

The shaping of the concept of 'sustainability' in the EU agenda

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Overview

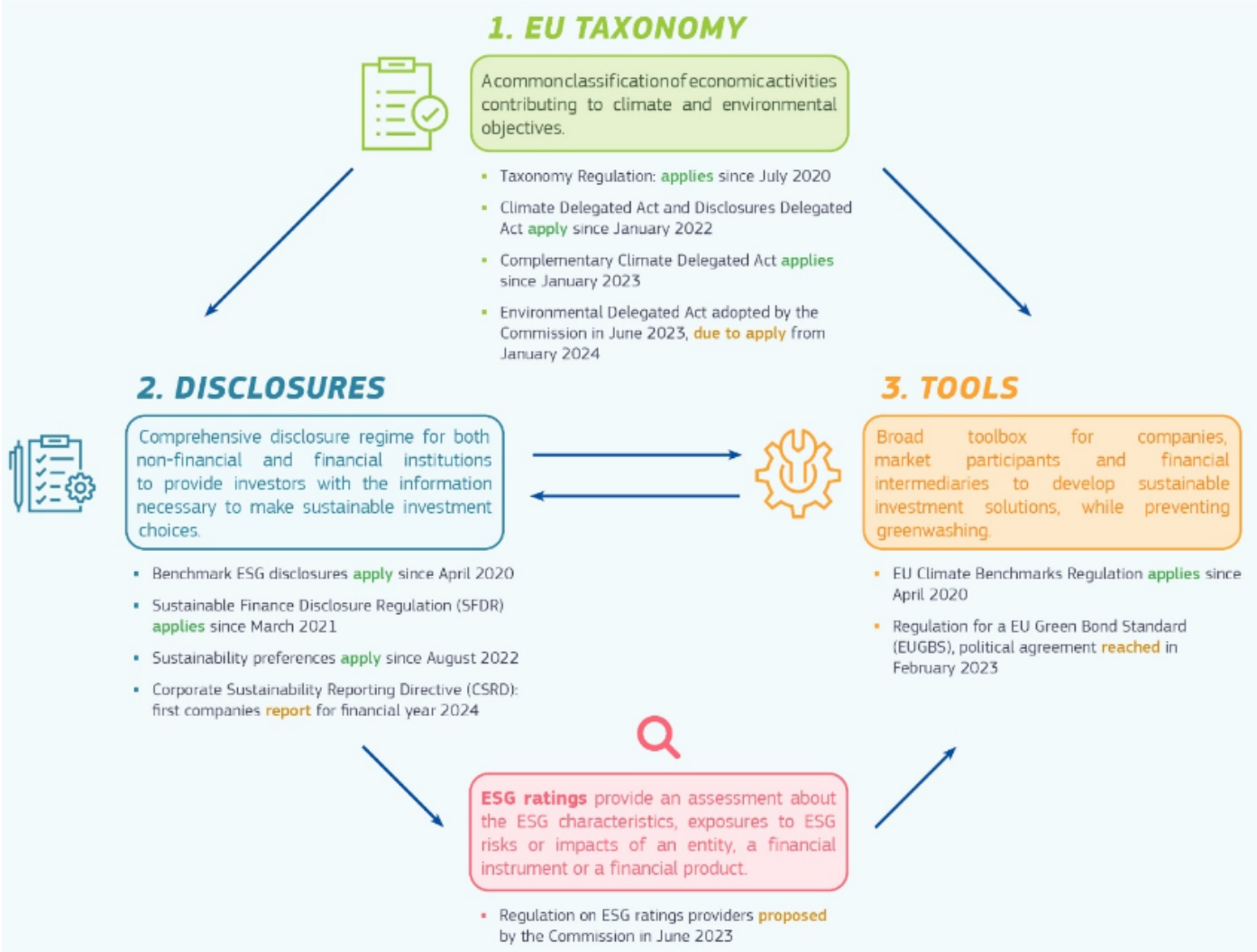
- A snapshot of the EU sustainable finance agenda
- Definitional initiatives
 - EU Taxonomy
 - EU Green Bond Standard
 - ESG ratings
- General considerations

Sustainable finance and (EU) law

- EU comprehensive SF agenda in tandem with broader sustainability and climate agenda
- EU as a **forerunner in the global policy space**



A broad, *in fieri* agenda



EU Commission, A sustainable finance framework that works on the ground, 2023

Definitions of “sustainability” in the EU SF agenda

EU Taxonomy

EU Green Bond Standard

Proposal for ESG Ratings
Regulation

EU Climate Benchmarks
(Regulation 2016/2011/EU)

The cornerstone of the EU SF framework: the EU Taxonomy



Classification system for “environmentally sustainable” activities:

Taxonomy Regulation (2020/852/EU)

High-level principles to qualify

Taxonomy-compliance

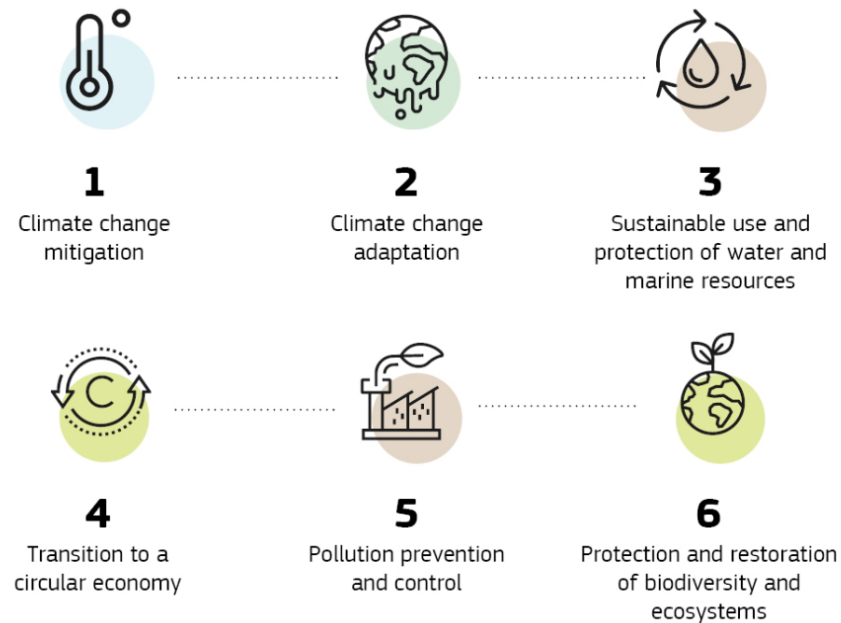
[published in Official Journal on **22 June 2020**
and entered into force on **12 July 2020**]

