

# Sustainable Finance in the EU: Priorities to unlock financing and investment

November 2023



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## Foreword

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As the impacts of climate change and nature degradation continue to be seen around us, it is imperative to make further progress in meeting global and regional climate change, nature restoration and broader sustainability goals.

The next EU mandate will cover the lead up to 2030 and will be a critical period in which progress must be made. It is vital that the EU maintains focus on providing the policy and regulatory environment to support the transition of the economy to meet these goals. As the European Commission has recognised, achieving these goals will require very significant further investments by both governments and the private sector.

Over the last five years, the EU has built a comprehensive regulatory framework which aims to channel private capital in support of sustainability goals. AFME continues to support the objectives of mobilising capital in support of sustainability objectives. This report provides our members' constructive feedback on challenges they are facing in scaling sustainable finance, how the EU regulatory framework is functioning, and how it can be strengthened to further support these objectives.

We hope that these recommendations provide an important contribution as policymakers reflect upon the progress made and opportunities to enhance the policy and regulatory framework for sustainable finance.



**Adam Farkas**  
**Chief Executive**  
Association for Financial Markets in Europe

**“It is imperative to make further progress in meeting global and regional climate change, nature restoration and broader sustainability goals”**



## Introduction

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AFME continues to strongly support the important role of capital markets and private finance in supporting the transition of the EU and global economies to meet climate, environmental and social objectives. As the European Commission has highlighted, the EU will need additional investments of c. EUR 700 billion annually to meet the objectives of the Green Deal, REPowerEU and the Net Zero Industry Act, with the majority reliant on private financing.<sup>1</sup>

Financial institutions have an important role to play in providing and facilitating the financing and capital needed to support companies as they decarbonise. However, to make progress in meeting sustainability goals, it is crucial that the EU institutions and Member States focus on putting in place the policies, roadmaps, incentives, mandates and investments for the real economy to have the information, the tools and incentives to adapt their businesses. This will in turn facilitate finance which will be available to support companies' investment and financing needs throughout the transition. We believe that this should be the foremost priority.

The more that governments and companies across the economy understand their transition needs and make the necessary substantial investments, and the more governments and policymakers establish roadmaps and make available the necessary incentives to allow real economy companies to transition, the better that investors and financial institutions will be able to channel finance in support of the very significant investment needed.

The building blocks for the regulatory framework for sustainable finance in the EU are now in place or in the process of implementation. The last five years have seen a Herculean effort from policymakers, regulators and financial institutions to establish and implement a regulatory framework for sustainable finance. This has been done at speed and has created important new legislation aiming to facilitate the provision of finance in support of the EU's sustainability objectives and to ensure that financial institutions manage climate and environmental risk effectively.

The EU has established the most ambitious, comprehensive and complex regulatory framework for sustainable finance in the world.<sup>2</sup> While this has put the EU at the forefront of regulation in this area, now is an important time to take stock, provide time for implementation and reflect upon how this is working and how it can be improved. It is also essential to keep in mind that financial institutions will continue to face a huge challenge in implementing the regulatory framework over the next few years.

It is essential that the EU regulatory framework supports banks' role in helping finance the transition and that it works in a way that supports the growth and competitiveness of the EU economy. This report provides AFME's perspective and recommendations to inform this work, building upon detailed discussions and a survey of our member firms.

**“It is essential that the EU regulatory framework supports banks' role in helping finance the transition”**

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<sup>1</sup> Communication “A sustainable finance framework that works on the ground”, 13 June 2023

<sup>2</sup> See [AFME Sustainable Finance in Europe: Regulatory State of Play Report](#) for an overview of the European regulatory framework and how it impacts financial institutions.



## Introduction

Most importantly, a stocktake of progress to date should include an assessment of whether the financial regulatory framework is achieving its ultimate objective of supporting real economy transition. While sustainable finance regulation can facilitate the provision of financing for sustainable activities through the growth of sustainability labelled financial products as one tool for financing real economy transition, this is insufficient in itself to drive the degree of real economy change required. The EU's head start is quickly being eclipsed by simpler and more generous policy frameworks focused on incentivising real economy transition, in particular the US Inflation Reduction Act (IRA). Finance and investment in support of IRA-related real economy activity is not driven by sustainable finance regulation but by the commercial incentives for real economy transition that the IRA creates.

Banks' ability to provide finance in support of the transition will depend on whether the conditions are in place to enable the real economy to transition, which then creates opportunities for finance and investment to support those real economy activities.

It is therefore crucial that the focus on the real economy transition is prioritised for the next European Commission mandate. Alongside this, further evaluation and enhancement of the regulatory framework for sustainable finance should be undertaken to ensure that it works as effectively as possible, minimises the complexity and burden on financial institutions and is interoperable with requirements in other jurisdictions. It is also important that key concepts are clear to enhance trust in markets for sustainable investment and financing, and to reduce the risk of greenwashing.

Against this background, the next European Commission has a key role to play in advancing the EU's sustainable finance framework in support of its climate and environmental goals. AFME looks forward to continuing to provide constructive input to this work.

AFME has surveyed its members on how they see the functioning of the current framework, the implementation challenges they face in applying it to financing companies and how its effectiveness could be improved. We have worked with members to provide constructive input to policymakers and this paper highlights our recommendations. Key areas addressed include how policymakers and regulators can further enable financial institutions in providing financing in support of climate, environmental and social goals in a way that supports growth and competitiveness, and provide a regulatory framework that works effectively to achieve this.

**“The next European Commission has a key role to play in advancing the EU’s sustainable finance framework in support of its climate and environmental goals”**



Our five high level priority recommendations are to:

- 1) Maintain focus on establishing roadmaps, reducing regulatory barriers for the deployment of sustainable investment projects and providing incentives for the real economy transition;
- 2) Ensure that the regulatory framework is achieving its goals, is coherent and usable in practice to promote and support sustainable finance (including transition finance);
- 3) Provide a stable regulatory framework with time for implementation and review how it is working in practice, with targeted guidance/changes introduced where needed in consultation with market participants;
- 4) Ensure that regulation is promoting investment and does not adversely impact the competitiveness of financial institutions or companies operating in the EU and internationally; and
- 5) Enhance international coordination and improve international interoperability with other key jurisdictions.

Alongside our recommendations on improving the functioning of the EU regulatory framework, we also set out our recommendations in three further important areas which we see as priorities for EU policymakers:

- 1) Facilitating transition finance;
- 2) Developing carbon markets; and
- 3) Scaling finance for nature.

The next section provides an overview of AFME's policy recommendations. These are discussed in greater detail in the sections that follow. Part one addresses the functioning of the EU regulatory framework for sustainable finance, reflecting upon feedback from our members, and considers how current challenges could be addressed. Part two is focused on the important role of transition finance and how this can be supported. Part three discusses how carbon markets can be further developed; and part four considers how finance can support nature and biodiversity objectives.

**“How can policymakers and regulators further enable financial institutions in providing financing in support of climate, environmental and social goals in a way that supports growth and competitiveness?”**



## Summary of policy recommendations

Policy objective/priority	AFME Policy recommendation(s)
<b>1. Enable the real economy transition</b> See sections 1.1.1 and 1.3	Maintain focus on establishing roadmaps, reducing regulatory barriers to the deployment of sustainable investment projects and providing incentives for the real economy transition.
<b>2. Introduce an “investment and competitiveness” check for regulation</b>	Introduce a new “investment and competitiveness check” to ensure that regulation is promoting investment and does not adversely impact the competitiveness of financial institutions or companies operating in the EU and internationally.
<b>3. Address ESG data availability challenges</b> See section 1.1.2	Support companies with Corporate Sustainability Reporting Directive (CSRD) implementation.  Address the sequencing of financial sector and real economy reporting and implications for financial sector disclosures where data is not disclosed by counterparties.  Maintain focus on the international interoperability of standards.  Finalise appropriate regulation of providers of ESG ratings and review whether action is required with respect to providers of ESG data products.
<b>4. Improve the usability of the EU Taxonomy</b> See section 1.1.3	Review the approach to Do-No-Significant-Harm (DNSH) to adopt a more user-friendly, principles-based approach.  Seek to foster the role of the EU Taxonomy as an effective instrument to support the sustainable transition of the real economy.  Seek to improve the usability of the EU Taxonomy, including for financing companies outside the EU.  Maintain emphasis on the work being done by the International Platform on Sustainable Finance to promote interoperability and consistency between taxonomies.
<b>5. Improve the functioning of Sustainable Finance Disclosure Regulation (SFDR)</b> See section 1.1.4	Proceed with the SFDR review with the aim of improving the functioning and clarity of the framework.
<b>6. Streamline and clarify financial sector reporting</b> See section 1.4	Streamline and improve the coherence of financial sector reporting requirements under SFDR, CSRD, Pillar 3 and Taxonomy Regulation.  Review the Green Asset Ratio (GAR) and other Key Performance Indicators (KPIs) for financial institutions under the EU Taxonomy Regulation.  Review the treatment of derivatives under SFDR and Taxonomy KPIs.  Consider opportunities to streamline disclosures under Pillar 3, ensuring consistency with CSRD and international alignment of Pillar 3 ESG reporting with work of the Basel Committee.
<b>7. Ensure coherence of transition planning requirements</b> See section 1.1.6	Ensure that transition planning requirements for companies and financial institutions are clear, coherent across regulation and internationally interoperable.
<b>8. Addressing greenwashing risk</b> See section 1.1.5	Ensure that the supervisory approach to addressing greenwashing balances the objectives of ensuring trust in the sustainable finance market without stifling innovation and growth of the market.
<b>9. Improve international application and interoperability</b> See section 1.1.7	Further strengthen cooperation with other jurisdictions to address international counterparts to enhance the international interoperability of EU and international regulation with a view to minimising fragmentation and overlapping regulation.  Areas for further coordination with other jurisdictions should include sustainability disclosures, sustainability due diligence, regulation of ESG ratings providers and any EU sustainability product categorisation system.





Policy objective/priority	AFME Policy recommendation(s)
<p><b>10. Promote and facilitate transition finance</b> See <b>section 2</b></p>	<p>Provide greater emphasis on the importance and role of transition finance as the EU and global economies continue to decarbonise and adapt to a low carbon economy, recognising that financial institutions will need to provide finance to all parts of the economy throughout the transition.</p> <p>Introduce policy measures to support and incentivise the real economy transition and promote the adoption of transition plans.</p> <p>Conduct a review of regulation with a “transition finance lens” to ensure that it is not unnecessarily constraining companies from accessing finance to support their transition.</p> <p>Open a dialogue with financial institutions to address challenges with the provision of transition finance.</p>
<p><b>11. Further develop carbon markets</b> See <b>section 3</b></p>	<p>Continue to strengthen the EU Emissions Trading Scheme (ETS) and work with international partners to further develop compliance markets internationally.</p> <p>Consider how policy and regulatory support for voluntary carbon markets can provide clarity on the role that they can play and to help support the growth of the market in credible carbon credits.</p>
<p><b>12. Scale finance for nature and biodiversity</b> See <b>section 4</b></p>	<p>Provide clarity and certainty on government policy needed to support existing high-level commitments on nature and coordinate corporate alignment with broader policy objectives.</p> <p>Work with market participants to address challenges in financing in support of nature and biodiversity, and support the growth of the market in natural capital financing products.</p>



## How well is the EU regulatory framework functioning?

### 1. How well is the EU regulatory framework for sustainable finance functioning and how can it be more effective?

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AFME welcomes the European Commission's emphasis on the importance of ensuring that the regulatory framework for sustainable finance works on the ground. The regulatory framework has been developed at speed with numerous initiatives and regulatory requirements introduced in a short space of time, giving rise to implementation challenges including a lack of appropriate sequencing and a need to improve coherence across regulation.

Market participants continue to experience significant challenges with implementing certain regulatory requirements and applying tools in support of financing the climate and environmental transition. It is therefore essential to reflect upon the existing framework, identify and address the usability, coherence and other challenges that are holding back the potential to achieve its goals.

AFME has surveyed its members and discussed how banks are utilising the sustainable finance framework, where they see challenges arising from the regulatory framework and how these could be addressed. This section of the paper highlights our views and recommendations on our proposed priority areas where we consider that improvements should be made so that the sustainable finance framework facilitates financing in support of the transition.

The key areas of the regulatory framework which we consider should be addressed as priorities include:

- 1) Addressing implications for financial sector disclosures where data is not available due to not being assessed as material by companies applying the ESRS or due to a lack of sequencing of disclosure obligations on the financial and non-financial sectors.
- 2) Improving the usability of the approach to Do-No-Significant-Harm in the EU Taxonomy.
- 3) Reviewing the functioning of SFDR.
- 4) Ensuring that the supervisory approach to addressing greenwashing balances the objectives of ensuring trust in the sustainable finance market without stifling innovation and growth of the market.
- 5) Ensuring that transition planning requirements are clear and consistent across EU regulation, support financial institutions' ability to support the transition globally, and are established in a manner that encourages international interoperability.
- 6) Further increasing cooperation with other jurisdictions through international and bilateral regulatory dialogues with a view to minimising fragmentation and overlapping regulation.
- 7) Improving the usability of EU standards for financing companies outside the EU, for example interoperability between the EU and other taxonomies and enhancing interoperability of sustainability disclosures.
- 8) Reviewing the effectiveness of the Green Asset Ratio and other KPIs introduced for financial undertakings under Article 8 EU Taxonomy Regulation and addressing challenges with Pillar 3 ESG disclosures.
- 9) Ensuring derivative transactions are included in the various investors ESG reporting metrics.

