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By email

Director General
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
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Re: Consultation on the Renewed Sustainable Finance Strategy

Dear Sir

Thank you for this opportunity to provide views on the Consultation on the Renewed Sustainable Finance Strategy (the CP). Over the last few years there has been a significant transformation in the recognition of climate risk and sustainable finance as features of the financial system and, accordingly, of financial regulation. What only a short time ago were at best ancillary considerations have now become central concerns. The Central Bank of Ireland (the Bank) welcomes this development.

As an integrated central bank, prudential and conduct regulator, macroprudential and resolution authority, the Bank approaches these developments in the light of our statutory mandates of safeguarding monetary and financial stability, securing the proper and effective regulation of financial service providers and markets, and ensuring that the best interests of consumers of financial services are protected. We approach environmental risk and sustainable finance based on these mandates.

In the Strategic Plan of the Central Bank of Ireland, we make clear that the objective of financial regulation includes ensuring that the financial system operates in the best interests of consumers and the wider economy. This recognises that financial regulation is not an end in itself but is there in service of wider economic and social goals. What is clear from developments of the recent period is that the legislative authorities are increasingly determined that a key objective to be achieved is the move to a more sustainable economy. That represents a far-reaching development both for financial regulators and for participants in financial markets and services.

Therefore, in assessing the development of sustainable finance, we recognise that the Bank's core mandates have become increasingly embedded in addressing matters related to sustainable finance measures and the mitigation of sustainability risks.

More specifically, in meeting our conduct mandate, we seek to ensure that financial markets function transparently and well, with investors and consumers being fairly treated. Where investments or financial products are described as green or sustainable they must be based on reliable parameters that are consistently applied both within jurisdictions and across Europe. Without this, not only are investors being provided with misleading information and being mis-sold products, but confidence in the implementation of the sustainability agenda runs a significant risk of being undermined.

In meeting our prudential mandate, we seek to manage the risks to the ongoing soundness and stability of financial firms. As climate and other environmental risks give rise to physical and transition risks, these in turn can, depending upon the type of event and underlying correlations, give rise to either individual firm or wider sectoral prudential vulnerabilities. As a prudential regulator, we are increasingly embedding climate risk issues into our supervisory assessments and engaging with regulated firms to ensure that they themselves are aware of their exposures and that they are incorporating climate-related risks into prudent risk management and investment practices.

In meeting our macroprudential mandate, we also seek to ensure appropriate data is available to assess the exposures of the financial system to risks over time and across sectors. In recognising climate change as a source of structural risk facing the financial system, the Bank considers that priority needs to be given to deepening our collective understanding around the nature and magnitude of financial risks stemming from environmental change and ensure that the financial system manages those risks appropriately.

Furthermore, by way of illustration of our commitment to embed sustainability practices and to lead by example, the Bank has signed a 'Low Carbon Pledge'[1] to commit to reducing Scope 1 and 2 greenhouse gas emission intensity by 50% by 2030 with the aim of becoming a net zero carbon emissions organisation by 2050.

In responding to this CP, our views can be captured under four headings:

1. A focus on effective implementation.
2. Protecting consumers' and investors' interests.
3. Maintaining a risk-based approach.
4. Increased cooperation and convergence.

We also provide more detailed, tailored views on specific aspects of the CP in the Annex to this letter.

[1] Organised by Business in the Community Ireland, the Low Carbon Pledge is a commitment for Irish business to invest time and resources into creating a more sustainable operation – by being more energy efficient and reducing carbon usage.

1. A focus on effective implementation

As mentioned, sustainable finance has quickly risen up the financial regulatory agenda. We recognise that the multi-stranded and ambitious nature of the proposals in the original Action Plan and this CP are both necessary and a reflection of the collective urgency to meet international climate targets and the scale of the task at hand. Great progress has been made over the recent period, with the following legislative proposals agreed:

- Taxonomy Regulation
- Disclosures Regulation
- Benchmark Regulation (Amendment)
- Integration of sustainability considerations in the ESA (founding) regulations.

Without diminishing the importance of continued necessary progress on the legislative and regulatory front, we believe that a central focus for the coming period should be on the effective implementation of these legislative changes.