Delegated Acts

Technical screening criteria

- Climate Delegated Act (Commission Delegated Regulation (EU) 2021/2139)
- Complementary Climate Delegated Act (Commission Delegated Regulation (EU) 2022/1214)
- Environmental Delegated Act (Commission Delegated Regulation (EU) 2023/2486)
- Amendments to Climate Delegated Act (Commission Delegated Regulation (EU) 2023/2485)
- Commission Delegated Regulation (EU) 2023/2486

Taxonomy-compliant activities



Article 9, Regulation 2020/852/EU: Activities:

- Making a substantial contribution to one (out of six) environmental objectives
- Not “doing significant harm” to any of the other five environmental objectives;
- Complying with **minimum safeguards**
- Complying with the **technical screening criteria** set out in the Taxonomy delegated acts:

Source: EU Taxonomy Navigator, 2023

Taxonomy's technical screening criteria

3.3. Manufacture of low carbon technologies for transport

Description of the activity

Manufacture, repair, maintenance, retrofitting, repurposing and upgrade of low carbon transport vehicles, rolling stock and vessels.

The economic activities in this category could be associated with several NACE codes, in particular C29.1, C30.1, C30.2, C30.9, C33.15, C33.17 in accordance with the statistical classification of economic activities established by Regulation (EC) No 1893/2006.

An economic activity in this category is an enabling activity in accordance with Article 10(1), point (i), of Regulation (EU) 2020/852 where it complies with the technical screening criteria set out in this Section.

Technical screening criteria

Substantial contribution to climate change mitigation
The economic activity manufactures, repairs, maintains, retrofits ⁽⁷⁴⁾ , repurposes or upgrades:
(a) trains, passenger coaches and wagons that have zero direct (tailpipe) CO ₂ emissions;
(b) trains, passenger coaches and wagons that have zero direct tailpipe CO ₂ emission when operated on a track with necessary infrastructure, and use a conventional engine where such infrastructure is not available (bimode);
(c) urban, suburban and road passenger transport devices, where the direct (tailpipe) CO ₂ emissions of the vehicles are zero;
(d) until 31 December 2025, vehicles designated as categories M2 and M3 ⁽⁷⁵⁾ that have a type of bodywork classified as 'CA' (single-deck vehicle), 'CB' (double-deck vehicle), 'CC' (single-deck articulated vehicle) or 'CD' (double-deck articulated vehicle) ⁽⁷⁶⁾ , and comply with the latest EURO VI standard, i.e. both with the requirements of Regulation (EC) No 595/2009 of the European Parliament and of the Council ⁽⁷⁷⁾ and, from the time of the entry into force of amendments to that Regulation, in those amending acts, even before they become applicable, and with the latest step of the Euro VI standard set out in Table 1 of Appendix 9 to Annex I to Commission Regulation (EU) No 582/2011 ⁽⁷⁸⁾ where the provisions governing that step have entered into force but have not yet become applicable for this type of vehicle ⁽⁷⁹⁾ . Where such standard is not available, the direct CO ₂ emissions of the vehicles are zero;

(m) sea and coastal passenger water transport vessels, not dedicated to transporting fossil fuels, that:	
(i) have zero direct (tailpipe) CO ₂ emissions;	
(ii) until 31 December 2025, hybrid and dual fuel vessels derive at least 25 % of their energy from zero direct (tailpipe) CO ₂ emission fuels or plug-in power for their normal operation at sea and in ports;	
(iii) until 31 December 2025, the vessels have an attained Energy Efficiency Design Index (EEDI) value 10 % below the EEDI requirements applicable on 1 April 2022 if the vessels are able to run on zero direct (tailpipe) CO ₂ emission fuels or on fuels from renewable sources ⁽⁸⁹⁾ .	
Do no significant harm ('DNSH')	
(2)Climate change adaptation	The activity complies with the criteria set out in Appendix A to this Annex.
(3)Sustainable use and protection of water and marine resources	The activity complies with the criteria set out in Appendix B to this Annex.
(4)Transition to a circular economy	The activity assesses the availability of and, where feasible, adopts techniques that support: (a)reuse and use of secondary raw materials and re-used components in products manufactured; (b)design for high durability, recyclability, easy disassembly and adaptability of products manufactured; (c)waste management that prioritises recycling over disposal, in the manufacturing process; (d)information on and traceability of substances of concern throughout the life cycle of the manufactured products.



The Taxonomy in practice

1) Basis for reporting (Art 8 Taxonomy Regulation, [Delegated Regulation 2021/2178](#))

- large and listed companies: % revenues from activities in line with Taxonomy
- “Green” funds (eg pension funds) (Art 9 Regulation 2019/2088/EU): % of activities in line with Taxonomy
- Banks: green asset ratio



2) Benchmark to qualify **bonds** as **green** (EU Green Bond Standard, [Regulation \(EU\) 2023/2631](#))



Benchmark for “greenness” of companies, funds and financial products?



Taxonomy: potentials and challenges (I)



Mandatory, granular and science-based



First example globally and “global gold standard”