Alongside this, it is also vital to continue to work on Capital Markets Union to further develop EU capital markets and promote effective, competitive financial markets. Alongside primary markets, it is also important to recognise the important function of secondary markets in providing liquidity, allocating capital effectively and in reflecting risks and opportunities in issuers' cost of capital.<sup>3</sup>

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<sup>3</sup> See AFME's CMU KPIs Report (Sixth Edition)



## 1. How well is the EU regulatory framework functioning?

### 1.1 Facilitating sustainable financing products and investments

Significant progress has been made in establishing the EU regulatory framework to facilitate and promote the provision of sustainable finance. A number of key areas of regulation now apply, with several more in the course of implementation.

The market for sustainable finance products such as bonds, loans, funds, indices continues to grow, with significant demand from investors.<sup>4</sup> Sustainability continues to be integrated across banks' activities and businesses. Nevertheless, the lack of clarity on policy to support the real economy transition combined with a number of significant challenges with the policy and regulatory framework are holding back the potential to further channel investments in support of sustainability objectives.

Financial institutions are experiencing a number of common challenges across products. The top ten challenges identified include the following:

- 1) Lack of clarity on real economy transition and coherence with the sustainable finance regulatory framework;
- 2) The availability of high quality data to support the use of sustainable finance tools and financial institutions' own disclosure obligations;
- 3) The usability and application of the EU Taxonomy;
- 4) The application of SFDR;
- 5) Inconsistent treatment of derivatives in various disclosure metrics under the EU Taxonomy Regulation and SFDR;
- 6) Alignment & coherence across the various ESG products disclosure regulations (e.g. SFDR, BMR, MIFID)
- 7) Sequencing of the various reforms (e.g. SFDR, Taxonomy, BMR, Pillar 3)
- 8) Concerns regarding potential allegations of greenwashing;
- 9) Coherence and consistency of transition plans; and
- 10) Challenges with international application and interoperability.

**“Significant progress has been made in establishing the EU regulatory framework to facilitate and promote the provision of sustainable finance”**

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<sup>4</sup> See AFME's latest ESG Finance research report, available [here](#)



## 1. How well is the EU regulatory framework functioning?

### 1.1.1 Clarity on the real economy transition and coherence with the sustainable finance regulatory framework

Policy clarity and certainty on climate and environmental goals, and the EU's path to support the real economy in achieving them, is needed for real economy companies to be able to invest to align their activities and for investors and financial institutions to align financing in support of those goals. It is important to recognise that banks' balance sheets are a reflection of the wider economy. Developing policy for the transition of the real economy is therefore vital to facilitate private financing.

While we understand that it can be challenging for policymakers to provide detailed pathways for all sectors of the economy and that efforts have been made to provide further details on the transition for key sectors, for example through the Green Deal Industrial Plan, we continue to strongly encourage policymakers to provide as much direction and certainty as possible to help companies transition.

Roadmaps for investment and transition of key sectors remain a crucial factor in facilitating investment and associated financing. We therefore encourage the EU to continue its focus on establishing roadmaps and setting out further detail on sectoral plans for the transition of the real economy.

As discussed below, beyond establishing incentives and encouragement of, for example, clean energy production and technologies to aid with decarbonisation, it is also important to provide clarity on expectations for sectors of the economy that are currently significant emitters. Focusing on helping these sectors transition and providing transition roadmaps will help facilitate the transition finance that is needed. Sectoral transition roadmaps and other real economy support can be an important factor to enable investors and financial institutions to provide transition financing and investment in support of this. In order to drive real economy transition, these roadmaps should be accompanied by measures that provide corporates with the commercial opportunities to transition, and financial institutions with the opportunity to support that real economy activity with finance and investment.

It is also important to ensure that real economy transition roadmaps and policy measures are joined up with financing tools and the sustainable finance framework. For example, investments encouraged under the proposed Net Zero Industry Act should not be penalised under other EU sustainable finance legislation such as SFDR or the EU Taxonomy.

### 1.1.2 Availability of sustainability data

The importance of improving the availability and comparability of sustainability data across the economy has been recognised as a key priority by the EU and its international counterparts. While AFME supports the efforts to improve the availability of sustainability data to support investors, banks and other stakeholders, financial institutions are experiencing significant challenges obtaining data to meet a host of overlapping regulatory disclosure obligations.

Despite the progress made, enhancing data availability received the highest priority rating for further developing the market for sustainable finance in our member survey, reflecting continued challenges for financial institutions in this area.

The CSRD will increase the availability of sustainability data, with important progress also underway through the ISSB and in other jurisdictions. Its application will be especially useful to facilitate compliance with SFDR, Pillar 3 and BMR requirements – mitigating some of the sequencing issues with the implementation of the EU sustainable finance framework. However, reporting under the CSRD will not be available for some time with the full benefits not seen for several years as implementation is phased in. Unlisted SMEs are also not obliged to report under the ESRS, representing a significant portion of the EU economy. It will also take time for other jurisdictions to implement sustainability reporting requirements.



## 1. How well is the EU regulatory framework functioning?

Investors and financial institutions continue to face significant challenges with the availability of reliable sustainability data to inform their decisions, utilise sustainable finance tools and comply with their own disclosure requirements. For these reasons, 73% of respondents to our member survey saw sustainability data gaps as remaining “very significant and likely to remain significant in the foreseeable future”, with the remaining 27% seeing data gaps as “still significant but expected to be addressed as CSRD is implemented”.

AFME welcomes the cooperation between the European Commission, EFRAG and the ISSB to maximise interoperability of EU standards with the global baseline developed by the ISSB. We strongly encourage the European Commission and EFRAG to continue to work with their international counterparts to promote international progress with sustainability reporting and maximising the interoperability of standards globally. This is vital as financial institutions need access to sustainability data of companies that they finance globally to comply with EU requirements including their own disclosures under EU regulation and to support the provision of financing to companies based outside the EU.

The ESRS are a very significant step forward in enhancing the availability of sustainability data and facilitating financial institutions’ efforts to comply with other EU sustainability reporting requirements. Therefore, it remains important to ensure that sustainability reporting by companies in accordance with the ESRS is coherent with regulatory obligations placed on financial institutions.

As has been acknowledged by the European Commission, certain data required by financial institutions to meet disclosures under SFDR, the CRR and the BMR may not be disclosed by a company when it assesses that this is not material. AFME welcomes the requirement in the ESRS that where a company concludes that a relevant datapoint is not material, it has to include a statement to that effect and the guidance in the Q&A clarifies that market participants “may assume that any indicator reported as non-material by an investee company does not contribute to the corresponding indicator of principal adverse impacts in the context of the SFDR disclosures.”<sup>5</sup> It will be important to provide the necessary further clarifications on the approach to be taken in SFDR, Pillar 3 reporting and the BMR when a company has assessed that a relevant datapoint is not material, particularly as the Q&A does not provide any guidance on the approach to be taken to Pillar 3 or BMR reporting. In addition, further guidance is needed on how financial institutions should take account of data that is not reported due to being assessed as not material for the purposes of their own reporting under CSRD. Please see section 1.4 below for further discussion of the challenges arising with financial sector disclosures.

As discussed below, we view transition plans as an important tool to focus companies on better understanding what it will take for their business to transition and providing financial institutions with greater insight into a company’s decarbonisation objectives and strategy, thereby supporting transition finance. This was also recognised in the recent European Commission Recommendation on Transition Finance. We view it as an important priority for the European Commission and Member States to support companies in developing credible transition plans, for example by setting out transition roadmaps. However, transition plans in and of themselves will not drive real economy transition without shifts in the fundamentals of the real economy that provide companies with the commercial opportunities to transition, and financial institutions with the opportunity to support that real economy activity with finance and investment.

Finally, financial institutions currently have to rely on ESG data providers, estimates and proxies to fill data gaps, giving rise to a risk that the data is not 100% accurate and legal and reputational risks. Raw ESG data products are increasingly relied upon by investors and financial institutions for purposes including investment decisions, risk management and their own disclosures. Financial institutions continue to rely on ESG data products and even as the data gap should diminish with the implementation of the CSRD, this will take time and estimates will remain important for companies outside the scope of the CSRD. AFME members report from their experience that some ESG data product providers lack robust internal controls over data, including over raw data, and users face too many errors, including discrepancies between the raw metrics reported by the data provider and those disclosed by the reporting entity. However, the contractual relationship with providers proves to be insufficient to remediate deficiencies in data reliability. Changing data providers is a very big challenge for users and, for data coverage reasons, can prove quite difficult given the structure of the market (concentrated on large players, or niche players for specific coverage).



## 1. How well is the EU regulatory framework functioning?

Alongside sustainability data, ESG ratings also play an increasingly important role in the market. We welcome the recognition of the need to introduce a regulatory framework for ESG ratings providers to enhance confidence in the market for ESG ratings, establishing minimum requirements for transparency and governance of ESG ratings providers in line with the IOSCO Recommendations on ESG Ratings and Data Products Providers.<sup>6</sup> It is therefore critical that appropriate steps are taken to reduce the risk of unintended greenwashing by both ESG ratings and ESG data providers, and we consider that it is important for the European Commission and ESMA to continue to assess the market for ESG data products and to keep the need for taking regulatory action under review.

### 1.1.3 Usability of the EU Taxonomy

The EU Taxonomy was established as a key pillar of the EU sustainable finance framework, providing a science-based classification system for sustainable activities aimed at facilitating financing of such activities. Its usability is essential to successfully achieve its objective of facilitating sustainable investment. It is important that the EU Taxonomy is effective not only across primary markets, but also secondary markets and derivatives.

The design of the EU Taxonomy should support the objective of facilitating sustainable investment, and EU Taxonomy-based reporting should be geared towards providing market participants with decision-useful information.

In our survey of AFME members, the objectives of reducing the complexity of the EU framework and addressing taxonomy usability challenges feature prominently among the key priorities to improve the effectiveness of the sustainable finance regulatory framework. This finding can be seen as evidence of there being room for improvement and that the EU Taxonomy has yet to fulfil its potential to become an important tool for issuers and financial market participants.

AFME welcomes the continued work of the European Commission and EU Platform on Sustainable Finance (PSF) seeking to enhance the usability of the EU Taxonomy, including refining the technical aspects of the methodology to assess derivatives.

As the European Commission and the PSF<sup>7</sup> have recognised, users face several challenges with applying the EU Taxonomy in practice. Key challenges, also identified by our members, include demonstrating alignment with Do No Significant Harm (DNSH) criteria, the complexity of applying the framework, international application and interoperability with taxonomies in other jurisdictions. As discussed in section 1.4 below, banks also face significant challenges with implementing the Taxonomy disclosure requirements.

The objective of the upcoming European Commission review of the EU Taxonomy, and of future guidance issued by the PSF, should be to enhance the usability of the Taxonomy, reflecting upon input from users.

Meanwhile, both the PSF and industry stakeholders have worked hard to identify and mitigate the key challenges with the implementation of the EU Taxonomy and to harness its potential to facilitate investment and finance. These challenges are linked with demonstrating and reporting taxonomy alignment, the usability of the screening criteria, and the application of key concepts, definitions and disclosure requirements.

The guidance published by the PSF and the Commission's stocktake published as part of its latest sustainable finance package suggest that some of the key concepts underpinning the Taxonomy and its disclosures should be carefully considered and, potentially, revised. For a groundbreaking framework such as the EU Taxonomy, this upcoming review is an invaluable opportunity to take stock of what has been most effective and what does not work on the ground. Our survey was also helpful to identify the priority areas to address – calculating the Green Asset Ratio (GAR)<sup>8</sup>, conducting a Do-No-Significant-Harm (DNSH) assessment and including derivatives in the Taxonomy alignment ratio at product level under SFDR, consistently with the other SFDR ratios.

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<sup>6</sup> See AFME position paper on EU ESG Ratings Regulation, September 2023

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<sup>7</sup> Platform report on usability of the EU Taxonomy, October 2022

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<sup>8</sup> See section 1.4 below.



## 1. How well is the EU regulatory framework functioning?

### Do No Significant Harm

An overly prescriptive approach to assessing the alignment of activities with DNSH criteria, compounded by a lack of available granular data, means that it is frequently very challenging to conduct the assessment and, ultimately, demonstrate Taxonomy alignment. We agree with the conclusion of the PSF that *“In its current form, some of the DNSH testing criteria create substantial interpretation and usability challenges. If left unaddressed, this could impact the goal of generating complete, comparable, and reliable disclosure.”*<sup>9</sup> Challenges also arise from the level of detail required to be assessed, the lack of available data and the approach which relies on references to EU legislation.

This has sometimes led banks' clients to underestimate their Taxonomy alignment (particularly their Taxonomy-aligned CapEx). The related delegated acts, specifying over 700 DNSH requirements, often define DNSH criteria in relation to other pieces of EU legislation which are very different in content and basis, requiring local or sectoral knowledge. Further, the requirements are not always prescriptive, meaning that judgement is required.

We therefore recommend that the approach to DNSH assessment is a priority for further review of the usability of the EU Taxonomy.

A streamlined, less prescriptive and principles-based approach to DNSH would address many usability issues. A principles-based approach would establish general principles for avoiding harm, enabling a more user-friendly approach rather than such a detailed and activity-specific approach with specific thresholds for compliance. In this case, the screening would be based on ESG information at the company level. This information would inform an assessment as to whether further scrutiny is needed and material ahead of the allocation of proceeds. Controversy screening can be useful to check companies' involvement in controversial conduct that has worked or may work against the Taxonomy's environmental objectives.

Notably, as recognised by the PSF, the requirements and criteria to conduct the DNSH assessment cannot be readily applied to economic activities in non-EU jurisdictions. This is an important limiting factor for the wider adoption and application of the EU Taxonomy.

Taxonomies in other jurisdictions may offer examples of how the DNSH assessment can be streamlined or how interoperability can be enhanced.