Furthermore, in our regulatory and supervisory engagements, the Bank has and will continue to set out our expectations for industry regarding new sustainability-related obligations. Notably, the recent and ongoing work at the ESAs form the basis for this engagement. These include:

- ESA Development of Regulatory Technical Standards on the Disclosures Regulation;
- ESA advice on undue short-term pressures on corporations from the financial sector;
- ESMA advice on integrating sustainability risks and factors in MiFID, UCITS and AIFMD;
- EBA work on ESG risks in the supervisory review and evaluation process performed by competent authorities, including sustainability considerations in institutions' strategy and risk management, and providing supervisors with adequate tools to understand, monitor and assess ESG risks in their supervisory practices;
- EIOPA advice on the integration of sustainability risks and factors in Solvency II and the Insurance Distribution Directive; and
- EIOPA Opinion on Sustainability within Solvency II.

We will therefore seek to ensure that industry will, as required, adapt processes, systems and internal controls to reflect sustainability risks both within the financial system and their own business models. Moreover, we recognise that this is necessary in order to build the technical capacity and knowledge to correctly analyse sustainability risks, and to ensure that the financial system is fit for purpose and properly implemented in an evolving landscape.

It is important that as regulators begin to supervise these new obligations, there is a sufficient opportunity for achieving strong and meaningful implementation of these legislative changes, including developing best practices and strong convergence in supervisory approach at European level. As we know, amongst the changes introduced by the Action Plan, two essential building blocks are:

i. The development of the first of the EU taxonomies to address one of the fundamental requirements, that of creating a harmonised classification system of what can be considered an environmentally sustainable economic activity, so that all actors in the space can share a common language, and;

ii. Introducing a sustainability-related disclosures framework, which builds on using the taxonomy.

These alone represent major developments with significant new requirements for regulated entities. There is a need, therefore, for a strong focus on effective implementation. Without this, there is a risk of a two-speed policy process emerging between formulation and implementation and with that, the potential for market fragmentation and investor confusion.

The Bank also notes concerns around the availability and quality of corporate reported data and the lack of consistency and comparability across third party reporting frameworks. In recognising that many of these issues are captured under the recent Non Financial Reporting Directive (NFRD) consultation, it is further noted that the reporting frameworks currently allow for flexibility with respect to corporate disclosures. This results in a lack of consistency of ESG disclosures, thereby undermining their credibility, and increasing the risks of further market fragmentation and a loss of investor confidence. In developing measures to ensure consistency of the underlying corporate data, the Commission should seek to ensure that a period of implementation to assess outcomes is also afforded.

Furthermore, in seeking to ensure the effectiveness of any proposed sustainability related obligations, the Bank wishes to also stress that longstanding work to improve standards of governance and corporate cultures would help further integrate a more long-term approach in the financial sector. Specifically, the Bank in the recent past has seen first-hand how ineffective governance and poor corporate cultures have contributed significantly to failings and failures within the financial industry. These failings and failures have shown how short-term profits were prioritised over long-term stakeholder interests, leading to an erosion of trust of consumers and investors in the financial system that serves them. For this reason, we have been seeking to restore confidence in the wider financial system by introducing measures intended to drive higher standards of governance and effective corporate cultures and ensure a long term view. We have also committed to bringing improvements in the levels of diversity across regulated financial services firms, having found it can meaningfully contribute to improved decision-making, risk management and a reduction in the likelihood of group-think. It should be noted that while long-termism is an important consideration in promoting sustainable practises, short-termism also plays a key role in the financial system, particularly in ensuring competitive, responsive, liquid markets. Any measures to address short-termism therefore needs to find the right balance between the two perspectives.

2. Protecting consumers' and investors' interests

For consumers and investors, the transparency which the first Action Plan promises to bring to the market, in both enhancing disclosures and providing a methodology behind environmental sustainability will help to promote their interests. More specifically, they will in the process, mitigate "greenwashing" and help ensure there is a consistent and coherent way for sustainability to be addressed by financial market participants and regulators. These are welcome measures in helping the Bank meet one of our core mandates and so in principle we are supportive of them. However, addressing "greenwashing" is only one aspect of our Consumer Protection mandate. While the Bank can support increased and effective standardisation, measures to strengthen consumer protection must be clear, suitable and effective in meeting their ends. We cannot support any measures which may give rise to confusion, or where financial products are offered or advised which are not in the consumer's best interests.

In this context, we note that as the legislative framework evolves, challenges around consistency of criteria may emerge. Already we see in the Disclosures Regulation differentiation between sustainable finance products which are being defined as "light green" (Article 8) and "dark green" (Article 9). If further differentiation is also established in the proposed development of an Ecolabels framework, green bond standard, and alignment with (where relevant) existing PRIIPS obligations, there exists the strong risk that, in addition to potential market fragmentation, both financial market participants and consumers will be unable to effectively distinguish between what is and what is not a sustainable financial product.