Usability and interoperability



Keeping up to speed with scientific progress



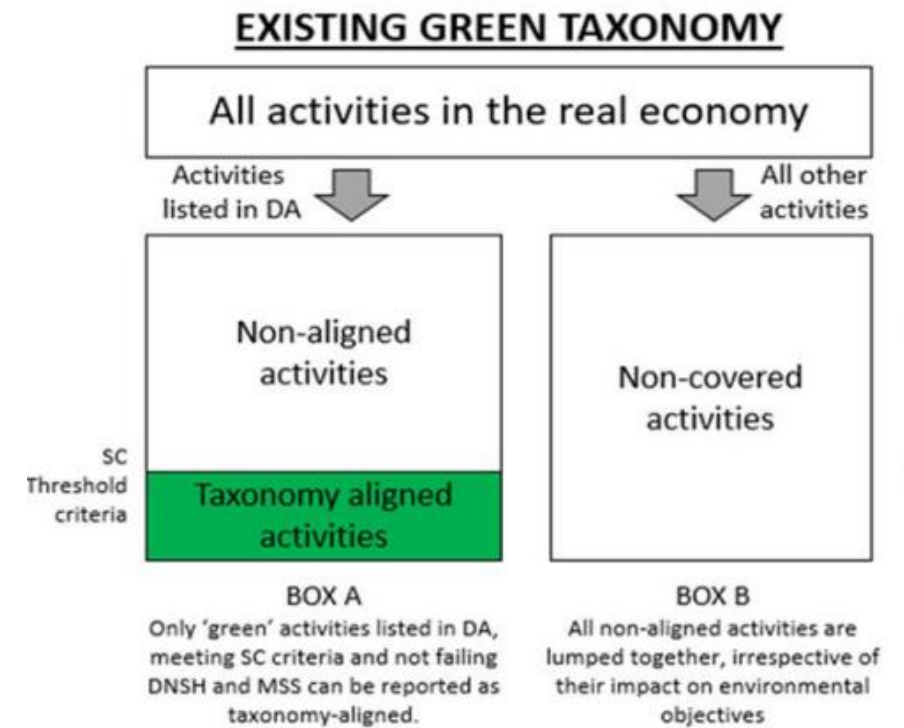
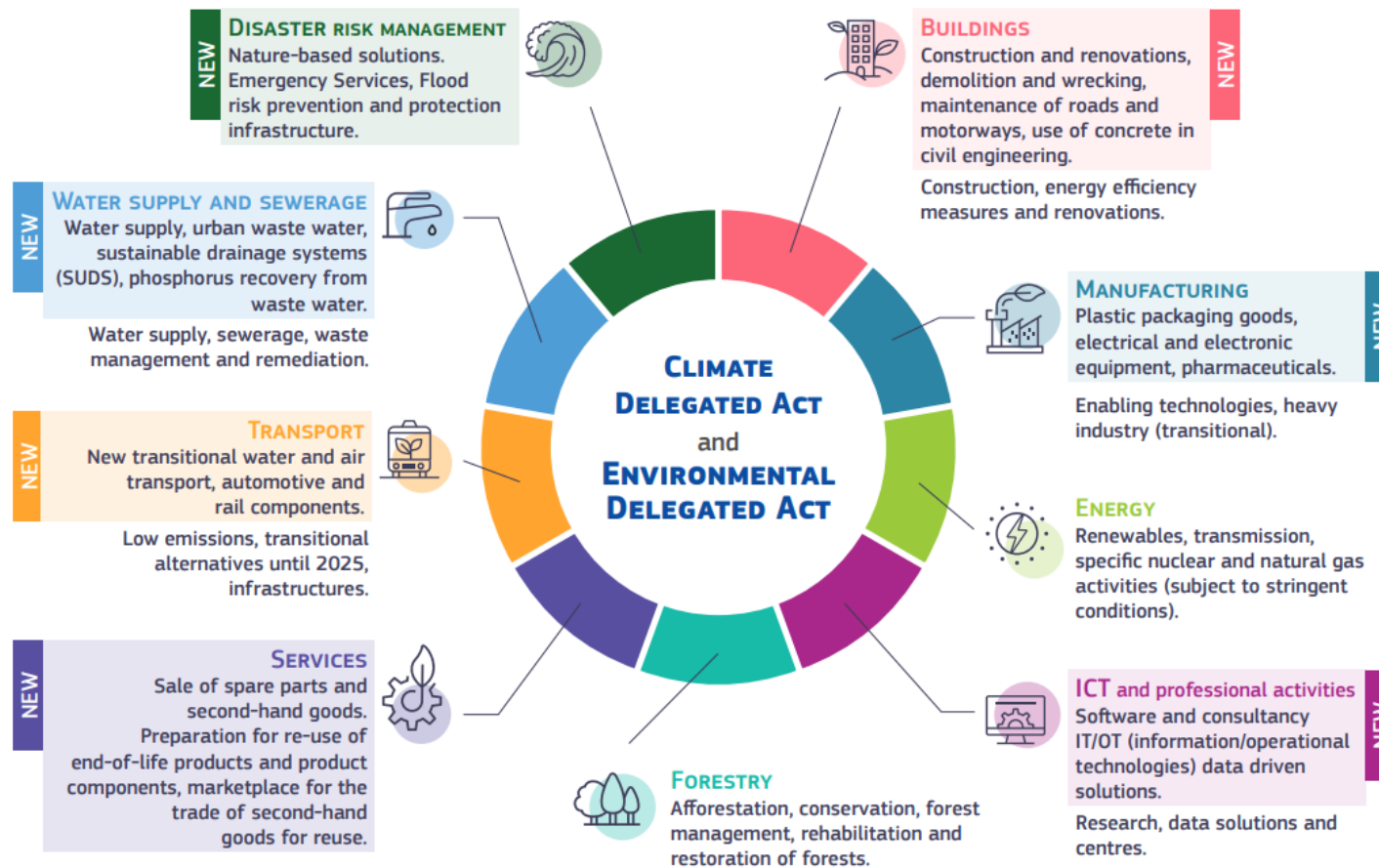
Scope:

- **only E**, not S & G
- **Politicisation of the debate** → inclusion of gas and nuclear
- **Binary system** → how about “transitional” activities?
(Commission Delegated Regulation (EU) 2022/1214)