The DNSH criteria underpinning Singapore's sustainable finance taxonomy, developed by the Monetary Authority of Singapore (MAS), offers an example of a more principles-based approach, containing references to international norms and standards rather than local laws and regulation.

In the UK, the Green Technical Advisory Group (GTAG) expert group, tasked with providing independent advice to the UK government on the development and implementation of a UK Taxonomy, is currently examining options for reviewing and potentially streamlining DNSH with the stated objective of increasing the ease of use and appeal of reporting against the UK Green Taxonomy, while retaining the ambition of the DNSH provisions, noting that this advice could also support improvements in DNSH in other taxonomies. Options include the development of minimum principles for emerging economies without green taxonomies, and collaborating with other countries to develop taxonomies that are based on the same principles.<sup>10</sup>

Alongside the aforementioned principles-based approach - whereby, for many activities, the DNSH can be presumed to be met in principle - we would welcome some flexibility with regard to the use of assumptions and modelled input in the instances where DNSH cannot be assessed precisely (e.g. no real data available, non-EU jurisdiction of the activity). We would also encourage the option to have the ability to perform the DNSH assessment at the entity level and not solely at the activity level - similarly to how PAI assessments are performed under the SFDR by asset managers and institutional investors.

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<sup>9</sup> Platform report on usability of the EU Taxonomy, October 2022, p.51

<sup>10</sup> See “Streamlining and increasing the usability of the Do No Significant Harm (DNSH) criteria within the UK Green Taxonomy, Green Technical Advisory Group, August 2023



## 1. How well is the EU regulatory framework functioning?

Finally, we recommend conducting a survey across the economy to collect information on specific projects/activities which would be EU Taxonomy eligible but not fully aligned due to an inability to assess DNSH. Simply having detailed information on why DNSH for specific projects is not working would provide meaningful input to policymakers on the changes needed to the EU Taxonomy Regulation Delegated Acts.

Please also refer to section 1.4 below for our views on the usability and effectiveness of the GAR and other financial undertaking KPIs under Article 8 of the EU Taxonomy Regulation.

### 1.1.4 Sustainable Finance Disclosure Regulation (SFDR)

The SFDR was an important milestone for the development of the EU regulatory framework. As a disclosure regime designed to counter greenwashing and provide end investors with decision-useful information to define and pursue their sustainability preferences, the SFDR was the first of its kind.

Financial institutions have undertaken very extensive work to implement requirements and adapt to evolving guidance. As the European Commission has acknowledged, market participants have experienced significant challenges associated with the application of the SFDR. Implementing the standards, containing granular entity- and product-level disclosure requirements, has proved very challenging for financial market participants. Besides implementing the standards, some of the key concepts underpinning the SFDR and its policy objectives have caused confusion in the market, from the perspective of both financial institutions and end-investors.

First, as the European Commission has acknowledged, the disclosure regime established by the SFDR has been effectively adopted by the market to categorise sustainable investment products into three distinct groups: (i) products that do not integrate ESG characteristics nor pursue sustainability objectives; (ii) 'Article 8' products promoting ESG characteristics; and (iii) 'Article 9' products with sustainable investment objectives. As financial institutions make progress in mainstreaming sustainability considerations across all aspects of their business and investment strategy, and these factors become increasingly relevant across more sectors and geographies, so more sustainable investment products started integrating ESG considerations.

The lack of a clear definition of 'promoting' for Article 8 products – related either to how a product is marketed or to the products' expected impact on people and planet - exacerbates confusion in the market. Most importantly, while disclosure requirements must be designed to capture a broad range of products, to ensure that claims are justified, this is a different objective to establishing criteria for a sustainable investment labelling regime. The two approaches are difficult to reconcile, meaning that a disclosure regime is not designed for the purpose of classifying sustainable investment products. The prevalent interpretation of the SFDR is thus misleading for end-investors and may expose firms to accusations of greenwashing. When investigating possible drivers of greenwashing in the financial industry, in the context of the joint ESAs call for evidence<sup>11</sup>, we have observed that this has led financial institutions to remain silent on how they integrate ESG considerations in certain investment products to avoid reputational issues – a phenomenon opposite to greenwashing that has been referred to as 'green hushing'.

Secondly, EU and national authorities have intervened at various stages of implementation to clarify key concepts and requirements, and this remains an ongoing exercise. At each iteration, financial market participants went through the costly and uncertain process of reviewing their disclosures and making necessary changes to comply with the product-level disclosures – leading to the reclassification of numerous Article 9 and Article 8 products – further decreasing confidence in the de-facto classification implementation of the regulation. Further changes are also currently under consideration including ESMA's consultation on guidelines for funds using ESG or sustainability-related terms in their name which would lead to further changes that fund managers would have to make. This has led to confusion in the market, costs for fund managers and undermined market confidence.

Thirdly, derivatives are either ignored or treated inconsistently across the SFDR's three disclosure ratios: Taxonomy, Sustainable Investment and PAI. Further consideration must be given to derivatives as they constitute an important tool to manage companies' business risk via their impacts on companies' cost of capital, i.e. cost at which future access to debt or equity funding could be accessed.

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11 See AFME response to Joint ESAs Call for Evidence on Greenwashing, January 2023





## 1. How well is the EU regulatory framework functioning?

Further, the data gaps and lack of appropriate sequencing of disclosure requirements for the financial and non-financial sectors, described above at section 1.1.2, combined with the granularity of the requirements for the assessment of PAIs and the calculation of related indicators, has led financial market participants to sometimes rely on estimates and proxies – possibly incurring further reputational and compliance challenges.

Finally, careful consideration should be given to the interlinkages between the SFDR and other key pieces of the EU sustainable finance framework. The PSF has recently highlighted how the challenges with the application of the EU Taxonomy and, in particular, with DNSH assessment and international application, relate to the workability and accuracy of disclosures made in accordance with the SFDR.

AFME has also highlighted the interlinkages with the integration of ESG considerations in the suitability assessment process carried out under the revised MiFID requirements as well as with discretionary portfolio management.<sup>12</sup> Further work is needed to ensure that ESMA guidelines on sustainability aspects of the MiFID II suitability requirements help retail investors set realistic expectations and make more informed sustainable investment decisions, for instance by clarifying the inclusion of derivatives and structured products and that the inclusion of sustainability-related information in product templates to meet the disclosure requirements in Article 8 SFDR does not entail the classification of a fund into a sustainable category. It can be difficult for distributors of financial products to explain to clients why, for instance, an Article 8 fund is not eligible to match sustainability preferences under MiFID if it does not declare a minimum percentage of Sustainable Investments or if it does not take into consideration principal adverse impacts indicators on sustainability factors.

AFME welcomes the European Commission's acknowledgment of challenges and issues highlighted by market participants associated with the application of SFDR and the public consultation on the review of the SFDR intended to explore ways to address those challenges and issues. We support the evaluation of how the current regulation is functioning and consideration of how it could be improved to better achieve its objectives. AFME will be responding separately to the consultation and looks forward to contributing further to the review.

### 1.1.5 Concerns regarding potential accusations of greenwashing

AFME members highlight an increasing focus on fears of being accused of greenwashing as holding back the potential growth of the market for sustainable finance products. Legal and reputational risk has increased in the political and regulatory environment, with both companies and financial institutions facing a continually-evolving and increasingly complex regulatory regime with uncertainty over key concepts.<sup>13</sup>

Addressing greenwashing is an important priority to provide confidence in the market and address misleading statements. However, it is important to approach this in a way that does not stifle innovation or growth of the market.

In order to reduce greenwashing concerns, it is important to provide stability of the regulatory framework, enhance clarity where necessary and ensure that an appropriate approach is taken to the supervision of greenwashing risks by supervisory authorities, focusing on cases where there is an element of fault and providing an environment that supports innovation and growth in the market.

It is important that supervisors' approach not only addresses egregious greenwashing practices to enhance confidence in the market, but also provides a supervisory environment that supports innovation and the development of the market. To date the ESAs' work appears to have been focused primarily on the former with less consideration of the latter. We would encourage the ESAs to engage with market participants on how they could achieve this balance.

As ESMA recognised in its Progress Report on Greenwashing<sup>14</sup>, uncertainty and inconsistencies in the regulatory framework are one of the drivers of greenwashing. Addressing the issues raised in this paper should also help reduce the risk of greenwashing by enhancing clarity and consistency of important concepts and application of the regulation.

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<sup>12</sup> See AFME and ISDA response to ESMA consultation paper on guidelines on sustainability aspects of the MiFID II suitability requirements.

<sup>13</sup> NGFS has recently published a report highlighting climate litigation risk for financial institutions.

<sup>14</sup> ESMA Progress Report on Greenwashing, 31 May 2023



## 1. How well is the EU regulatory framework functioning?

Providing stability of regulatory requirements was ranked by AFME members as a high priority for further developing the market for sustainable financing. Market participants face a highly complex regulatory framework, with evolving interpretation and guidance. While this is to some extent a product of the desire and need to act quickly, it is important to provide a stable regulatory backdrop to aid investor understanding and allow market participants time to implement it, develop products and have confidence that requirements will not be continually changing.

We therefore propose that while targeted changes and further guidance should be provided as recommended in this paper, it is important that these are targeted and done in conjunction with market participants to avoid adding further complexity or adversely impacting the market. In this respect, as discussed further in section 2 below, the provision of transition finance is an example of an area where it is particularly important that policymakers and regulators provide support to promote the provision of transition finance and provide financial institutions with the confidence that they need to develop innovative solutions and provide vital finance to companies as they transition. A prescriptive regulatory approach to transition finance could have significant unintended consequences in hampering the financial sector's ability to facilitate finance and investment in support of the transition.

To help firms navigate this complex and nascent environment, we suggest that the ESAs focus on providing examples of best practice on anti-greenwashing governance. This will provide firms with clarity and support the implementation of robust processes to protect against greenwashing. The ESAs should also give due consideration as to how greenwashing risks can arise in different ways across different products and services (e.g. capital markets activities vs discretionary portfolio management). AFME continues to encourage the ESAs to carefully consider this as they finalise their report on addressing greenwashing in the financial services sector.<sup>15</sup>

As discussed further in section 1.1.2 above, financial institutions also face greenwashing risks associated with their required compliance with reporting requirements before the necessary underlying data is available from companies that they finance, requiring them to rely on proxies and estimated data. For example, Pillar 3 reporting requirements were imposed before the necessary data was available from banks' clients, creating additional risk for financial institutions. While we understand the desire from policymakers not to wait for perfect data, an appropriate approach to supervisory support for financial institutions' good faith reporting should be provided. For example, supervisory authorities should not unduly penalise banks that are unable to produce comprehensive ESG prudential disclosures due to data limitations regarding the activities of their counterparties (e.g. scope 3 emissions).

Finally, voluntary commitments are highlighted in the ESAs' Progress Reports on greenwashing as one of the areas most prone to greenwashing. However, it is important to stress that these are voluntary commitments that not only depend on banks but also on governments and other stakeholders' actions. If such governments and stakeholders do not play their part or unexpected external factors occur along the way, these external factors could impact the final goal pursued. Additionally, if the voluntary commitment relies on robust global frameworks and standards (like the NZBA), those recognised standards and respective performance audits should serve as sufficient safeguards. It seems the above considerations are not contemplated by the Progress Reports.

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<sup>15</sup> See AFME's feedback to the ESAs' Call for Evidence on Greenwashing, January 2023



## 1. How well is the EU regulatory framework functioning?

### 1.1.6 Coherence and consistency of requirements for transition plans<sup>16</sup>

AFME strongly supports work to create a consistent framework for high-quality transition plan disclosures for companies across key sectors of the real economy. Transition plans can encourage companies to take a strategic approach to adapting their businesses to a low carbon economy and providing important information to investors, financial institutions and other stakeholders.

Corporate transition plans can provide relevant information to enable banks to support companies with the finance and investment needed for their transition through transition finance, to deliver on their own Net Zero strategic targets, to prepare their own disclosures (including their own transition plans) and to aid their assessment and management of climate risk.

However, transition plans are still in their early stages of development, and adoption of transition plans will not result in the desired climate outcomes in the absence of shifts in government policy, consumer demand, and technological innovation. It is important to recognise that the ability of the financial industry to facilitate and finance the transition will depend on the availability of real economy transition opportunities to finance and invest in, and that real economy transition opportunities will be largely dependent on external factors such as government action that shifts the relative economic attractiveness of clean energy and net-zero technologies. Real economy transition plans should therefore provide the financial sector with more data that may be helpful in identifying opportunities to provide finance and investment in support of the transition.

Greater standardisation of transition plan disclosure should also help companies provide the information required by financial institutions and enhance comparability for investors. However, it is important to acknowledge that transition plan disclosure should also provide enough flexibility accounting for the fact that each company's business strategy with respect to the Net Zero transition will need to be tailored to its particular business model, size, geography, and other unique factors. A balance must be struck between providing comparability while also avoiding prescribing and standardising companies' global business strategy.

While we welcome progress in the EU and internationally on the development of a framework for transition planning, it is essential that this framework is clear, consistent and works globally.

To mitigate some of these challenges, it is important to ensure:

- a) A coherent, clear framework for companies and financial institutions in the EU; and
- b) International interoperability of transition planning requirements.

