by asset managers; (ii) whether there are any practices in capital markets that generate undue short-term pressure in the real economy.

5 Action Plan implementation

Bold and ambitious policies towards meeting the challenges of climate change, environmental degradation, resource depletion, and social sustainability can only be successful if tackled with the right prioritisation and sequencing.

This Action Plan emphasises in particular the importance and urgency of developing an EU taxonomy, which would provide unified definitions and enable reliable and comparable information on sustainable investments. This is a pre-condition for actions like standards, labels, the calibration of prudential requirements and the use of low-carbon benchmarks. The EU taxonomy is also complementary to the implementation of actions like corporate disclosure or the provision of financial advice.[36] While the taxonomy work will begin on climate change mitigation, the scope will

36 Annex I illustrates the crucial role of the EU taxonomy for the various measures set out in this Action Plan.

be progressively expanded to climate change adaptation and other environmental issues and, later on, to social sustainability. Such an approach reflects the urgency to act against climate change and to meet our long-term climate and energy targets.

The implementation strategy combines non-legislative and legislative actions with new measures and carefully targeted amendments to existing rules. Alongside legislative measures, non-legislative measures would ensure adaptability and minimise administrative burdens.[37] The Commission will ensure that any relevant impact of financial services legislation on sustainability is properly assessed in the relevant impact assessments, public consultations and ex-post evaluations, in line with the Better Regulation guidelines and toolbox.[38]

The smooth implementation of this Action Plan, as well as monitoring the achievement of its three main objectives, will need appropriate technical support and a solid governance structure, given the expertise needed around all fields of sustainable development.

In the short term, the Action Plan calls on the ESAs to provide direct support to its implementation by performing specific tasks, along the lines suggested in this strategy. Notably, the ESAs should provide guidance on how sustainability considerations can be effectively taken into account in relevant EU financial services legislation and help to identify existing gaps. They should also promote convergence on the implementation of sustainability considerations in EU law. The Commission will assess the future resourcing of the ESAs in the context of the post-2020 multiannual financial framework. In the short term the ESAs should play an important role in identifying and reporting on the risks that sustainability factors pose to financial stability. This could be done through the development of a common EU methodology for relevant scenario analyses, which could later evolve into climate/environment stress testing.

In the longer term, in view of the implications that the new classification system (taxonomy) has on the implementation of this Action Plan and to ensure adaptability over time, the Commission will consider setting up a more stable governance structure, to be operational once the legal framework on taxonomy is in place. This governance structure would be a public-private platform bringing together experts and market participants with public sector bodies, such as the ESAs, the EEA, the European Investment Bank (EIB) and Eurostat. In particular, this Platform would monitor key developments to ensure the progressive scale-up and adaptability of the EU sustainability taxonomy. Over time, it may also carry out other tasks necessary to achieve the objectives of this Action Plan. The Platform may also advise the Commission on future sustainable finance actions and will provide a central forum of discussion among policy-makers and other relevant stakeholders. By raising awareness and facilitating the work ahead, the Platform would ensure that sustainability remains a permanent feature of policy design over time.

6 The way forward

This Action Plan will be instrumental to help deliver on the Paris Climate Agreement and the Sustainable Development Goals set out in the Commission's Communication on 'Next steps for a Sustainable European future: European actions for sustainability'. In the State of the Union Address 2017, President Jean-Claude Juncker declared the ambition for Europe to be the leader when it comes to the fight against climate change. Following the decision of the United States to withdraw from the 2015 Paris Agreement, there is a growing need for global leadership in the move towards sustainable development. Europe is well-placed to step into the role of global leader and, in doing so, can become the chosen destination for sustainable investments, such as low-carbon technologies.

37 Annex II clarifies the timeline and sequencing of key measures set out in this Action Plan.

38 https://ec.europa.eu/info/better-regulation-guidelines-and-toolbox_en

The Commission recognises that the financial sector has a key role to play in reaching these fundamental environmental and social goals, as large amounts of private capital need to be mobilised for such change. The Commission will also aim at minimising the impact of new financial stability risks stemming from environmental and social issues for the financial system and citizens that are affected by the significant negative impact of climate change. This would help European businesses to remain competitive in a changing global economy.