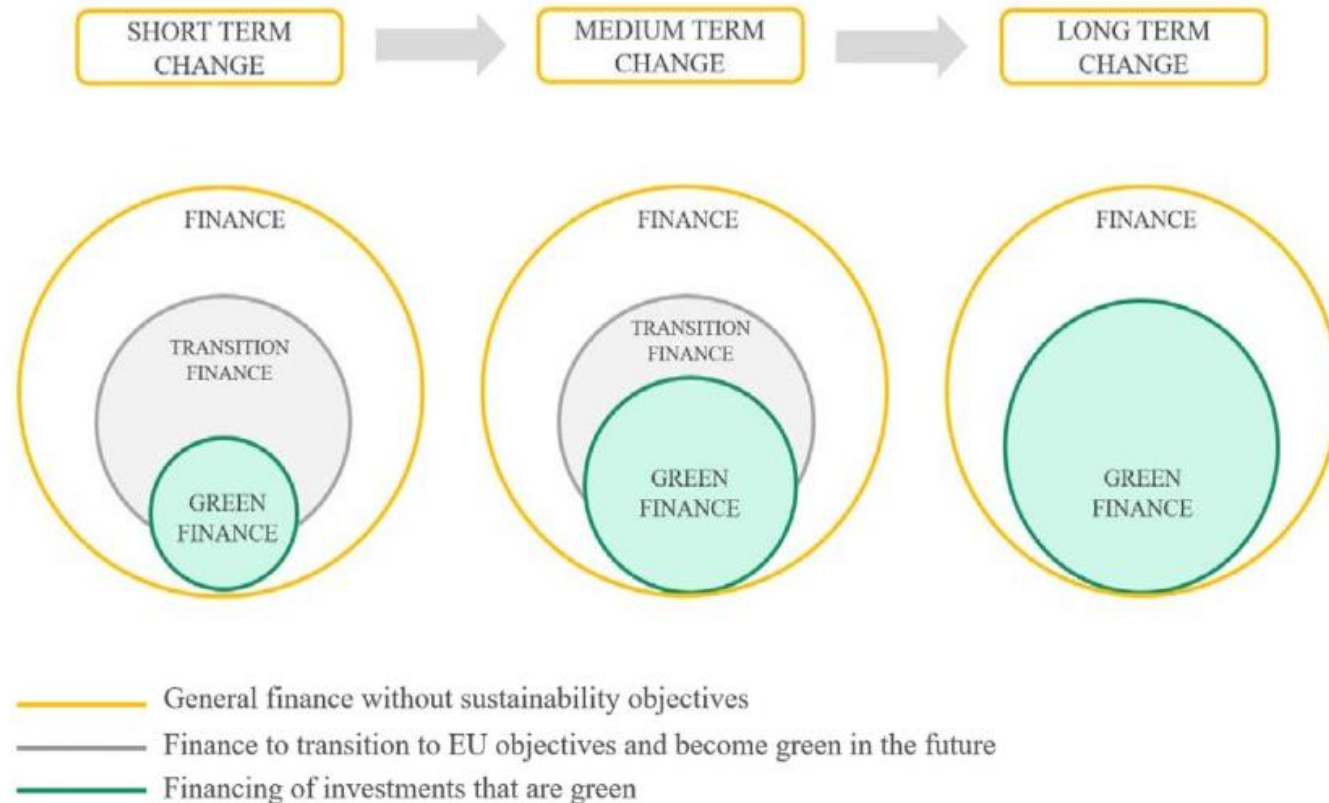
Taxonomy: potentials and challenges (II)

- scope and coverage



Taxonomy: reorienting economic activities?

Figure 1: Relationship between green and transition finance today and over time



Source: [EU Commission's Recommendation on transition finance, 2023](#)

“Sustainable” debt instruments: green bonds

- First issuance by European Investment Bank (**EIB**) (“Climate Awareness Bond”, 2007)
- Bonds: Debt securities: traded on capital markets, investors not becoming shareholders
- “Green”: “**use of proceeds**” (allocation of cash flows from investors)

Why?

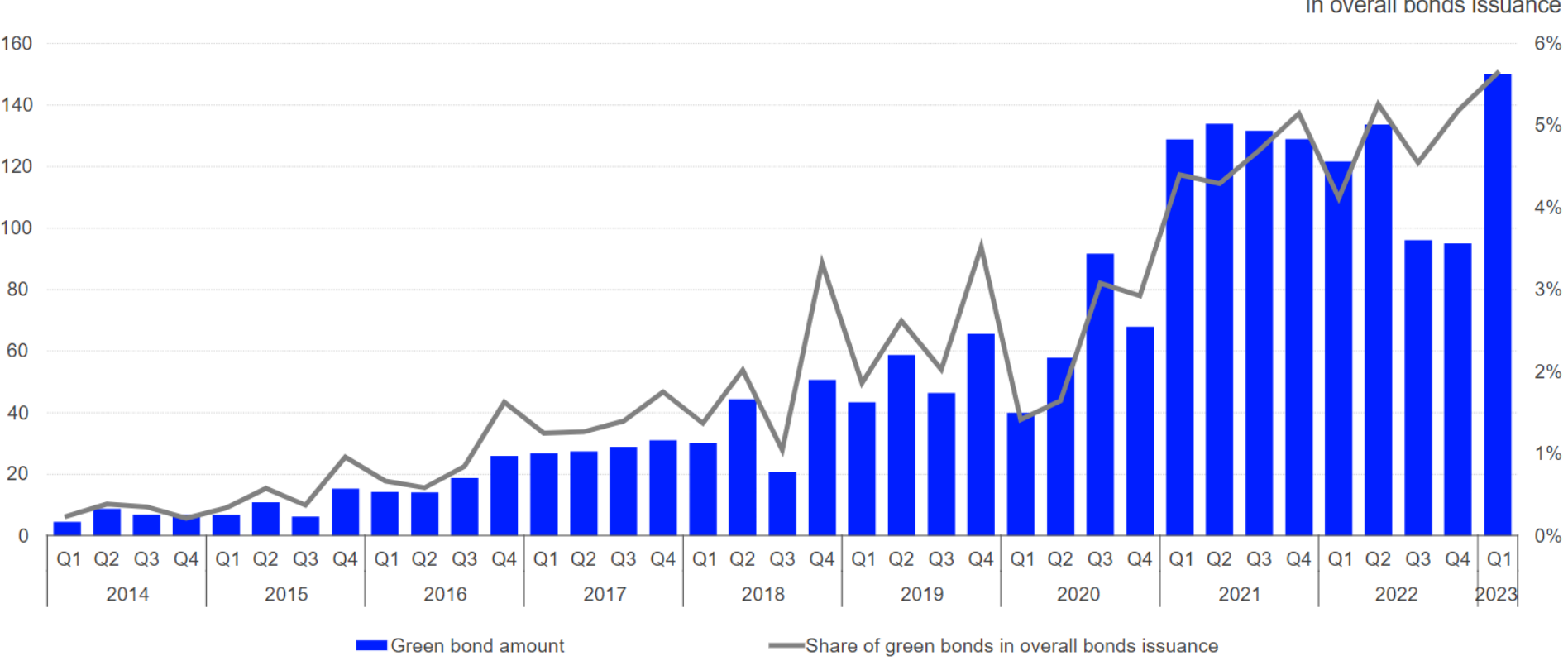


Green bonds: a success story?