Furthermore, consumer protections such as suitability, product governance and disclosure, require thoughtful integration with any new legislation. The provision to investors of advice and information on sustainable products should be balanced with consumers' other investment needs, objectives and preferences. In short, the investment and advisory process must be fit for purpose. In this context, we note the Disclosures Regulation has created some confusion around how financial market participants should assess a client's suitability preferences against an embedded sustainability fiduciary duty, and how the client disclosure templates required under this regulation should best interact with disclosure obligations under PRIIPS. While the Bank will seek to address such issues within the ESAs, we consider that such issues could create confusion for investors and market participants. Therefore, as the Commission seeks to integrate sustainability factors into existing financial regulation, it should seek to ensure that any definitions or concepts of sustainability are consistent in order to avoid further market fragmentation, confusion for investors and market participants, and divergent approaches between Member States. Such confusion and divergence raises the risk of the provision of misleading information and misselling, and thereby poses risks to investor confidence and future investor participation. Future developments in the regulatory framework should therefore seek the views of the ESAs in order to ensure an integrated, well-calibrated approach.

3. Maintaining a risk-based approach

Banking and Insurance prudential framework

As a key component of a resilient financial system and a driver of financial stability, the Bank strives to ensure prudential standards for both credit institutions, investment firms and insurance undertakings are robust and based on effective risk management tools and the accurate risk pricing of assets. In supervising the prudential framework, the Bank employs an assertive, risk-based, analytical and outcome focused approach, underpinned by robust enforcement powers, consistent with European and international good practice. While much debate has focussed on whether there should be a "green" supporting factor as a measure to recognise the lower risk associated with such assets, the evidence of such a risk differential has not been firmly established, (we refer specifically to the EIOPA opinion[2] and the recent report by the NGFS[3] in this regard). Our strong view therefore remains that any changes to the prudential framework must first be underpinned by an accurate assessment of climate-related risks in order to ensure the framework remains risk-based. The Bank is supportive of measures that develop accurate risk profiling and asset pricing in order to assess financial institutions' exposure to non-green and brown assets. Given the increased pace of the transition to a green economy, the Bank recognises that efforts to extrapolate the information on risks related to climate (and ESG factors) through backward-looking analysis will be difficult and potentially inaccurate. In addition, existing approaches to risk modelling are based mainly on backward-looking methodologies dependent on historical data, which may not be suitable to evaluate the nature of the risks caused by climate change.

Given the challenges of measuring climate-related risks, this work must be supported by tools and processes to enable the identification of economic activities most exposed to climate-related risks, allowing for an assessment of the scale of such risks faced by institutions. Therefore, in order to assist prudential regulation to adapt to the "green economy", the necessary risk-based assessment in this area will need to be underpinned by an agreed methodology and taxonomy as they would allow development of more accurate forward-looking risk management tools such as stress testing and scenario analyses. This risk-based approach is essential to ensuring the prudential soundness of individual financial institutions as well as the financial system as a whole. As a risk-based supervisor, we will, therefore, seek to embed climate risk into prudential supervision by seeking to map the many ways through which either physical or transition risks can affect the Irish financial system or different parts within it. This will involve engagement with regulated firms to ensure that they identify relevant exposures and are incorporating climate-related risks into their risk management processes.

More specifically, in terms of insurance risk management, the Bank expects Irish insurance undertakings to give full consideration to assessing climate related risks and to adopt a longer-term perspective. Risk management frameworks, and firms' ORSA in particular, should reflect these

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[2] EIOPA Opinion on Sustainability within Solvency II

[3] NGFS A Status Report on Financial Institutions' Experiences from working with green, non green and brown financial assets and a potential risk differential

considerations, including taking a prudent approach to the high degree of modelling uncertainty. We expect to see evidence of robust analysis, prudence and challenge, including from the board, and timely and effective action considering both financial and relevant sustainability risks. The ORSA is a useful tool to assess the investment strategy and asset allocation under different market conditions and "sustainable" conditions considering that there is a view that the undertaking could be exposed to long-term risks.

The EIOPA opinion on sustainability (referred to above) outlines how (re)insurers can contribute to identifying, measuring and managing risks arising from climate change, through their investment and underwriting activities. We recognise that some insurers have begun to consider the implications of the investment and underwriting liability decisions/exposures to sustainability. For example, adapting processes, systems and internal controls to reflect sustainability risks in order to build the technical capacity and knowledge to analyse sustainability risks and ensure that the investment and advisory process is properly implemented and adhered to over time.