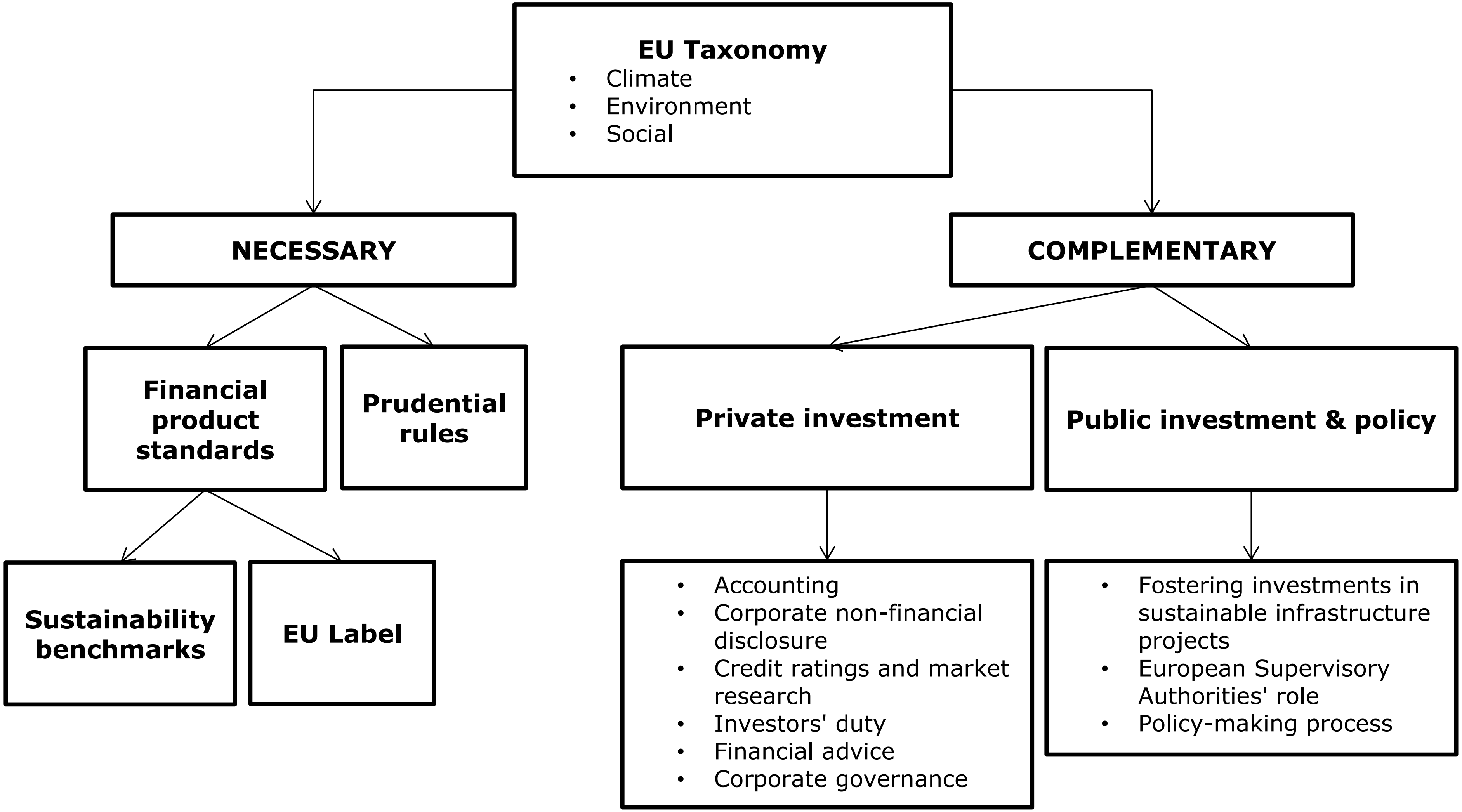
The European Union, however, cannot deliver this long-lasting change alone. A coordinated, global effort is crucial. By setting a benchmark for sustainable finance policies in this Action Plan, the Commission also calls on other players, including Member States,[39] supervisors, the private sector and major non-EU countries, to take decisive action to promote and lead transformation in their respective areas. This Action Plan thus aims to be a blueprint for future discussions in international fora to promote a renewed approach to managing the financial system more sustainably. The Commission will promote discussions on this Action Plan in existing fora, such as the Financial Stability Board, the G20, the G7, the United Nations and the International Organisation of Securities Commission (IOSCO).

The Commission will report on the implementation of this Action Plan in 2019. The strategy set out in this Action Plan is a first essential step in moving towards sustainability. But it needs to be complemented by measures in other areas[40], requiring concerted efforts from all relevant actors, to reach its full potential.