**“It is essential that the transition planning framework is clear, consistent and works globally”**

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<sup>16</sup> See AFME, *Climate transition plans in the EU: consistency and clarity*, March 2023



## 1. How well is the EU regulatory framework functioning?

### Coherence and clarity of EU regulation

There are several requirements relating to transition planning currently being finalised under EU legislation:

- **CSRD/ESRS:** The sector agnostic ESRS under CSRD include detailed disclosure requirements for transition plans for climate change mitigation where an organisation has one. If it does not have a transition plan, it must also include a statement to that effect and whether it will adopt one. We understand that these provisions may be supplemented in future sectoral standards to be developed by EFRAG.
- **Corporate Sustainability Due Diligence Directive (CSDDD):** Article 15 of the proposed CSDDD requires Member States to ensure that companies within its scope adopt transition plans and establishes criteria which the transition plans would have to meet.
- **Capital Requirements Directive (CRD):** The revisions to the CRD as part of the recent Banking Package include requirements for credit institutions to prepare transition plans and mandate the EBA to develop guidelines specifying the content of transitions plans.
- **EU Green Bond Standard Regulation:** includes requirements for issuers which are subject to the obligation to disclose transition plans under CSRD, or which voluntarily publish transition plans (i) to indicate the manner in which bond proceeds are intended to contribute to funding and implementing those plans; and (ii) to provide a link to the website where those plans are published. This information will have to be disclosed in the EU Green Bond factsheet, annual allocation report and impact report.

In addition to international coordination, it is essential that there is consistency and coherence of transition plan disclosures and requirements for companies and financial institutions across EU regulation. Definitions of transition plans need to be consistent, transition planning obligations need to be coherent with disclosure requirements and sector-specific requirements should adapt sector-agnostic requirements as appropriate, but should not create conflicting requirements.

The implementation of the ESRS over time will provide for widespread corporate disclosure on transition plans that is consistent across the economy. The ESRS transition plan requirements will result in disclosure on the plans of the undertaking, including implementing actions and related financial and investment plans, to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming in line with the Paris Agreement and the latest evidence provided by the IPCC. The ESRS will therefore serve as an effective baseline, ensuring consistency across sectors. Any further legislative requirements related to transition plans should refer to the ESRS and ensure consistency across EU requirements.

It is also essential to ensure that the regulatory framework provides sufficient flexibility to accommodate evolving practice in developing credible transition plans and ensures international compatibility. It is critical that other legislation, such as the CSDDD and CRD does not impose additional requirements that inadvertently conflict with, or create inconsistency with the ESRS, particularly given that EFRAG's sector-specific work is still ongoing and that approaches to transition planning are still in their infancy for the vast majority of companies.

Conflicting or confusing requirements risk creating market confusion or unnecessary compliance costs that may hamper the ability of companies and financial institutions to develop a coherent and consistent plan to align their businesses, portfolio, and operations with a net zero economy, undermining the overall decarbonisation effort.

It is also important to recognise that large companies and financial institutions which operate globally are defining their climate transition plan at group level as part of their global strategy to reach Net Zero. Therefore transition planning requirements should be applied at group level rather than at entity level. EU requirements should include an exemption available for EU subsidiaries of international groups, provided that the group publishes a transition plan under a similar standard (such as TCFD/ISSB). We would also propose that, where the group-level transition plan is developed under an insufficiently similar standard, they have the option to publish a supplementary country-level or entity-level document to provide the additional information as required.



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### International interoperability of transition planning

It is essential to ensure that EU transition planning requirements are aligned with international standards, including global market practice, and requirements in other jurisdictions. Climate change is a global challenge, and the world cannot reach Net Zero without addressing the transition of the broader global economy, including in jurisdictions with very different economic structures, levels of development, and transition pathways. As different jurisdictions look to create local or regional frameworks and requirements to facilitate their transition, firms that participate in the global economy are likely to be subject to transition planning requirements in more than one jurisdiction.

Given the urgent need for financing for developing economy transition, it will be important to ensure that EU transition plan requirements do not undercut global efforts to finance the transition in developing economies. For example, differing transition plan requirements globally could result in unintended impacts on facilitating financing for developing economies with different transition pathways. As another example, clean energy supply chains are global, and differing transition plan requirements globally could impact the ability of financial institutions to provide much-needed finance for clean energy supply chains in APAC jurisdictions with different net zero pathways (e.g. China has set a goal of achieving net zero by 2060).

Given the EU's leading role in the global economy, it will be essential that firms operating in the EU are not subject to conflicting requirements in other jurisdictions. Fragmentation of regulatory and supervisory transition plan requirements could undermine the objective of facilitating a timely and orderly transition. We strongly encourage the EU authorities to actively contribute to international work and coordination on transition planning requirements, including the work to be carried out by the FSB and IOSCO, to promote compatibility and interoperability of transition plans across jurisdictions.

We appreciate the work that EFRAG has done to drive interoperability with the ISSB's transition plan disclosure provisions, given that many other jurisdictions are expected to adopt ISSB-aligned disclosure requirements. Not only will this ease compliance for firms operating in multiple jurisdictions, but more importantly it will ensure a consistent global approach in recognition of the global nature of the transition that needs to happen. Interoperability of transition planning disclosure should also help companies provide the information required by financial institutions and enhance comparability for investors.

Many companies and financial institutions have significant international businesses and if there is insufficient consistency and coordination of approaches, there is a risk that companies are subject to multiple, potentially conflicting or overlapping requirements in different jurisdictions with the same objective, particularly if requirements are introduced at entity rather than group level. This risks undermining the objectives of a clear, comparable framework. We therefore strongly encourage international coordination to agree a common approach.

### Prudential regulation and transition plans

Prudential regulators should avoid assessing the credibility of a financial institution's transition plan because transition planning is fundamentally about business strategy. Moreover, given the range of methodological and framework variance on credibility determinations, as recognised by NGFS<sup>17</sup>, prudential supervisors likely do not have the appropriate resources or skills to make credibility assessments. Credibility assessments may also not fall within their macroprudential mandates, falling out of scope of their traditional role as bank supervisors.

As emphasised by NGFS, supervisors should consider the relevance of transition plans to their mandates. AFME acknowledges that prudential authorities have an interest in understanding financial institutions' transition plans in terms of their impact on strategic positioning, competitiveness, and potential risks for supervised institutions. Supervisors should clearly outline their expectations for how they intend to conduct this analysis, recognising the scope of their mandate.

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<sup>17</sup> See [Stocktake on Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities](#), NGFS, May 2023, at page 16.



## 1. How well is the EU regulatory framework functioning?

### 1.1.7 Challenges with international application and interoperability

While the EU has been at the forefront of developing regulation to promote sustainable finance, we are increasingly seeing progress at the international level and other jurisdictions around the world developing their own regulatory frameworks.

It is essential that the EU regulatory framework works effectively to not only promote financing companies in the EU, but also to companies outside the EU. It is also essential to ensure that EU regulation is interoperable with international standards and similar initiatives in other jurisdictions. This is important to promote the international competitiveness of EU companies and financial institutions; and to minimise duplication and fragmentation of requirements.

Key challenges faced by banks include:

- 1) Differences in corporate sustainability reporting standards, for example between the EU ESRS and the ISSB standards;
- 2) The application of EU Taxonomy to financing of activities outside the EU, where the relevant data is unavailable and/or practice may be aligned with the taxonomy of another jurisdiction;
- 3) Potential differences in requirements for transition plans and the need to ensure that EU requirements are sufficiently aligned and flexible to accommodate global groups;
- 4) The application of EU requirements to global groups with operations across the globe subject to local regulation and requirements;
- 5) Interaction between EU and other jurisdictional requirements such as between SFDR and UK FCA proposed investment fund labels regime; and
- 6) Potential conflicting sustainability due diligence requirements between those under the CSDDD and requirements in other jurisdictions.

We strongly encourage the EU authorities to further increase their cooperation with other jurisdictions, including through fora such as the G20, FSB, IOSCO, IPSF, NGFS, the ISSB Jurisdictional Working Group, Basel Committee amongst others. Interoperability issues should also be discussed in regional regulatory dialogues with a view to minimising fragmentation or overlapping regulation. It is important that further progress is made on improving the interoperability of sustainable finance frameworks and this should be a key priority for the next mandate of the European Commission.

We also strongly encourage EU policymakers and regulators to find ways to improve the usability of EU standards for financing companies outside the EU, for example interoperability between the EU and other taxonomies, enhancing interoperability of sustainability disclosures and ensuring that EU regulation takes appropriate account of the needs of both EU headquartered banks with operations outside the EU and banks headquartered outside the EU with business in the EU.

Areas for further coordination with other jurisdictions should include sustainability disclosures, sustainability due diligence, regulation of ESG ratings providers and any EU sustainability product categorisation system.



# 1. How well is the EU regulatory framework functioning?

## 1.2 Developing markets for sustainable financing products

In addition to the common challenges and recommendations above, this section reflects upon the state of the market for selected types of products and proposes some additional recommendations.

### 1.2.1 Green and sustainable bonds

AFME welcomed the agreement on the EU Green Bond Standard Regulation (EU GBS), establishing a voluntary standard that provides a high quality label for green bonds for financing aligned with the EU Taxonomy. While our members are seeing significant interest from clients in the use of the EU GBS, the potential use of the standard is constrained by the challenges of, and costs associated with, with demonstrating alignment under the EU Taxonomy discussed above and the availability of activities currently aligned with the EU Taxonomy. This is an additional driver for improving the usability of the EU Taxonomy to help issuers demonstrate taxonomy alignment and therefore eligibility for the EU GBS.

Alongside the EU GBS, the market continues to grow and develop based on market standards such as the ICMA Green Bond Principles.

With respect to Sustainability-Linked Bonds, these are an important instrument to support companies transitioning but as discussed in section 2 below, it is important to support issuers and financial institutions in developing appropriate KPIs to ensure credibility and avoid greenwashing. We encourage the European Commission and ESMA to consider working with market participants to develop examples/guidance and possible frameworks for reference in KPIs for sustainability-linked instruments, taking account of market standards such as the ICMA Sustainability-Linked Bonds Principles.

### 1.2.2 Green and sustainable securitisation

The EU's ambition to become climate-neutral by 2050 and to divide greenhouse gas emissions by 50% by 2030<sup>18</sup> will require €350 bn of additional financing per year to meet the 2030 emissions-reduction target in energy systems alone, plus €130 bn for other environmental goals.<sup>19</sup> Given the currently limited public resources, it is absolutely crucial that all sources of private capital and liquidity be mobilised across the full array of financial products.

Securitisation is an important tool to make a substantial contribution to these goals by facilitating banks both to free up regulatory capital *and* refinance lending to both wholesale and retail clients through access to the capital markets. According to AFME's report, "European Green Securitisation Regulatory State of Play: Obstacles to growth and opportunities for leadership" and S&P Global Ratings' assessment contained therein,<sup>20</sup> securitisable green lending could exceed €300 billion annually by 2030 in respect of three asset classes only, namely residential mortgage loans on energy-efficient properties, loans for green home renovations and electric vehicle financing. Securitisation, therefore, has a huge potential to finance the green consumer transition through these three asset classes alone.

Despite its huge potential, green securitisation issuance in Europe (including the UK) remains disappointingly low. As noted by the EBA, in Q1 2021 securitisation only accounted for 1% of green bonds issuance in the EU, compared to 50% in the US and 11% in China. The difference is equally staggering if one also looks at data over a longer period, namely 2019-2023H1. Green securitisation issuance represents only 1% of total European green issuance, whereas it stands at 5.1% in China and 24.9% in the US. Unsurprisingly, therefore, the European Commission's report on the functioning of the Securitisation Regulation stated that "expectations for a highly dynamic market with increasing volumes and a growing number of participants do not yet seem to have been fulfilled".

Securitisation is an adequate tool to finance green assets such as mortgages on energy-efficient homes, electric vehicle loans and leases, vehicle charging stations, solar leases or SME loans funding energy transition, to name a few.

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18 [https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/delivering-european-green-deal\\_en](https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/delivering-european-green-deal_en)

19 Communication from the Commission to the European Parliament, the Council, the European Economic and Social committee and the Committee of the regions empty - Strategy for Financing the Transition to a Sustainable Economy, Strasbourg, 6.7.2021 – [here](#).

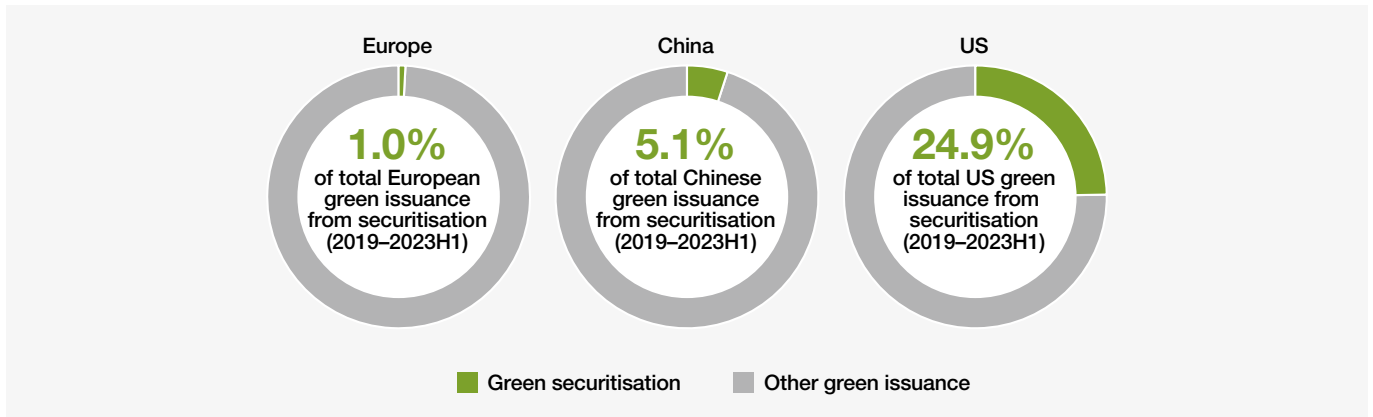
20 AFME, European Green Securitisation Regulatory State of Play: Obstacles to growth and opportunities for leadership (December 2022) ([here](#))



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However, the current EU securitisation regulatory framework remains an impediment rather than an accelerator for the expansion of securitisation, embedding costly capital, operational and disclosure requirements. Hopefully, the EU's ambitious goal to become climate neutral should create the conditions to revisit the EU securitisation regulatory framework, so that this important tool can achieve its full potential in the financing of the European economy.