Germany's Inaugural Federal Green Bond Issuance
 Demand, 5x Oversubscribed
 2020 | Government, Sustainable Finance

GREEN BONDS are the stars of climate finance.
 which channel funds raised towards

Green bond issuance (USD billions)

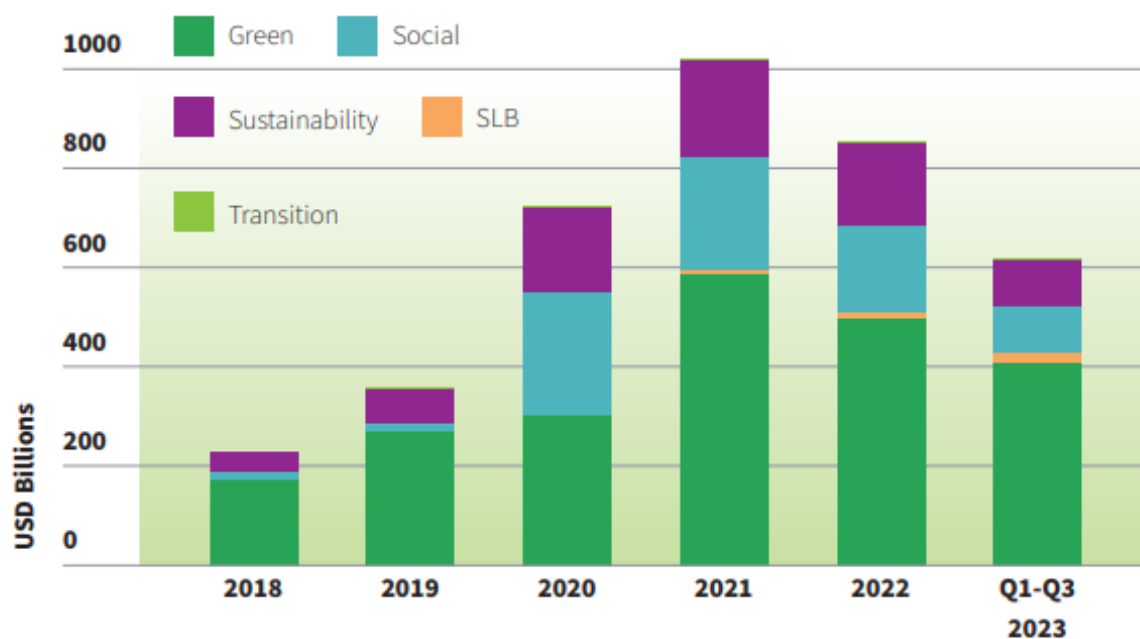


and oversubscribed
 0 million to
 and follows
 company.
 Printable PDF
 Recent media releases
 and for green bond sale
 is ago
 turns from a new green bond on Tuesday after it re

Source: [LSEG, 2023](#)

The universe of “sustainable” bonds (I)

Green bonds contributed 64% to aligned volume in 2023



Source: Climate Bonds Initiative

Source: [Climate Bonds initiative](https://www.climatebondsinitiative.com/), 2023

Scorecard: GSS+ debt recorded by Climate Bonds



Climate Bonds INITIATIVE

GB-TAP Green Bond Technical Assistance Program

IFC International Finance Corporation IN PARTNERSHIP WITH

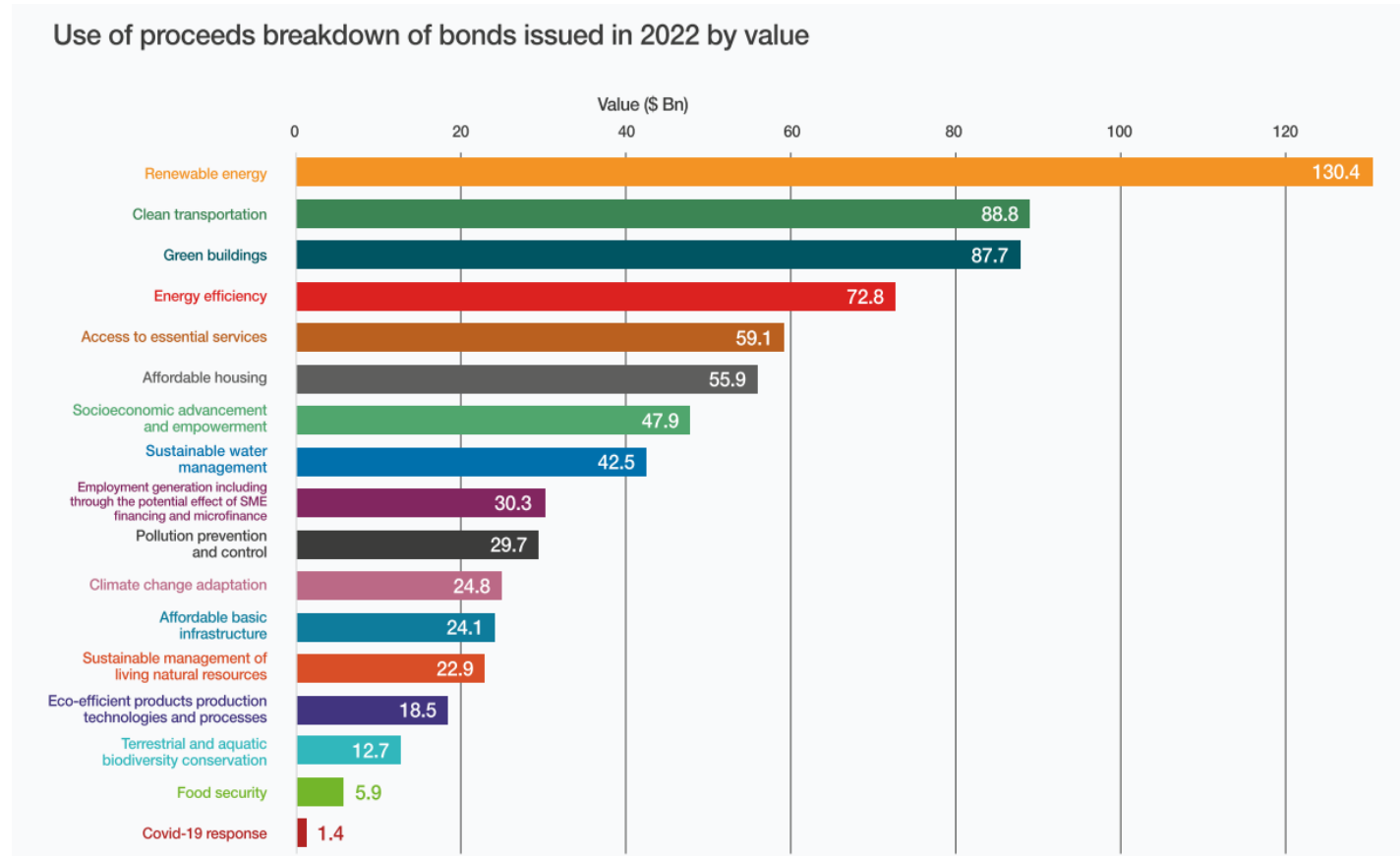
	Q3 2023		2023 YTD		Cumulative since 2006	
	USDbn	% total	USDbn	% total	USDbn	% total
Green	110.6	65	415.0	67	2613.0	62
Social	27.4	16	95.8	16	762.7	19
Sustainability	22.1	13	88.8	14	764.2	18
SLB	8.6	5	16.8	3	42.5	1
Transition	0.7	0.4%	1.7	0.3	12.7	0.3
Total	169.5	100	618.2	100	4228.1	100