The Bank welcomes the opportunity to engage and coordinate with European and international efforts to understand climate risks including increased awareness amongst firms, the cost of transition to a low carbon economy and greater transparency around disclosures of material climate-related financial risks.

<u>Macroprudential policy</u>

The Bank judges that it is too early to determine with confidence whether the macroprudential toolkit is sufficient to mitigate potential financial stability risks stemming from climate change. The work to assess the nature and magnitude of financial risks stemming from climate change is still in development. It is certainly the case, though, that the macroprudential toolkit is very much focused on the banking sector at this stage, whereas – by its nature – climate change is likely to affect all parts of the financial system. The Bank therefore strongly encourages European authorities to maintain sufficient flexibility to introduce additional macroprudential tools to tackle potential financial stability risks from climate change, should further advancements in our understanding of the nature and magnitude of the risks point to the need for different forms of macroprudential policy interventions.

<u>Legislative framework</u>

In considering the development of non-prudential financial regulation to support the transition to a sustainable economy, it is also essential to maintain a strong risk-based approach. The Bank notes that the CP queries whether there is merit in, inter alia, adapting rules on fiduciary duties and sectorial rules to directly require them to consider and integrate adverse impacts of investment decisions more generally. In this regard, our above views on the necessity for such discussions and decisions taking place at ESA-level apply to these and similar questions. By ensuring proper consideration at ESA level, the Bank and its fellow competent authorities have the opportunity to assess the impact of initial sustainability measures and determine, whether, on a risk-based approach there is a need for further amendment to sectoral financial legislation.

In this context, with respect to taking account of sustainability risks in the investment decisions of asset managers, the Bank is supportive of ESMA's technical advice on integrating sustainability risks and factors in the (i) UCITS Directive and the AIFMD and (ii) MiFID II. The advice recommended a high-level principles-based approach, requiring both fund management companies and investment firms to take into account and integrate sustainability risks when complying with their existing organisational requirements, and resource and staff function management. In the case of management companies, both UCITS management companies and AIFMs will have to take into account sustainability risks and, where applicable, the principal adverse impact of investment decisions on sustainability factors, when carrying out their due diligence requirements. They would be required to develop engagement strategies for the exercise of voting rights and reducing principal adverse impact of investee companies on sustainability factors. These advices provides a basis for legislative amendments to integrate sustainability factors into the portfolios of fund managers.

4. Cooperation and convergence

As the sustainable finance framework has rapidly evolved, the Bank considers that, in the near term, priority needs to be given to deepening our collective understanding around the nature and magnitude of sustainability risks such as climate change and ensure that regulated financial institutions themselves accelerate progress in managing those risks appropriately. International co-operation in this area is key. Firstly, management of climate-related financial risks requires developing a collective expertise and understanding of the impact of climate change and the transition to a low-carbon economy on the macro-financial environment. Economists, financial stability experts and supervisors are all still developing that expertise and will benefit from close collaboration. Secondly, the global nature of financial markets means that regulated financial institutions often have large cross-border exposures. This means for example that assessing risks to financial stability – and mitigating those risks appropriately – requires an understanding of the differential impact that climate change and the transition to a low-carbon economy would have across different parts of the world. Again, international collaboration is key to ensure this happens in an effective manner.

More specifically, in light of these comments, we emphasise the importance of international convergence toward recognised and effective standards. As issues related to sustainability move to the forefront of both EU and global policy setters agendas there has naturally been a significant increase in activity in this area. From an EU perspective, bodies such as the Technical Expert Group, the ESAs, ESRB, ECB, Commission, develop sustainability definitions, criteria, standards and risk metrics, while globally the FSB, NGFS, SIF, and IOSCO work to similar agendas. Given the advancements made by the EU in developing the taxonomy, disclosure and benchmark standards, the EU should seek to use its influence to ensure that its framework underpins internationally consistent ESG definitions, labels and standards. The Bank considers that the EU developed International Platform for Sustainable Finance has a vital role to play in this regard.

Lastly, the Bank considers that as the Action Plan falls to be implemented, a consistent approach to its implementation and supervision is necessary. In this context, the Bank wishes to support the ongoing and future role of the ESAs in promoting greater supervisory convergence at EU level for the benefit of all our citizens and the wider economy.