### Green securitisation (2019 – 2023H1)



The EU Green Bond Standard included cash securitisation in its scope and followed the EBA's relevant recommendations.<sup>21</sup> In other words, the EU GBS requirements apply at the originator level rather than the issuer/securitisation special purpose entity ("SSPE") level, and the "use of proceeds" approach has been adopted, meaning that a securitisation not backed by a portfolio of green assets can still qualify for the "EuGB" label provided that the originator commits to using all the proceeds from the green bond to generate new green assets. As there is currently limited EU Taxonomy aligned green collateral to securitise, the "use of proceeds" approach, and securitisation itself by extension, can be an important enabler of the green transition.

However, synthetic securitisation, currently excluded from the framework, provides a much more cost-effective way of securitising project finance and SME lending which cannot be easily securitised via cash securitisations. The importance of SME lending in the CMU project and the prolific use of project finance to fund renewable developments, such as photovoltaic and wind farms, highlight the relevance of synthetic securitisation to the purpose of the EU GBS which is to help finance sustainable investments. Consequently, its appropriate integration in the framework by legislators should be one of the future priorities.

Whilst the EU GBS is a positive step in the right direction, the European green securitisation market will not be able to flourish unless certain regulatory impediments embedded in the framework are also addressed. Disproportionate capital, operational and disclosure requirements, for example, pose constant challenges to market participants and prevent the revival of issuance volumes in the product.<sup>22</sup> We hope that meeting the financing needs for the transition will create the necessary political impetus for the EU securitisation regulatory framework to be revisited, so that securitisation can be fully utilised for the purpose of financing the European economy.

<sup>21</sup> EBA report, "Developing a framework for sustainable securitisation" ([here](#)).

<sup>22</sup> It is telling that over the years the European ABS market has declined in size. According to [ESM](#), in 2008, its size (including the UK) was 75% that of the US, however it diminished to only 6% in 2020, a year after the implementation of the EU securitisation framework.





## 1. How well is the EU regulatory framework functioning?

### 1.2.3 Derivatives

While derivatives can generally be considered to be a more indirect form of investment that does not provide direct financing to companies (such as in primary markets only), they play an important role in financing the transition.<sup>23</sup> Derivatives perform a critical role in economic activity by enabling and helping businesses and investors better manage the risks to which they are exposed, and to more effectively align their exposures with risk tolerance and risk management requirements. The derivatives market also plays a major role in enhancing transparency, through the provision of forward information on the underlying commodities, securities, or assets, and this ultimately contributes to long-term sustainability objectives.<sup>24</sup> Derivatives allow investors to be exposed to companies' equity and debt and therefore contribute to the definition of their cost of capital / refinancing in the future.

We recommend, as ISDA has proposed<sup>25</sup>, that a common methodology for the measurement of derivatives is developed across the various key performance indicators in the EU Taxonomy, SFDR (across the three ratios: PAIs, Taxonomy and Sustainable Investments) and the MIFID sustainability preferences framework. We encourage further work to achieve this through continuous collaboration between the Platform on Sustainable Finance, the European Commission, ESAs and relevant industry stakeholders.

### 1.2.4 Green and sustainable loans

Lending continues to be a very significant component of financing for companies in the EU, particularly pending further progress on CMU. As for green and sustainable bonds, market standards are available for green and sustainable lending.

Similar considerations apply for lending as for bonds, including challenges in applying the EU Taxonomy (including for general purpose loans which do not finance specific activities) and in establishing credible KPIs for sustainability-linked lending. As discussed below, lending also forms an important source of transition finance.

Market standards for green loans have been developed by the Loan Market Association to promote standardisation.<sup>26</sup> AFME also welcomes the EBA's work on green loans and recommends the rapid development of guidelines on the origination and monitoring of green loans to help mitigate banks' increased costs. While market standards appear to be functioning well, a voluntary green label for loans could be considered after having assessed how successful the adoption of the EU GBS becomes.

### 1.2.5 Green equity

Equity financing provides an important component for many businesses including, for example, companies seeking investment to scale up and also for large listed companies. Implementation of sustainability reporting requirements and adoption of transition plans will provide equity investors with additional sustainability information.

In addition to setting out details for the real economy transition, clarifying issues with SFDR for equity funds and improving the operability of the EU Taxonomy at entity level would help support equity investment.

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23 See [Overview of ESG-related Derivatives Products and Transactions](#), ISDA, 2021

24 See [Derivatives in Sustainable Finance](#), Lannoo, K. and A. Thomadakis (2020), CEPS-ECMI Study, Centre for European Policy Studies.

25 See [ISDA response to Joint ESAs consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures](#), July 2023.

26 [Loan Market Association \(LMA\) Green Loan Principles](#)



## 1. How well is the EU regulatory framework functioning?

### 1.3 Encouraging further investment

AFME welcomes the recent emphasis on addressing barriers and providing incentives to support the real economy transition including the objectives of the EU Green Deal Industrial Plan for the Net-Zero Age. It is important to look beyond regulation to drive behaviour and provide investment opportunities in support of environmental and social objectives.

Policymakers should continue to work on how investment can be incentivised and work with financial institutions to de-risk investments and unlock private finance in support of these goals. It is also imperative to continue to develop and deepen EU capital markets and channel a greater proportion of EU savings into investments.

For example, we encourage further focus on how public finance and private finance can work together to provide the financing needed. It is important that public and development finance is channelled to support and unlock private finance, including through blended finance structures, particularly where the risk is greater and does not crowd out private finance in investable projects. We welcome efforts to date in this area, noting some positive examples<sup>27</sup>, but believe that it has further potential to have a significant impact and will be a crucial tool in achieving progress.

For climate technology companies on the frontier of sustainable fuels, carbon management and decarbonisation of hard-to-abate sectors, it is imperative that the EU develops fiscal and financial incentives to help these nascent industries scale up. This is important not only to compete with other jurisdictions' incentives such as US Inflation Reduction Act's simple and generous subsidies, but more importantly to turn the economic needle in favour of these projects versus the counterfactual (e.g. in the case of many sustainable fuels vs the fossil fuel equivalent). These companies are developing greenfield projects with a new technology component and are currently on the critical pathway to development needing support to de-risk projects and ultimately create network effects for these technologies which are needed to reduce costs and provide scale. Fiscal incentives should be coordinated at EU level and be subject to EU State Aid rules to avoid fragmentation of the single market.

As discussed elsewhere in this paper, providing as much certainty as possible on roadmaps for the transition of different sectors of the economy and a stable regulatory environment should also help to promote investment.

Moreover, as discussed in section 1.1.5 above, addressing greenwashing risks is also important to help foster conditions for encouraging further investment.

Policymakers should review how further retail investment can be channelled in support of sustainable investments, for example through introducing product labels for retail investment funds, facilitating green investment products, fiscal incentives etc. Members report significant demand from retail clients for their savings and investments to be invested in support of sustainability objectives, yet a lack of understanding by retail investors regarding the availability of investments and challenges arising from the complexity of the regulatory framework is holding back its potential.

Where appropriate, financial regulation should also support the objective of channelling investment for sustainability objectives. For example, the revisions to the Infrastructure Supporting Factor under the CRR to include a requirement for alignment with the EU Taxonomy will limit its availability to support investments rather than support further financing.

We also encourage policymakers to mobilise resources to improve investor education, providing market participants and especially retail investors with the tools to identify opportunities aligned with their interests and articulate better their sustainability preferences. Policymakers and regulators have a role to play in educating and disseminating information on robust standards and global frameworks to ensure that stakeholders have well-founded opinions.

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<sup>27</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_23\\_3982](https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3982)



## 1. How well is the EU regulatory framework functioning?

### 1.4 Financial sector disclosures

Banks continue to face significant operational challenges with disclosures under the EU Taxonomy Regulation, Pillar 3 ESG reporting and SFDR. Feedback from our member survey highlighted significant challenges with the following areas:

- a) Sequencing of financial and non-financial sector reporting and data availability and reliability;
- b) Complexity and coherence of the EU framework; and
- c) International applicability and interoperability.

We recommend that the European Commission reviews the effectiveness and meaningfulness of the Green Asset Ratio and supports banks in effective disclosures, addressing the data gaps arising from sequencing challenges of the EU imposing disclosure requirements on financial institutions in advance of the information being available from their clients and counterparties.

While sequencing challenges should reduce in due course once companies report under CSRD, it is important to understand that data challenges will remain. For example, data may not be available from companies that are not within the scope of CSRD, including unlisted SMEs and companies in third countries that are not in scope.

As discussed above, it is also important to ensure that financial institutions can report effectively under these requirements where the information is not disclosed by a counterparty or investee company because it is not assessed as material under the ESRS.

Financial institutions will also require specific sectoral guidance on the implementation of the ESRS. AFME members have highlighted issues such as how to implement the materiality assessment and the concept of the value chain for financial institutions as key areas where further engagement and guidance will be needed. Financial institutions face challenges in their value chain reporting as data needs to be retrieved from counterparties' disclosures with the value chain for commercial banks including a large number of SMEs. In such cases, the use of proxies and estimates should be avoided to the extent possible, due to: i) the high costs it entails; ii) the initial need for companies to increase confidence with the new set of required sustainability data and to develop necessary skills; and iii) the risk to jeopardise comparability between values coming from different companies having different methodologies in the use of estimates and proxies.

#### Green Asset Ratio and other KPIs

##### The GAR does not provide meaningful information

The Green Asset Ratio (GAR) under Article 8 of the EU Taxonomy Regulation and also included in Pillar 3 ESG disclosures should be reviewed. The GAR gives rise to several usability challenges and issues with its calculation methodology, which makes it a less reliable or useful metric for investors or other stakeholders to assess the progress of a bank in financing the sustainability transition.

The lack of symmetry between the numerator and the denominator in the GAR leads to a lack of comparability of its disclosures amongst banks. This asymmetry is due to the fact that while the numerator comprises taxonomy aligned activities in the scope of CSRD, the denominator counts instead the total assets independently from the scope of CSRD, including, therefore, assets that cannot be eligible for the EU Taxonomy and will never be taxonomy aligned. Different banks have different business models and the current GAR formula does not enable meaningful comparison against banks as different banks have different proportions of taxonomy eligible activities on their balance sheet. The ratio is significantly impacted by factors such as the proportion of business in sectors covered by the EU Taxonomy, the services that they provide (including the proportion of retail counterparties on their balance sheet) and the proportion of their balance sheet outside the EU (which is unlikely to be eligible for the EU Taxonomy). The asymmetrical treatment of derivatives in the GAR ratio is also an issue that needs refining.



## 1. How well is the EU regulatory framework functioning?

In addition, the GAR only captures taxonomy-aligned activities. It therefore does not adequately capture financing of activities that contribute to the transition and fall within the European Commission's definition of transition finance, but which are not currently aligned with the EU Taxonomy. As discussed further below, the GAR does not incentivise, and could potentially disincentivise, the provision of transition finance. It does not therefore provide a measure of the overall contribution of a financial institution to financing the transition. It is also potentially misleading as an indicator because it will never be possible to achieve a 100% ratio. For these reasons, eligibility for inclusion in the GAR is not well positioned to facilitate sustainable financing or reduce the cost of financing for taxonomy aligned activities.

GAR reporting entails a very significant operational exercise for banks, requiring detailed information from clients, counterparties and investee companies, with low benefits. In addition to being a burden for banks, it also creates burdens for their clients in providing the required information. We therefore question the value arising from the GAR when assessed against the operational burden and costs associated with it for the European banking industry. Other international jurisdictions have not imposed similar requirements, affecting the competitiveness of banks within the scope of EU Taxonomy reporting.

### Review of KPIs

In addition to the asymmetry of the numerator and denominator discussed above, there are several flaws in the current design of the GAR.

The GAR does not currently capture sustainable projects that are financed through specialized lending (including project finance), conducted through dedicated vehicles (e.g., Special Purpose Vehicles - SPV) that are frequently outside the scope of the CSRD because typically they are not public interest entities and/or do not exceed the threshold of 500 employees.

Specialised lending should be considered as a special case where the Special Purpose Vehicle (SPV) operates as a mere intermediary vehicle between the lender and the promoter implementing the project. Therefore, financial undertakings should be allowed to include in the GAR calculation dedicated financings with "known use of proceeds", where the financed assets comply with the relevant Technical Screening Criteria under the EU Taxonomy.

With reference to exposures (equity, debt and financing) towards funds and asset managers, several elements should be clarified, e.g.: i) what are the requirements that a fund/asset manager must fulfil to consider an exposure (equity, debt and financing) taxonomy eligible/aligned; ii) assuming that exposures towards funds/asset managers are taxonomy eligible/aligned, if it is possible to verify the alignment by applying a look-through assessment or using Taxonomy alignment in accordance with the SFDR; iii) the necessity to verify whether the fund/asset manager is in the scope of NFRD/CSRD or is the subsidiary of a parent company in the scope of CSRD/NFRD.

With respect to the specific KPIs, in contrast to the approach for corporates, under the EU Taxonomy, banks are required to report the extent of their taxonomy alignment by reference to separate KPIs: (i) Green Asset Ratio (balance sheet assets); (ii) Financial Guarantees; (iii) Assets under Management (AUM); (iv) Trading Portfolio; and (v) Fees and Commissions. The EU has introduced a staggered introduction of the application of these requirements starting with the most important KPIs (Green Asset Ratio, Financial Guarantees and AUM).