© Climate Bonds Initiative, 2023



The universe of “sustainable” bonds (II)

- **Green Bonds:** predominantly used to finance **Energy, Buildings and Transport** (approximately 80%)
- **Social bonds:** access to essential services, social housing, poverty
- **Sustainability bonds:** a combination of green and social features



Source: Environmental Finance, 2023.

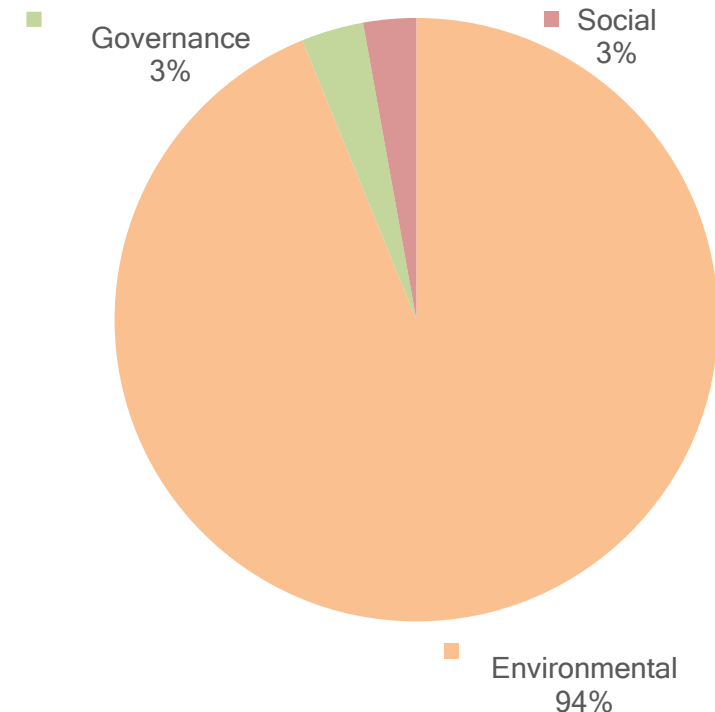
www.eui.eu



Green bonds vs. sustainability-linked bonds

- **Sustainability-Linked Bonds (SLBs)** are instruments to raise funds tied to sustainability related commitments
- Since **2019** ([ENEL](#))
- Differences from use-of-proceeds bonds:
 - Company-level sustainability commitment set out in sustainability performance targets and measured by key performance indicators
 - Penalty mechanism (often coupon step-up) kicks in if targets are not achieved
 - Proceeds mainly allocated to general or refinancing purposes

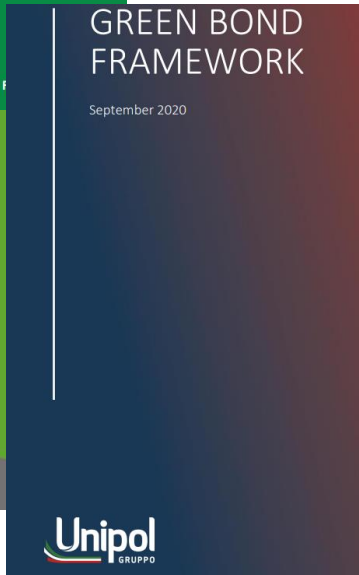
Environmental KPIs dominate
Share of KPIs used in SLBs (%)



Note: Sustainability-linked bonds by KPI/SPT ESG category
Sources: Refinitiv EIKON, ESMA.