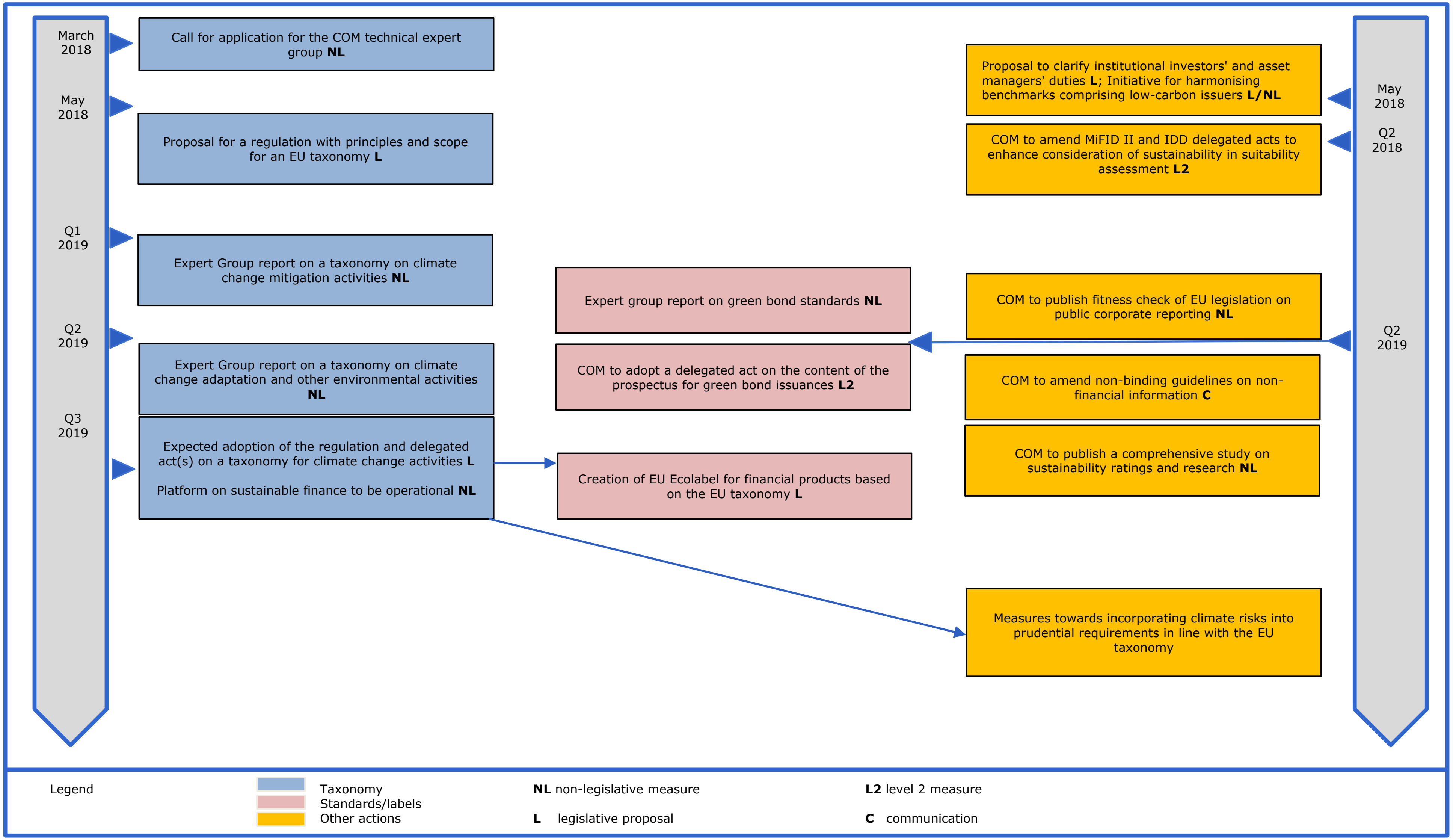
39 The Commission will set up a dedicated Member States expert group on sustainable finance.

40 Such as environment (including natural capital), social dimensions, marine resources and agriculture.

Annex I – Role of the EU taxonomy in the Action Plan



Annex II - Implementation timeline



Annex III – Workplan of the initiatives set out by this Action Plan

This annex provides an overview of the initiatives included in the Action Plan. The tables below also indicate- where already determined – whether a measure takes a form of **legislative proposal (L), level 2 measure (L2) or non-legislative measure (NL).**

1. ESTABLISHING AN EU CLASSIFICATION SYSTEM FOR SUSTAINABILITY ACTIVITIES		
Subject to the results of its impact assessment, Commission legislative proposal on the development of an EU taxonomy for climate change, environmentally and socially sustainable activities	**(L)**	Q2 2018
Report of the Commission technical expert group providing a taxonomy for climate change mitigation activities	**(NL)**	Q1 2019
Report of the Commission technical expert group providing a taxonomy for climate change adaptation and other environmental activities	**(NL)**	Q2 2019