We support the position taken in the EU Taxonomy that relevant KPIs for banks should not be the same as for corporates. However, we believe that KPIs for banks should focus on the Taxonomy alignment of the economic activities where the bank has the ability to influence capital flows towards sustainable outcomes. We do not see the benefit of a KPI which aims to show the Taxonomy alignment of the fees/commissions received from clients in relation to activities other than lending and investments. There are several reasons for this – (i) financial services which are not directly linked to financing (such as custody and clearing) have very tenuous links to real economy activity; (ii) the Taxonomy metric is backward looking and, for financial institutions reporting KPIs, they rely on data reported by corporates on its economic activities during the previous year. For the fees/commissions KPI, where the client of the financial undertaking is another financial undertaking, this data has the potential to be another year out of date (i.e., from the year before the previous year); and (iii) if an undertaking's client base must be assessed for Taxonomy-aligned purposes, it is unclear why this KPI would only apply to credit institutions and not any other corporate entity receiving fees from clients. For these reasons the fees/commissions KPI, in its current form, risks providing a very misleading impression to stakeholders.



## 1. How well is the EU regulatory framework functioning?

We encourage the European Commission to consider the findings of the PSF in its October 2022 Data and Usability report, which recommended that the Fees and Commissions KPI should be qualified so as to encourage the credit institution to offer Taxonomy-aligned products and services to its clients. In this respect, the PSF recommended that the KPI should only apply to fees and commissions that are generated from activities that have the capacity to influence capital flows towards sustainable outcomes; other activities should be excluded.

Last but not least, the GAR (stock & flow) needs to be simplified, as it is much too granular in its current form and such granularity does not provide valuable information to investors. As such we recommend removing the following unnecessary level of details:

- The need to distinguish per counterparty the type of financing (via loans or equity) as banks mostly finance their clients via credit instruments
- The requirement to distinguish the share of enabling and transitional activities. This distinction makes sense at the corporate level, but not at the bank level which provides a portfolio view.

### Recommendation

We welcome the forthcoming review of the Disclosure Delegated Act under the EU Taxonomy Regulation. We believe that it is important to review whether the GAR is achieving its intended purpose and address the challenges that we have identified.

We do not consider that the GAR, as currently formulated, is achieving its intended purpose. We therefore recommend that the European Commission considers (i) whether the GAR remains a relevant mandatory metric or whether it could be recast as a voluntary disclosure requirement to reduce the ever-increasing reporting burden for EU banks and their clients; and (ii) the composition of the GAR to increase its relevance and comparability.

Since the GAR was introduced, there has been a significant development in other reporting requirements and environmental performance metrics such as progress with meeting banks' sustainability targets, transition plans and disclosures under CSRD. We expect that these are likely to generate significantly more decision-useful information for investors than Taxonomy reporting. A voluntary KPI would let the market assess the relevance of the metric: if investors find it useful they will drive disclosure, but as banks continue to increase their reporting on sustainability, we expect that investors may be more focused on other metrics such as progress with meeting banks' targets and transition plans.

To the extent that the GAR is retained, it is important address its composition to make it a more meaningful KPI. It is necessary to align the numerator and denominator of the ratio, address the inclusion of derivatives and financing provided through SPVs as discussed above to improve the comparability and meaningfulness of the ratio.

### Pillar 3 disclosures

Feedback to our member survey confirms that banks continue to face significant challenges with implementing requirements for Pillar 3 ESG disclosures and concerns that the reporting is not providing information that enables meaningful comparison between banks.

While we welcome the acknowledgment by the EBA of some of the data challenges and the efforts made, for example to phase in certain requirements, data availability and a lack of sequencing between corporate and financial sector sustainability disclosures remain significant challenges. This is a very costly and time-intensive exercise and we therefore consider that a cost-benefit review is appropriate to avoid disproportionate requirements for EU banks. Such review would also be the opportunity to assess introducing the principle of materiality as is the case in the CSRD to support consistency between counterparties' reported data under the CSRD and banks' Pillar 3 disclosures. Members would also appreciate a discussion with the EBA on areas where additional guidance could be helpful to address implementation challenges.



## 1. How well is the EU regulatory framework functioning?

This is also an area where the EU has front-run work in the Basel Committee. We strongly encourage the EU authorities to participate in the discussions on a Basel Pillar 3 standard and to align the EU requirements with the international standard in due course to ensure a level playing field for EU banks, minimise conflicting requirements for banks with international operations and to aid comparability for investors.

As discussed above with respect to the ESRS, it is important that the EU authorities provide clarification as to how banks should report under Pillar 3 where the relevant company has not disclosed the relevant data point(s) under the ESRS due to assessing that it is not material.

### 1.5 Prudential treatment of climate and environmental risks

Significant work has been undertaken to develop supervisory expectations with respect to banks' management of climate and environmental risks. If the European Commission deems adaptations to the prudential framework are needed at Level 1, we urge consideration of the approach and guidance developed by the EBA and ECB, which follows a risk-based approach to climate-related and environmental risks in the prudential framework. We would further encourage the EBA to continue to embed a risk-based approach in future regulatory initiatives they are mandated to undertake as part of CRR3 implementation.

As acknowledged by the EBA, while banks can reflect the risks that could result from too slow a transition for certain entities, as well as support the financing of technology to drive towards a low carbon economy, banks should not be a proxy for governments' action, be that through fiscal measures or direct policy towards industries that can't or won't transition. Thus, we are supportive of the EBA's view that targeted amendments to the existing prudential requirements, where the prudential framework does not already reflect environmental risks, is more effective in addressing environmental risks than dedicated treatments such as adjustment factors, which notably have not been adopted in Level 1 legislation in the current EU 2019-2024 legislature. As has been recognised by co-legislators, regulators and supervisors alike, there are several challenges associated with the design and implementation of "adjustment factors".

AFME is reflecting further on the recent EBA report on the role of environmental and social risks in the prudential framework.<sup>28</sup>

In addition to ensuring a level-playing field between banks in the EU, we believe that any changes introduced in the prudential framework to address environmental risks should have an international agreement first through Basel Committee standards. In this respect, we note that the BCBS has set out principles for the effective management and supervision of climate-related financial risks. This mandates banks to identify and quantify climate-related financial risks and incorporate those assessed as material over relevant time horizons into their internal capital and liquidity adequacy assessment processes. These are reflected in the ECB guide on Climate-related and Environmental Risks which banks are expected to have fully implemented by the end of 2024.

Finally on a case-by-case basis, where banks have not taken action or made progress to address climate risks in line with these principles, supervisors have Pillar 2 tools at their disposal. Nevertheless, we would urge caution in using Pillar 2 until there is better understanding of scenario analysis and also to ensure that overlap or double counting between supervisory requirements does not occur. Consequently, in the longer term, it would be useful for supervisors to set out the scope of application of Pillar 2 to ensure a level playing field.

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28 Report on the role of environmental and social risks in the prudential framework , European Banking Authority, October 2023



## 1. How well is the EU regulatory framework functioning?

### 1.6 Climate risk stress testing

While climate risk stress testing (CRST) exercises and scenario analysis are still in a learning phase, a consensus between regulators, supervisors, and banks support using climate stress tests and scenario analysis as the leading method to understanding how climate risks could evolve and impact bank balance sheets in a forward looking way. Under the next Commission we expect a number of important Level 2 regulatory standards to be developed, based on lessons learnt from supervisory exercises to date, which will establish a framework for banks' internal and regulatory climate risk stress testing. This will be informed by the Commission's 'Fit for 55 exercise' taking place in 2024 to assess the extent to which early climate risk related shocks could already generate significant stress for the financial system as a whole in the period up to 2030. In light of this, AFME in collaboration with Oliver Wyman, has published a report<sup>29</sup> setting out the industry view on the future of CRST exercises and progress made by EU banks since the 2022 ECB climate risk stress test to develop their internal capacity to undertake such exercises. The report elaborates on the role and perspective of EU regulators regarding the future of climate risk stress testing; how regulatory exercises connect to bank's internal climate exercises; and how CRST output can be used by banks and regulators.

Recommendations on the future for regulatory climate risk stress testing include:

- a) **Future EU approach to CRST exercises:** banks suggest regulators provide early clarity on the process and data requirements for the 2024 Fit for 55 exercise. In relation to the EBA mandates that will establish a framework for regulatory and internal stress testing, these should be run at a minimum every two years and leverage the Fit for 55 and ECB 2022 exercise. They should consider interaction with other supervisory initiatives and the internal obligations of banks. Further, supervisory guidance on how banks should build their internal stress testing and modelling capabilities would help to drive greater industry consistency.
- b) **Potential integration of CRST exercises into the Pillar 1 Capital Framework:** All banks surveyed considered it too early to use CRST to inform and embed climate risks into Pillar 1 as existing assessment models are not sufficiently developed to accurately capture climate-related losses. In this respect, more than two-thirds of banks (67%) consider that climate risks should only be considered in Pillar 2, against 33% considering these could potentially be covered in Pillar 1 in the long, term once the risks are better understood. In addition, some banks are considering a Pillar 2 overlay to account for climate-related losses, although caution will be needed to avoid double counting. It will also be important to consider international developments to ensure some level of international consistency and comparability of outcomes.
- c) **Design of CRST exercises:** Regulators should consider: introduction of materiality thresholds for portfolios; banks' development of consistent data governance framework alongside regulatory guidance and increasing requirements to collect it; meaningful and quantifiable scenario analysis (not solely limited to credit risk) with shorter time horizons; and, in the longer term, a framework for nature-related risk considerations, which should take account of the progress of the work of the TNFD and NGFS.

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29 A common path to improve European climate risk stress testing and scenarios analysis, AFME and Oliver Wyman, June 2023



## 2. Transition finance

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### 2.1 The role and importance of transition finance

Alongside financing activities and entities that are “green” or “sustainable”, it is essential that financing is available to companies that do not currently meet the criteria for assessment as “green” or “sustainable”, for example under the EU Taxonomy. To achieve the goals of the Paris Agreement, it is necessary for all sectors of the economy to decarbonise, including hard-to-abate industries.

While financing entities and activities which substantially contribute to sustainability objectives in line with EU or other taxonomies is undoubtedly an important policy goal where progress is being made, we recommend shifting the focus to the role of economy-wide policy frameworks to facilitate transition finance at scale.

We are pleased to see the growing recognition of the importance of facilitating transition finance as part of the whole-of-economy global transition to sustainability. Climate change is a global challenge and the world cannot reach Net Zero without addressing the transition of the broader global economy, including in jurisdictions with very different economic structures, levels of development, and transition pathways.

We welcome initiatives in the EU and internationally including work of the European Commission, G20 Sustainable Finance Working Group, OECD and others. We see this as a crucial focus for the next European Commission mandate as transition finance, on a significant scale, will be vital to achieve the EU’s climate and environmental commitments.

Last year, the G20 Sustainable Finance Working Group highlighted that *“current green and sustainable finance alignment approaches generally aim to support activities that are already green and sustainable. However, a much larger part of the global economy, including sectors that are currently GHG intensive but in its process of transitioning to low or net-zero emissions, also require financing. An excessively narrow interpretation of “green” or “sustainable” finance could limit the flow of capital towards activities and investments that are needed to support the climate transition. For example, it may entail the risk that some GHG-intensive firms be penalized despite having credible transition plans, thus increasing the cost of capital to firms in need of investment to realize their green transition goals.”*<sup>30</sup>

It is therefore essential to ensure that the policy framework avoids such a narrow interpretation of sustainable finance and supports the provision of finance and investment to real economy corporates at different stages of their transition journey. As outlined in the European Commission’s Communication of 2021 on a Strategy for Financing the Transition to a Sustainable Economy, there is a need for an holistic approach to sustainable finance regardless of sectors, geographies, actors and the different starting points in the transition.

It is important to review the EU policy and regulatory framework to ensure that it is supporting transition finance. In this respect, we welcome the recent European Commission’s recommendations<sup>31</sup> aimed at supporting market participants that wish to obtain or provide transition finance by offering practical suggestions on how to approach transition finance. It remains important to clarify definitions and concepts relating to transition finance to provide clarity to the market. This should be done in conjunction with international counterparts, many of which are establishing guidance around transition finance, to ensure a common approach.

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30 2022 G20 Sustainable Finance Report

31 Commission Recommendation 2023/1425 on facilitating finance for the transition to a sustainable economy, June 2023





### 2.2 Financing tools for transition finance

It is important to enable banks to deploy a broad range of financing tools to support businesses as they transition including equity, bonds, loans and other financial products. Different types of financing will be suited to different companies depending upon factors such as their size, capital structure, financing needs and business model.

The types of financial instruments for the provision of transition finance are already available in the market and are similar to those available for other forms of sustainable finance. These include use of proceeds bonds, sustainability-linked bonds, general purpose lending, sustainability-linked lending, and equity investment. Market standards for bond and loan products are available, for example under ICMA Green Bond Principles and LMA Green Loan Principles. The availability of the EU Green Bond Standard for transition finance is likely to be limited due to the need for use of proceeds to be aligned with the EU Taxonomy. In particular, transitioning companies may not meet substantial contribution and/or DNSH criteria. There is also a lack of a clear transition finance labelling framework for investment funds, with various approaches developing in the market towards funds investing in transitioning companies and a lack of clarity as to how transition finance fits with the definition of sustainable investment under SFDR.

The financing products are therefore available for transition finance. However, when using these tools to provide transition finance, financial institutions must overcome additional hurdles. Firms deal with a high degree of uncertainty due to the forward-looking nature of integrating transition targets into these financing tools. In doing so, many exogenous factors beyond the control of the firms may affect the achievement of these targets. This, combined with the limited availability of credible data and the additional scrutiny companies may face, exposes firms to risk of accusations of greenwashing which brings legal and reputational risk. It is therefore essential to put in place the regulatory support and necessary tools to address these challenges.