Market-based governance of “sustainable” bonds



CICERO
Shades of
Green

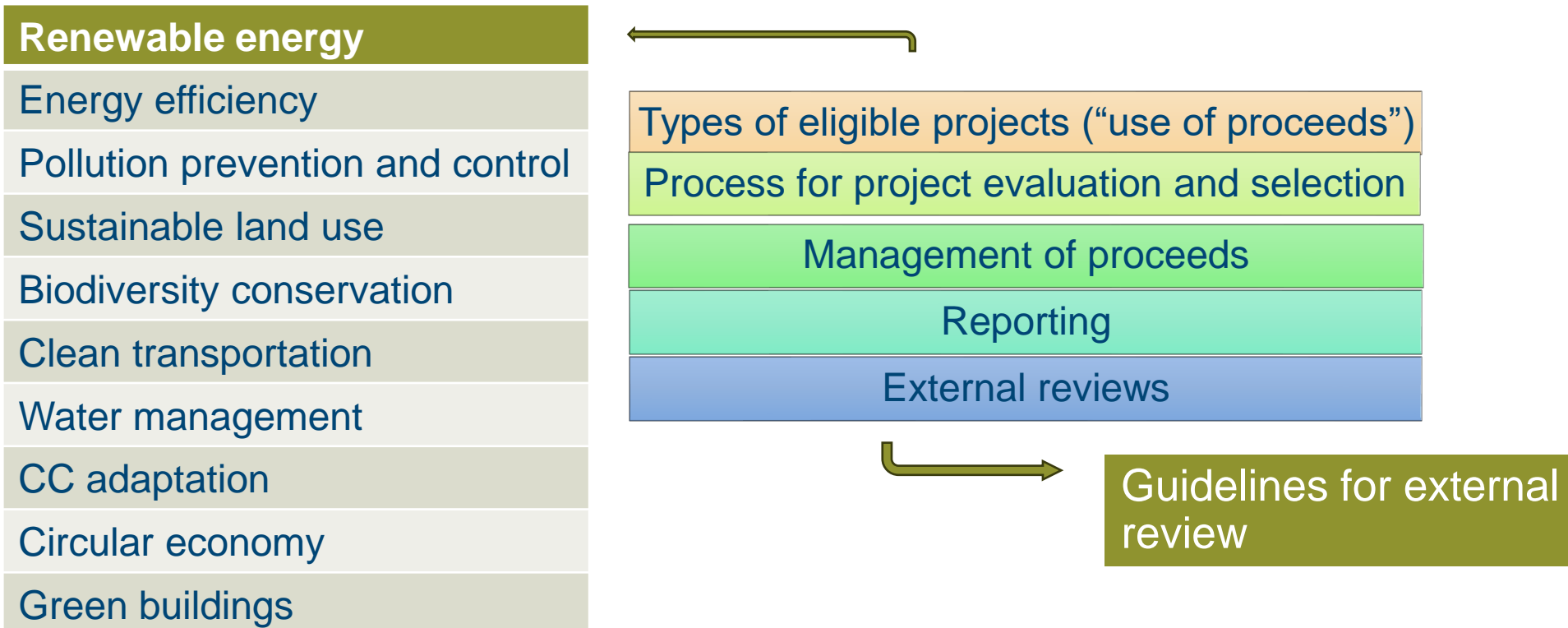
S&P Global
Ratings



Market (voluntary) standards

“Use of proceeds” instruments

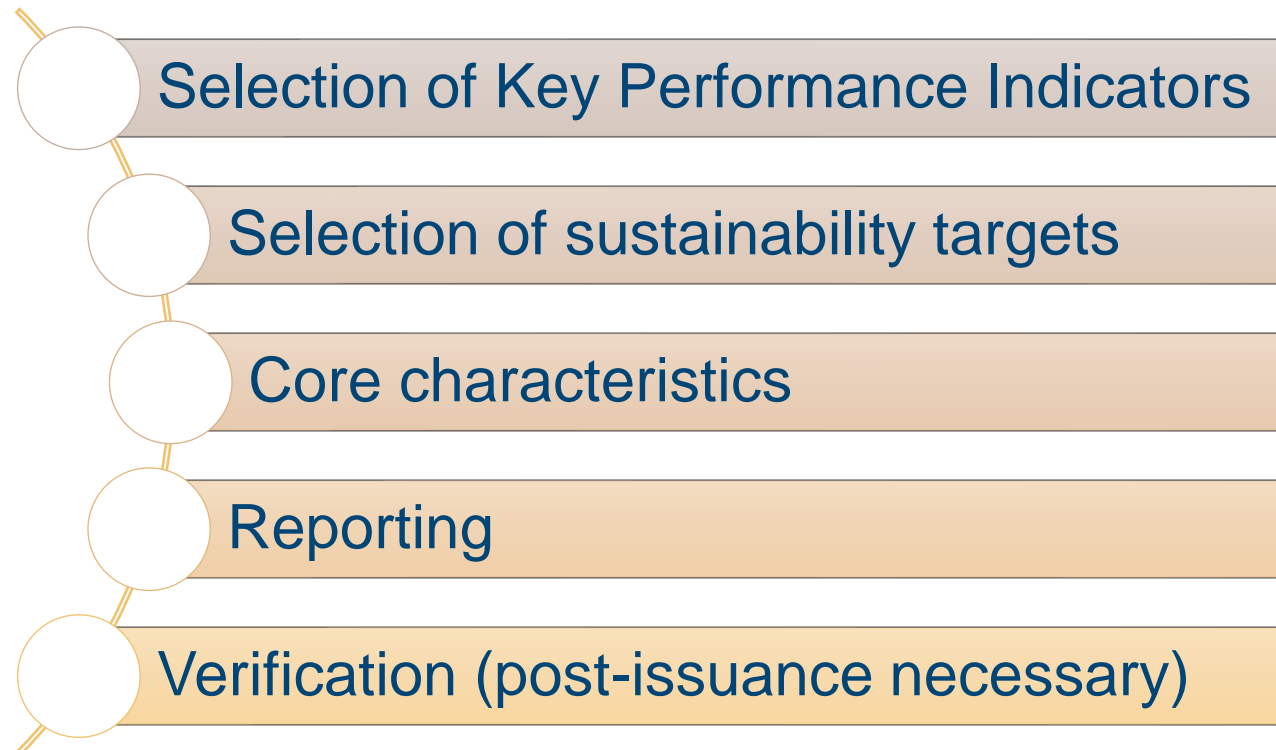
- **International Capital Markets Association (ICMA)**’s Green Bond Principles, Social Bond Principles, Sustainability Bond Guidelines



Market (voluntary) standards (II)

Sustainability-Linked instruments

- ICMA's Sustainability-Linked Bond Principles



External reviews

Types

- Second-party opinions
- Verifications (e.g. compliance with ICMA)
- Certifications
- (Ratings)

Challenges

- Totally **voluntary**
- divergent methodologies
- concentration in the industry
- expertise, conflicts of interest



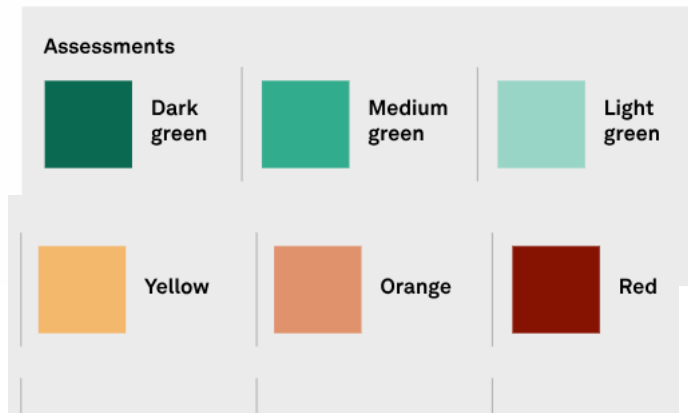
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Green