2. CREATING STANDARDS AND LABELS FOR GREEN FINANCIAL PRODUCTS		
Report of the Commission technical expert group on a standard for green bonds	**(NL)**	Q2 2019
Commission delegated act on the content of the prospectus for green bond issuances	**(L2)**	Q2 2019
Assessment of applying the EU Ecolabel to financial products	**(NL)**	As of Q2 2018

3. FOSTERING INVESTMENT IN SUSTAINABLE PROJECTS
Building on the ongoing efforts to reinforce advisory capacity, including for developing sustainable infrastructure projects, the Commission will take further measures that will improve the efficiency and impact of instruments aiming at sustainable investment support in the EU and in partner countries.

4. INCORPORATING SUSTAINABILITY WHEN PROVIDING INVESTMENT ADVICE		
Subject to the results of its impact assessment, Commission delegated acts (MiFID and IDD) on the suitability assessment	**(L2)**	Q2 2018
ESMA to include sustainability preferences as part of its guidelines on the suitability assessment	**(NL)**	Q4 2018

5. DEVELOPING SUSTAINABILITY BENCHMARKS		
Commission delegated acts on the transparency of the methodology of benchmarks and on the features of the benchmarks	**(L2)**	Q2 2018
Subject to the results of its impact assessment, an initiative creating a designated category of benchmarks comprising low-carbon issuers	**(L/NL)**	Q2 2018
Report of the Commission's technical expert group on the design and methodology of the low-carbon benchmark	**(NL)**	Q2 2019

6. BETTER INTEGRATING SUSTAINABILITY IN RATINGS AND RESEARCH		
Commission services report on progress made on the actions involving credit rating agencies	**(NL)**	Q3 2019
ESMA to assess current practices in the credit rating market; ESMA to include ESG information in its guidelines on disclosure for credit rating agencies	**(NL)**	Q2 2019
Study on sustainability ratings and research	**(NL)**	Q2 2019

7. CLARIFYING INSTITUTIONAL INVESTORS AND ASSET MANAGERS' DUTIES		
Subject to the results of its impact assessment, Commission legislative proposal to clarify institutional investors' and asset managers' duties on sustainability and to increase transparency of end-investors, including transparency on their strategy and climate-related exposures	**(L)**	Q2 2018

8. INCORPORATING SUSTAINABILITY IN PRUDENTIAL REQUIREMENTS		
Work towards incorporating climate risks into institutions' risk management policies and on the potential calibration of banks' capital requirements in the Capital Requirement Regulation and Directive to take into account climate change-related risks while safeguarding financial stability and ensuring coherence with the EU taxonomy.	Issue under discussion in the on-going legislative procedure	2018-2019
The Commission will invite the European Insurance and Occupational Pensions Authority to assess the impact of prudential rules for insurance companies on sustainable investment	**(NL)**	Q3 2018

9. STRENGTHENING SUSTAINABILITY DISCLOSURE AND ACCOUNTING RULE-MAKING		
Publication of conclusions of the fitness check on public corporate reporting. This will inform any future legislative action by the Commission.	**(NL)**	Q2 2019
Revision of the guidelines on non-financial information as regards climate-related information.	**(NL)**	Q2 2019
Subject to the result of its impact assessment, proposal requiring asset managers and institutional investors to disclose how they consider sustainability factors in their investment decision making process (as part of the proposal foreseen under action 7).	**(L)**	Q2 2018
Establishing a European Corporate Reporting Lab as part of EFRAG	**(NL)**	Q3 2018
Commission to systematically request EFRAG to assess in its endorsement advice the potential impact of new or revised IFRS standards on sustainable investments	**(NL)**	Q1 2018
Commission request to EFRAG to explore sound alternative accounting treatments to fair value measurement for long-term investment portfolios of equity and equity-type instruments	**(NL)**	Q2 2018
Commission report on the impact of IFRS 9 on long-term investments	**(NL)**	Q4 2018

10. FOSTERING SUSTAINABLE CORPORATE GOVERNANCE AND ATTENUATING SHORT-TERMISM IN CAPITAL MARKETS		
Assessment of possible ways to promote corporate governance more conducive to sustainable finance	**(NL)**	Q2 2019
ESAs to collect evidence of undue short-term pressure from capital markets on corporations and consider further steps based on such evidence	**(NL)**	Q1 2019

Annex IV - Visualisation of the actions