In overcoming these hurdles, it is important to recognise that the provision of transition finance or other financial services will not drive the real economy transition. The financial sector's ability to support the transition will depend on whether the policy incentives and economic conditions are in place to enable the real economy to transition, thereby creating opportunities for finance and investment to support real economy transition activities. The ability of corporates to successfully transition, and for financial institutions to facilitate and finance these transitions, is dependent on whether firms have economically viable opportunities to decarbonise their businesses – which may be affected by economy-wide policies, sectoral incentives, supply and demand dynamics, and connectivity across value chains.

### 2.3 Challenges in mainstreaming transition finance

While the importance of mainstreaming transition finance is increasingly recognised by policymakers, and banks and investors are keen to scale the provision of transition finance, financial institutions face several challenges which are holding back the potential of transition finance. These include:

- a) A lack of clear political and regulatory support for transition finance, supported by real economy measures and incentives;
- b) A lack of clear sectoral decarbonisation pathways for the real economy against which transition plans can be assessed;
- c) Concerns regarding reputational and legal risk arising from potential accusations of greenwashing;
- d) A lack of a common interpretation/understanding of transition finance;
- e) The high degree of uncertainty associated with the forward-looking nature of transition planning;
- f) Challenges with articulating the role of transition finance to stakeholders; and
- g) Concerns that pressure on financial institutions to reduce their financed emissions and KPIs for financial sector disclosures will disincentivise financing for high-emitting sectors or activities most in need of support for transition.



## 2. Transition finance

It is a complex, but important, exercise to address these challenges. AFME welcomes the focus of policymakers in the EU and at the international level on transition finance. We believe that this should be a key priority in order to ensure that companies are able to make the necessary investments to support their transition.

We would welcome a dialogue with policymakers on how the above challenges could be addressed. Many of these areas are interrelated and the priority should be stimulating the necessary investment in the real economy as we do not view a lack of financing as holding back the transition. Nevertheless, it is also important to consider how the policy framework can facilitate the provision of transition finance and we suggest three pillars to improve this:

- 1) Providing political and regulatory support for transition finance
- 2) The availability of transition plans and relevant data; and
- 3) The means to assess the credibility of transition plans and targets.

We discuss the progress in each of these areas and recommendations to support the development of transition finance below. This is a global challenge and is vital to support the transition globally. A number of other jurisdictions are also very focused on transition finance. We strongly encourage the EU authorities to continue to work with their colleagues in international fora such as the G20 Sustainable Finance Working Group, IOSCO, NGFS, IPSF amongst others.

### 2.4 Political and regulatory support for transition finance

Alongside putting in place the tools to facilitate transition finance, it is critical that greater political and regulatory support is provided to explain the role and importance of transition finance, and to provide an enabling policy environment which encourages opportunities to transition for real economy companies.

Financial institutions will need to provide finance to all parts of the economy, including high-emitting sectors, throughout the transition. Recognising this is essential to promote an enabling policy environment for real economy transition and the provision of finance to support this transition. We suggest that this should be at the centre of policy objectives. Until now, for understandable reasons, there has been a primary focus on the promotion of green finance, particularly in the EU. However, in order to achieve the EU's environmental commitments, we view it as essential that the EU actively promotes the role of transition finance across the whole of the economy.

It is vital that policymakers continue to focus on setting out transition roadmaps and support companies with their transition, supported by enabling policy and appropriate incentives. This is essential to drive the real economy transition.

Appropriate recognition needs to be provided to the role that financial institutions can play in enabling the financing of the transition, provided that the necessary supportive environment is there for the real economy to transition. Provision of finance alone will not drive the transition. The financial sector's ability to support the transition will depend on whether the policy incentives and economic conditions are in place to enable the real economy to transition, thereby creating opportunities for finance and investment to support real economy transition objectives. Accordingly, it is important to avoid an excessive focus on financial institutions reducing their financed emissions and take a broader perspective reflecting their enabling role working with companies to help them to adapt their businesses as part of the whole-of-economy transition.

It is also important to ensure that regulation is appropriately facilitating, and not disincentivising, the provision of transition finance. Current disclosure requirements for banks such as the Green Asset Ratio and Pillar 3 disclosures do not reflect banks' contributions to the transition of the economy through provision of transition finance. It is important that transition planning frameworks for banks provide a broader perspective, allowing banks to explain their broader contribution. It is also important that supervisors and regulators focus on their mandates to supervise risk and do not attempt to use financial sector regulation to actively steer the transition of the real economy. Finally, it is also important to ensure that the supervisory approach to addressing greenwashing does not stifle innovation or the willingness of financial institutions to engage with companies that may be earlier in their decarbonization journey, as this will include areas where financing and investment is most needed.



### 2.5 The availability of transition plans and relevant data

Credible, comparable transition plans can be a valuable tool for financial institutions to understand their clients' decarbonisation trajectories and engage with clients to understand plans, constraints and potential opportunities for financing. Financial institutions and investors need to be able to understand companies' transition strategy and how transition financing will be used to support this.

Progress is being made in establishing frameworks for transition plans and the associated sustainability reporting. AFME strongly supports the efforts both at international level and within the EU to develop frameworks for transition planning. It is important that progress continues to be made in establishing effective frameworks for transition planning, accompanied by support for companies in creating credible transition plans aligned with relevant sectoral pathways.<sup>32</sup>

AFME welcomes the steps taken to establish transition plan disclosure requirements for companies under the ESRS and ISSB sustainability reporting standards. The ISSB standard provides an initial global baseline for common disclosure of transition plan information. As discussed above (see section 1.1.6 above), it is important to ensure coherence of EU requirements and interoperability of EU and international standards.

As discussed above (see section 1.1.2), the progress in sustainability reporting should also improve the availability, comparability and reliability of sustainability data over the next few years as companies start reporting under the CSRD and under similar frameworks in other jurisdictions. This should provide further data available for financial institutions and investors to assess the transition strategy, emissions profiles and decarbonisation trajectories of companies seeking transition finance. AFME continues to support the progress in establishing sustainability reporting requirements across jurisdictions and emphasizes the need to enhance the interoperability of reporting standards.

### 2.6 Means to assess the credibility of transition plans and targets

In order to ensure that transition finance is financing real decarbonisation and avoid potential greenwashing risks, it is necessary for financial institutions and investors to have clarity on what constitutes a credible transition plan and credible sustainability targets.

The presence of multiple transition plan disclosure expectations creates confusion for investors and financial institutions alike. Currently, there is no clear market-tested standard laying out what constitutes a credible transition plan. The global landscape for transition plan disclosure is fragmented, with varying expectations for transition plan disclosure, including which metrics to use and the level of detail expected. These realities present challenges when it comes to evaluating and finding comparability across transition plan disclosure and making a credibility determination.

The factors that make up a credible transition plan are highly dependent on the reporting company's stakeholders and business strategy. A company's business strategy around climate and Net Zero will be strongly dependent on the individual company's circumstances, and variation across transition plans is likely. While credibility factors may vary, there are certain principles of a credible transition plan that apply consistently across sectors. These include whether or not the plan or targets are science-based, technically or economically feasible, and achievable. Beyond these high-level principles, transition plan disclosure will vary, and stakeholders and policymakers should avoid setting specific expectations on reporting targets.

Given the fragmented landscape of transition plan disclosure, AFME encourages market-based initiatives to collaborate and reach a common understanding on a shared set of views to evaluate transition plan and target credibility. Governments should leverage common approaches and standards for credibility to develop "good practice" expectations on transition plans. The collaboration between public and private sector initiatives could drive a common approach for determining credibility.

Policymakers and banking regulators should avoid setting expectations that financial institutions should take responsibility for assessing the credibility of real economy firm transition plans. Financial institutions use transition plan information in multiple ways for commercial or business opportunity that does involve conducting a credibility analysis. However, while financial institutions perform due diligence on the information they are presented with, they are not well positioned to make a credibility assessment.

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<sup>32</sup> See section 1.1.6 above for our proposals on transition plans.



## 2. Transition finance

As discussed above, decarbonisation roadmaps and expectations for the real economy transition should be set out by governments and policymakers and AFME continues to encourage policymakers to provide as much guidance as possible on decarbonisation trajectories or roadmaps for different sectors of the real economy. These roadmaps serve as an official reference for companies in the real economy, providing the clarity and reassurance needed to undertake investments over a longer time horizon. The European Commission has a mandate under the EU Climate Law to engage with sectors of the economy to prepare indicative voluntary roadmaps for achieving climate neutrality. This would provide an important reference point for companies when preparing credible transition plans.

AFME welcomes the recent Recommendation published by the European Commission on transition finance<sup>33</sup>. The Recommendation provides some helpful guidance for companies and market participants on how they may approach transition finance. It sets out a number of examples of references for provision of transition finance including:

- a) Investments in portfolios tracking EU climate benchmarks;
- b) EU strategic environmental Action Plans for Circular Economy<sup>34</sup>, Biodiversity<sup>35</sup> and Zero Pollution<sup>36</sup>;
- c) Investments in economic activities aligned with the EU Taxonomy;
- d) Investment in undertakings or activities with a credible transition plan; and
- e) Investments in undertakings or economic activities with credible science-based targets, where proportionate, that are supported by information ensuring integrity, transparency and accountability.

While the Recommendation does not provide specific guidance to financial institutions on how the credibility of a transition plan should be assessed, it does provide some guidance on use of credible transition pathways. The Annex provides general considerations for target setting, recommending that they use science-based decarbonisation scenarios and pathways in line with the Paris Agreement and discussing how some aspects of the EU sustainable finance framework can be used to help with this, such as the EU Taxonomy substantial contribution and DNSH criteria, transitional activities and aligned capital expenditure under the EU Taxonomy and climate benchmarks. Feedback from our members is that this guidance and these tools can be helpful in assessing companies' plans to transition, but that further work on sectoral decarbonisation pathways/roadmaps and regulatory support is required.

Alongside this, we see merit in exploring an investment fund label for transition finance investments as part of the SFDR Review, which could help facilitate investment in support of transition finance needs and provide greater clarity to investors that the fund meets certain criteria.

### 2.7 Summary of recommendations to promote and facilitate transition finance

The financing tools for transition finance are available in the market, but financial institutions and investors face challenges in supporting and enabling transition finance.

Our key recommendations are to provide greater emphasis on the importance of financing the transition across the whole of the economy as the EU and global economies continue to decarbonise and adapt to a low carbon economy, combined with measures to support real economy transition, promoting the development of effective and interoperable transition plan frameworks and a review of regulation with a "transition finance lens" to ensure that it is not unnecessarily constraining companies from accessing finance to support their transition.

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33 Commission Recommendation 2023/1425 on facilitating finance for the transition to a sustainable economy, June 2023

34 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on A new Circular Economy Action Plan: For a cleaner and more competitive Europe. COM/2020/98 final

35 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU Biodiversity Strategy for 2030: Bringing nature back into our lives. COM/2020/380 final

36 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Pathway to a Healthy Planet for All EU Action Plan: 'Towards Zero Pollution for Air, Water and Soil'. COM/2021/400 final



### 3. Development of carbon markets

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As European Commission President Ursula Von der Leyen has recently highlighted<sup>37</sup>, carbon pricing is one of the most effective tools to drive decarbonisation. Developing carbon markets helps establish carbon pricing, with an important role for both compliance and voluntary carbon markets.

In October 2021, GFMA published a report<sup>38</sup> highlighting the role and importance of both compliance and voluntary carbon markets to the transition to a low-carbon global economy. It provides an overview of the carbon markets ecosystem, highlights key challenges, and outlines recommendations for policymakers, market participants, and other key stakeholders to scale deep and liquid global carbon markets, while highlighting key enablers and dependencies.

AFME recommends that further consideration should be given to the role of compliance and voluntary carbon markets in the EU and how these can be further developed.

#### 3.1 Compliance markets and the EU Emissions Trading Scheme

AFME strongly encourages the EU to continue to work to strengthen the EU Emissions Trading Scheme (ETS) and work with its international partners to further develop compliance markets internationally, including reflecting upon the recommendations of the GFMA report and the recent IOSCO report on Compliance Carbon Markets<sup>39</sup>.

AFME welcomes the steps taken to increase the scope and ambition of the EU ETS. We encourage the European Commission to continue to consider opportunities for further expansion of the EU ETS and to enhance cooperation with other jurisdictions to promote the development of compliance carbon markets with a view to potential interoperability of emissions trading schemes over time.

#### 3.2 Voluntary carbon markets

As highlighted in the GFMA report and acknowledged, for example by IOSCO, voluntary carbon markets (VCMs) have an important role to play in supporting the transition to a low-carbon economy by facilitating the trading of carbon credits which are capable of being surrendered to offset a corresponding volume of carbon emissions.

The EU has made tangible steps to standardise, professionalise and create robust standards in VCMs in particular through the development of proposed EU Carbon Removal Certification “QU.A.L.I.TY” standards covering industrial carbon dioxide removals with permanent storage and sequestration (such as DACS / BECCS, biochar and bio oil storage; and some forms of nature based solutions such as soil carbon enhancements. Although early proposals have been drafted, the EU needs to quickly accelerate the pace of adoption of the standards, as well as drafting or ratifying regulatory technical standards under which the individual categories of assets can be measured, reported and verified under to ensure that developers of carbon dioxide removal projects can deliver projects at pace sufficient to meet ambitious carbon removals targets under EU NDC commitments.

By embracing and professionalising voluntary carbon markets, there is an opportunity to mitigate greenwashing while rapidly accelerating project development – the regulations could be structured in a way to create efficient and liquid carbon markets which incentivise the development of high quality, permanent, additional projects while creating a significant price penalty for poorer quality projects which do not qualify for the standards. This could be enhanced by inclusion of the credits under EU ETS (similar to proposals being discussed in the UK) or having a ‘green European investment bank’ to act as an off taker of last resort to provide liquidity and a price floor to project finance against development of such credits.