S&P Global
Ratings



S&P Global Ratings' Shades of Green

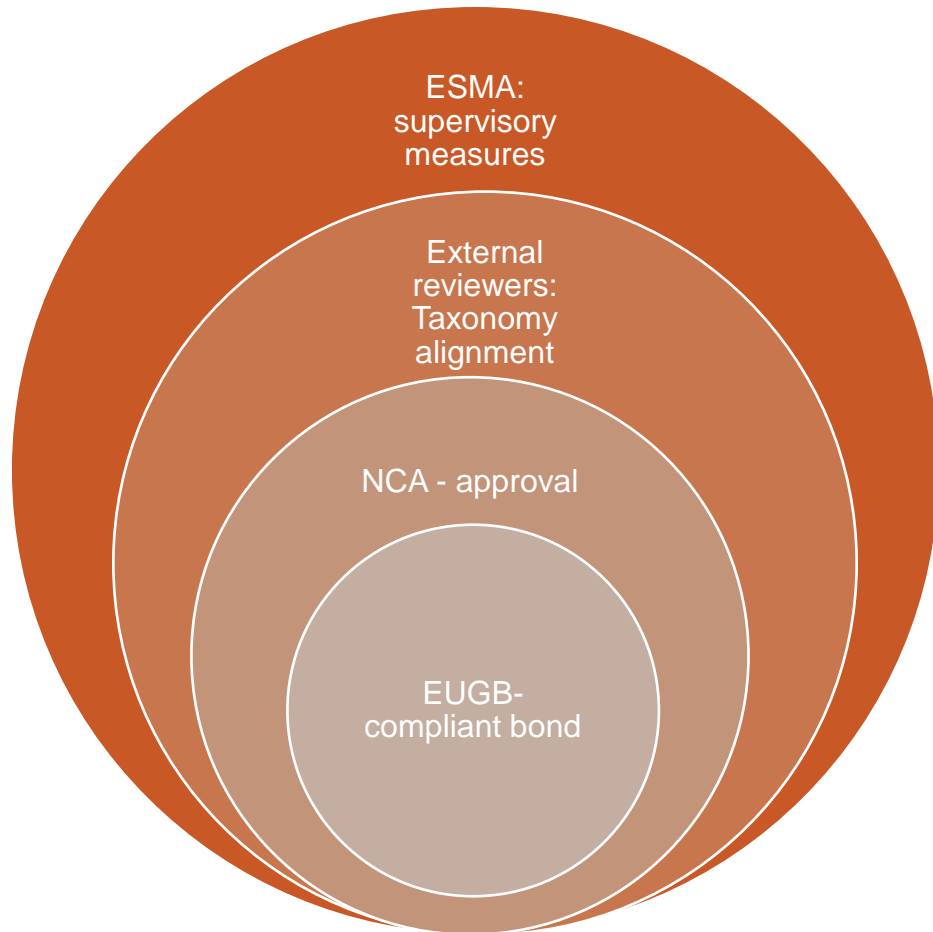


Regulatory oversight - the role of the EU Green Bond Regulation

(Regulation 2023/2631, approved in October 2023)

- **Voluntary EU Green Bond Standard (EUGBS)** but mandatory requirements
- Available to EU and non-EU issuers
- **Linked to mandatory science-based criteria (EU Taxonomy)** (at least 85% proceeds) → fighting “greenwashing”?
- **Transparency:** compulsory Factsheet (pre-issuance), Allocation and Impact reports (post-issuance)
- **Mandatory** external review
- Centralised process for **accreditation of reviewers** (ESMA)

Challenges of the EU Green Bond Standard



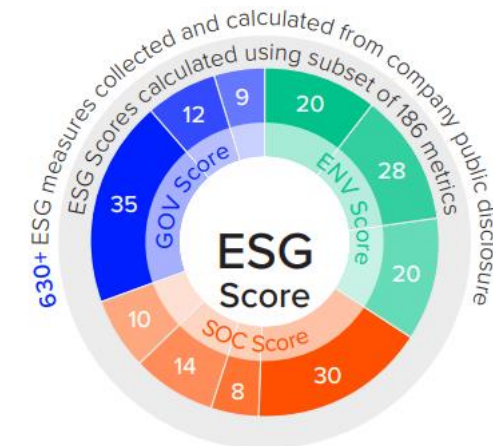
Will it suffice to tackle greenwashing?

- **Voluntary nature of the standard**
- Limited focus on the compliance with the Taxonomy criteria (only **reviewers**)
- Fragmented enforcement regime
- **Limited accountability of reviewers**

(Garcia Cerrato, Agostini, 2023)

ESG Ratings

- ESG ratings: “opinion, score, or both” “on a company or financial instrument’s **sustainability profile or characteristics**, exposure to **sustainability risks** or **impact** on society and/or the environment”
- “based on **established methodology** and **ranking system** of rating categories” (Proposal for a ESG ratings Regulation)
- Useful for **investors** (to assess) and for **companies** (to demonstrate)
- Third party providers, **inconsistent objectives** and **methodologies**: “aggregate confusion” (Berg, Kolbel, Rigobon, 2019)



Source: [FTSE 2023](#)

Source: Refinitiv, 2023



Proposal for ESG Ratings Regulation

- [Provisional Agreement](#) EP/Council reached on 6 February 2024
- **Indirect regulatory approach → no harmonisation of the rating methodology!**
 - Only transparency (**reporting**) on rating criteria
 - Mandatory **separation** of **E, S, G** scores
 - Licencing requirement (authorisation by ESMA); organisational requirements
 - **Conflicts of interests** rules (Art 15)
 - Supervision by ESMA

Key takeaways & general considerations

- EU rules as “global gold standard”?
- Fragmented approach to the definition of sustainability in the financial context
- Strong focus on transparency/reporting
- Sometimes **limited** harmonising impact
- Conflicting dynamics: **science, politics** and **markets**

Any questions?

Thank you for your attention!

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