The Annex to this letter sets out views on other aspects of the CP. We would be very pleased to engage further with you or your officials on any of the issues raised here.

Yours sincerely

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Director Financial Regulation – Policy and Risk	**Director of Financial Stability**
Central Bank of Ireland	**Central Bank of Ireland**

<u>Annex</u>

Supervision/Supervisory authorities

Given the emergence of sustainable finance in recent years, supervisors are also developing expertise in this area. In this context, it should be noted that there are challenges around how supervisors should "police" sustainable finance obligations on financial market participants. While the Taxonomy Regulation, makes clear that financial regulatory authorities should be responsible for ensuring adherence with the disclosure of Taxonomy-required information to investors, it does not however establish a verification mechanism of compliance with the criteria under the Regulation, leaving evaluation for doing to the first review of the Regulation. In addition, as you are aware, the Commission appointed Technical Expert Group (TEG) has recommended that verifiers of EU Green Bonds should be subject to an accreditation or authorisation and supervision regime under ESMA. In this context, the Bank strongly considers the need for a clear articulation of competent authority, ESA, and other bodies' responsibilities around the verification of Taxonomy-related data in order to ensure a convergent approach going forward.

Asset Management: Green label for funds

The Bank considers that while labels can help investors make more informed decisions as to the "green" credentials of an investment product, it is important they do not create undue burden or hamper product development. The Bank notes the specific question in relation to the development of a green label for investment funds. The Bank is generally supportive of standardisation of the Ecolabel (to avoid risk of market fragmentation) and therefore can also see merit in the development of a label to funds for professional investors. However, while such a label would prevent greenwashing or misselling to professional investors, as well increase consistency of terms for market participants and the regulators, the provision of such a fund label is unlikely to assist professional investors in making their investment decision. Effective implementation of the Disclosures Regulation should in any event be considered as a necessary first step to protect investors, professional or otherwise.

Prospectus

On matters relating to the prospectus, the Bank strongly agrees that in those cases where a prospectus has to be published, requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing. The Bank considers that improving the consistency and comparability of this disclosure is crucial to ensuring investor protection. This disclosure could take the form of a building block annex with only the most important information required to be disclosed rather than requiring a full prospectus or imposing overly onerous disclosure requirements. At present, the necessary information test under Article 6 of the Prospectus Regulation does not adequately address issues with greenwashing and does not enable effective comparability.

Furthermore, on the issue of including a link to the green bond standard (GBS) in the prospectus instead of being subject to specific disclosure requirements on green bonds in the prospectus, the Bank considers that a link to the relevant GBS should be included but there should also be information disclosed on how the issuer will meet this standard. This information could be incorporated by reference in the prospectus as issuers adopting the EU-GBS have already disclosed elsewhere - provided that the core components of the EU-GBS are fully consistent with the specific disclosure requirements for green bond issuances.

Green Securitisation

On securitisation, the Bank supports further examination of the potential for securitisation and covered bond markets to contribute to the financing of ESG assets. Conceptually speaking, we can see strong synergies in this area, in that securitisation and covered bonds provide a capital markets financing tool that is channelled directly to specific types of lending activity on bank balance sheets. These tools may therefore avoid some of the questions around how proceeds from green financing areas are actually utilised by banks and other financial institutions, in that there is a more of a direct link to a specific form of underlying asset. More broadly, while we are not aware of specific practical impediments to the securitisation of “green assets” in the EU, we do note the US securitisation market has a reasonably vibrant asset-class in the area of renewable energy (notably securitisation of solar PV projects). The Commission (or EBA, given its experience in securitisation and covered bond policy matters) could investigate why similar funding channels have not arisen in an EU context.

CMU

Market fragmentation, inadequate supervision of third party reporting frameworks and resulting effects to investor confidence, and the lack of effective tools to ensure an effective assurance or supervisory regime, pose a real risk not only to private investment in sustainable projects but also create an obstacle to cross border financial activities and the development of a CMU. Therefore, on a broader related point, in recognising that the original sustainable finance action plan was developed as part of the CMU proposals, the Bank is surprised with the absence of any high level proposals to link this renewed sustainable finance strategy with the ongoing development of a CMU. The Bank considers that there is considerable scope to greater align these projects. The Bank recognises the potential for CMU to deliver real benefits in terms of the economic welfare of European citizens. And, with the evolution of sustainable market infrastructure such as green exchanges and green bond markets, there exists the opportunity for alignment with a growing CMU.