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37 Speech at the Summit for a New Global Financing Pact, June 2023

38 Unlocking the Potential of Carbon Markets to achieve Global Net Zero, GFMA and BCG, October 2021

39 IOSCO Final Report on Compliance Carbon Markets, July 2023



### 3. Development of carbon markets

Voluntary carbon markets can help scale up the deployment of carbon dioxide removal solutions to address hard-to-abate residual emissions and help fill gaps for sectors not covered by compliance markets. Voluntary carbon markets can also support other ecosystem services, such as biodiversity, water or flood mitigation, to unlock additional investment in nature, for example through nature-based solutions. They can also provide a mechanism to help channel financing to developing countries, for example for nature-based solutions.

As has been widely acknowledged, there are a number of vulnerabilities in the market that need to be addressed to ensure the integrity of voluntary carbon markets and that there can be trust in the market. These challenges have held back the development of voluntary markets, which have not yet scaled to their full potential. They are highly fragmented and derive from a range of standards which make them vulnerable to criticism for lacking integrity and transparency.

Voluntary Markets must be underpinned by the same core principles that underpin any sound and robust financial market: (i) transparency; (ii) integrity; (iii) stability; and (iv) accountability.

Significant efforts have been undertaken through international initiatives such as the Integrity Council for the Voluntary Carbon Market (ICVCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI) to provide frameworks to ensure quality, transparency, credibility, and accountability for the voluntary carbon markets across the value chain. Important progress has been made recently including the publication of the ICVCM Core Carbon Principles and its assessment framework<sup>40</sup> and the VCMI Claims Code of Practice.<sup>41</sup>

AFME encourages the EU authorities to consider how they can provide policy and regulatory support for voluntary carbon markets, to provide clarity on the role that they can play in the transition and to help support the growth of the market in credible carbon credits. We recognise that IOSCO is currently considering how it can support the development and functioning of voluntary carbon markets<sup>42</sup>. We strongly encourage the EU authorities to continue to work with their international counterparts, to reflect upon the forthcoming IOSCO report and consult market participants on how the EU can best achieve this.

It's crucial that EU policymakers coordinate globally to promote alignment across VCM-related regulation. The global nature of voluntary carbon markets makes international coordination critical to avoid regulatory fragmentation that could otherwise inhibit the growth of the nascent voluntary carbon market. We are supportive of the EU taking a role globally to ensure that there is an effective interface with other markets, other regions, and other regulators. Regulatory efforts that are inconsistent or uncoordinated may inhibit the development of VCMs or increase market fragmentation.

**“AFME encourages the EU authorities to consider how they can provide policy and regulatory support for voluntary carbon markets”**

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40 ICVCM Core Carbon Principles, Assessment Framework and Assessment Procedure, July 2023

41 VCMI Claims Code of Practice, 28 June 2023

42 See also GFMA responses to IOSCO consultations on compliance and voluntary carbon markets



## 4. Scaling finance for nature

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With an estimated biodiversity financing gap of USD 598-824 billion per year<sup>43</sup>, it is vital to continue work to scale financial services that facilitate investment in support of the conservation and restoration of nature.

In November 2022, ahead of the COP15 UN Biodiversity Conference, AFME and EY published a report<sup>44</sup> highlighting the opportunities and challenges for scaling finance in support of nature and biodiversity.

While growing investor demand is creating new opportunities to develop nature-related financing products, the report found that banks and other market participants face challenges in mainstreaming and scaling nature finance products. The most fundamental challenge to unlocking nature-related finance is the lack of clarity on how the EU will implement the goals and targets under the Kunming-Montreal Global Biodiversity Framework (GBF). Without policy certainty and clarity, it will be challenging for corporates to align with the EU's direction of travel, and therefore challenging for financial institutions to support that real economy activity.

Other key challenges identified by members include:

- a) Complexity in defining metrics and KPIs;
- b) Lack of availability of verifiable data and assurance
- c) Achieving sufficient scale for investments;
- d) Investor expectations and risk-return appetite for relevant investments;
- e) A lack of a clear policy framework to incentivise private investment; and
- f) Long-term Investment timeframes.

The report also provides an overview of the natural capital finance products currently in the market and showcases a number of case studies of innovative practices currently being used by AFME members. Many of the sustainable finance tools discussed above are also being used for nature objectives, including use of proceeds bonds, sustainability-linked products and other financing solutions. Chapter 2 of the nature report discusses the opportunities and challenges with the use of different products.

**“While growing investor demand is creating new opportunities to develop nature-related financing products, banks and other market participants face challenges in mainstreaming and scaling nature finance products”**

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<sup>43</sup> Paulson Institute, *Financing Nature: Closing the Global Biodiversity Financing Gap* (2020)

<sup>44</sup> *Into the Wild: Why nature may be the next frontier for capital markets*, November 2022



## 4. Scaling finance for nature

The report made five key recommendations for policy developments that can help direct capital towards solutions to conserve and restore nature:

- 1) Gathering and translation of nature-related data into decision-grade data for financial services;
- 2) A strong global nature reporting framework;
- 3) Agreement on how to define measurable, meaningful impact on biodiversity through metrics and key performance indicators (KPIs);
- 4) Standardisation of product classifications; and
- 5) Development of a currency for nature.

AFME welcomes continued work by policymakers internationally and within the EU to address some of these key challenges including the work of the Taskforce on Nature-Related Financial Disclosures, the inclusion of biodiversity and other relevant disclosures (such as water and marine resources, pollution and climate change) under the ESRS and inclusion of biodiversity within the EU Taxonomy and the EU Green Bond Standard.

The agreement of the GBF at COP15 and publication of the TNFD framework are important steps forward. However, governments have not yet committed to taking concrete actions on nature loss. Unlike the Paris Agreement, the COP15 GBF agreement does not have a concrete government target other than providing for effective conservation and management of at least 30 percent of the world's land, coastal areas, and oceans by 2030. Without clear signals from governments, it is unclear how financial institutions could set targets and transition plans aligned with government commitments or assess transition risk from expected government action. In this respect the adoption of the EU Nature Restoration Law and the obligation of the EU to update its National Biodiversity Strategy and Action Plans to implement the GBF for COP16 in 2024 are important steps to follow through.

We encourage policymakers to provide greater clarity on the EU's approach to implementing the GBF and continue to work with market participants to address challenges and support the growth of the market in natural capital financing products to close the nature finance gap. Areas such as nature-based solutions, conservation and restoration solutions, biodiversity credits and development of voluntary carbon markets provide opportunities, combined with the need for public and private financing to work together.





## 5. Conclusion

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Over the last five years, the EU has established a comprehensive regulatory framework for sustainable finance. We hope that this report provides constructive input to EU policymakers and regulators to support an effective, well-functioning regulatory framework that achieves its objectives. AFME looks forward to continuing its dialogue with policymakers, members and other stakeholders in support of these important goals.



## Annex: Glossary

<b>Basel Committee or BCBS</b>	Basel Committee on Banking Supervision
<b>BMR</b>	EU Benchmark Regulation
<b>CMU</b>	Capital Markets Union
<b>CRD</b>	Capital Requirements Directive
<b>CRR</b>	Capital Requirements Regulation
<b>CRST</b>	Climate Risk Stress Testing
<b>CSDDD</b>	Corporate Sustainability Due Diligence Directive
<b>CSRD</b>	Corporate Sustainability Reporting Directive
<b>DNSH</b>	Do-No-Significant-Harm under the EU Taxonomy
<b>EBA</b>	European Banking Authority
<b>EFRAG</b>	European Financial Reporting Advisory Group
<b>ESAs</b>	European Supervisory Authorities
<b>ESG</b>	Environmental, Social and Governance
<b>ESMA</b>	European Securities and Markets Authority
<b>ESRS</b>	European Sustainability Reporting Standards
<b>ETS</b>	Emissions Trading Scheme
<b>EU GBS</b>	EU Green Bond Standard Regulation
<b>EU Taxonomy</b>	EU Taxonomy Regulation
<b>FCA</b>	UK Financial Conduct Authority
<b>FSB</b>	Financial Stability Board
<b>GAR</b>	Green Asset Ratio under the EU Taxonomy Regulation
<b>GBF</b>	The Kunming-Montreal Global Biodiversity Framework
<b>GTAG</b>	UK Green Technical Advisory Group
<b>ICVCM</b>	Integrity Council for the Voluntary Carbon Market
<b>IOSCO</b>	International Organization of Securities Commissions
<b>IPCC</b>	UN Intergovernmental Panel on Climate Change
<b>IPSF</b>	International Platform on Sustainable Finance
<b>ISSB</b>	International Sustainability Standards Board



<b>KPIs</b>	Key Performance Indicators
<b>MiFID II</b>	Markets in Financial Instruments Directive II
<b>NGFS</b>	Central Banks and Supervisors Network for Greening the Financial System
<b>NFRD</b>	Non-Financial Reporting Directive
<b>NZBA</b>	Net Zero Banking Alliance
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>PAI</b>	Principal Adverse Impact
<b>PSF</b>	EU Platform on Sustainable Finance
<b>SFDR</b>	Sustainable Finance Disclosure Regulation
<b>SME</b>	Small and Medium-sized Enterprise
<b>TCFD</b>	Taskforce on Climate-related Financial Disclosures
<b>TNFD</b>	Taskforce on Nature-related Financial Disclosures
<b>VCM</b>	Voluntary Carbon Markets
<b>VCMI</b>	Voluntary Carbon Markets Integrity Initiative



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## / About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society.

We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

### Focus

on a wide range of market, business and prudential issues

### Expertise

deep policy and technical skills

### Strong relationships

with European and global policymakers

### Breadth

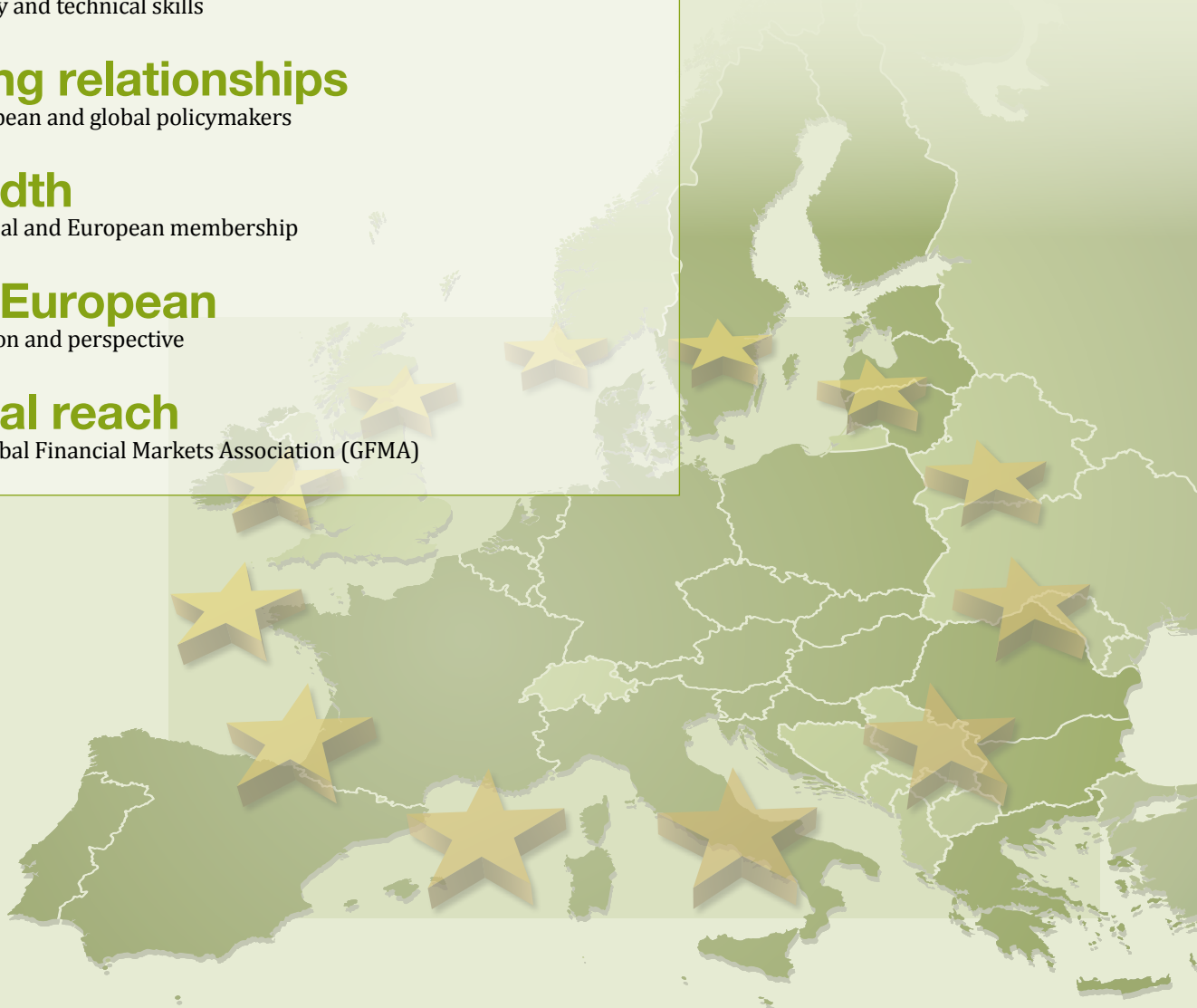
broad global and European membership

### Pan-European

organisation and perspective

### Global reach

via the Global Financial Markets Association (GFMA)



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