European Commission

EMAS

role in the transition to sustainable finance

CASE STUDY

Environment

EMAS' ROLE IN THE TRANSITION TO SUSTAINABLE FINANCE

The Paris Agreement to keep global temperature rise this century well below 2 degrees Celsius and the 17 Sustainable Development Goals (SDGs) of the Agenda 2030 are overarching guidelines for sustainable management. Sustainable management is based on business models which tackle social and ecological challenges by bringing sustainability goals and economic objectives together. But in order to achieve these goals, significant public and private investments are necessary. This is also reflected in Article 2 of the Paris Agreement, which says that "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development [is key to] response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty."[1]

The financial sector is essential when it comes to financing sustainable business since there is still a significant investment gap for the transformation of our economic system. For example, just in order to achieve the European climate and energy targets, an annual EU-wide additional investment of 180 billion EUR until 2030 is necessary[2]. These investments cannot be covered solely by public spending. This makes it mandatory to mobilise private capital[3].

A financial system that channels capital to environmentally friendly and socially acceptable economic activities can be a strong backbone of a green economy. Initiatives with clear criteria for sustainable investment, such as *divestment*[4], can utilize existing market mechanisms to impede fundraising for polluting and socially harmful activities and instead facilitate fundraising for ecological and socially beneficial projects.

Sustainable business also has a stabilising effect on global financial markets. Since companies with a sustainable business model take long-term risks and opportunities into account, they counterbalance risky short-term thinking on the financial markets. This is also essential in the light of a future financial crisis: Another shock hitting the financial markets would curb the necessary investments for the transformation process of the economic system and set back the goal of a sustainable economy for several years.

The goal of sustainable finance is to channel the flow of capital towards sustainable economic activities by considering environmental, social and governance (ESG) criteria.

Sustainable finance is about financing activities which produce sustainable goods and/or offer sustainable goods or services.

[1] https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN

[3] http://www.g20-insights.org/wp-content/uploads/2017/04/Climate_Green-Finance_V2.pdf

[4] Divestment is the removal of investment assets from companies involved in actions which are harmful to the environment.

CURRENT SUSTAINABLE FINANCE DEVELOPMENTS IN THE EUROPEAN UNION

A political agreement on the Taxonomy Regulation was found in December 2019; and the Council adopted the regulation on April 15th 2020.

The goal is now to have the Parliament approve it by 2020, so it can enter into force in 2021.

Based on the implementation of the SDGs and the Paris Agreement, the European Commission presented an Action Plan: Financing Sustainable Growth in early 2018. The action plan's overarching objective is "to connect finance with the specific needs of the European and global economy for the benefit of the planet and our society"[5].

The action plan and its regulatory proposals are intended to build a framework for sustainable investment and to promote transparency and long-term thinking in the financial economy and the real economy. This should be achieved through the following measures:

→ An EU-wide classification system **or taxonomy** to enable investors to refocus their investments on more sustainable technologies and businesses.

The EU taxonomy framework covers six EU environmental objectives:

1) climate change mitigation;
2) climate change adaptation;
3) sustainable use and protection of water and marine resources;
4) transition to a circular economy;
5) pollution prevention and control;
6) protection and restauration of biodiversity and ecosystems.

The first focus concentrated on climate change mitigation and adaptation: it identifies economic activities which support the achievement of these targets, without significantly damaging another environmental target.

→ Implementation of an **EU labelling** consistent with the EU taxonomy for green finance products to make it easier for investors to recognise sustainable investment products.

→ On June 18th 2019, the Technical Expert Group on Sustainable Finance published its report on a voluntary, non-legislative EU Green Bond Standard (EU-GBS)[6], and in March 2020 a usability guide for EU Green Bond Standard[7], to provide the European Commission with recommendations for implementing the EU GBS.

→ On top of that, the JRC published its second draft report on an EU Ecolabel for retail financial services (scope and criteria)[8] in December 2019.

→ Promotion of transparency of company balance sheets regarding sustainability by introducing basic requirements for financial market participants as well as non-financial reporting by companies (especially with a focus on climate-related information)[9].

→ In June 2019, the European Commission published guidelines on how to report climate-related information[10].

The European Commission is committed to review the Non-Financial Reporting Directive in 2020, and a consultation is in the process until mid-June 2020.

→ Promotion of sustainable management and reduction of short-term thinking on financial markets[11].

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN

[6] 2 page summary of key recommendations

[7] https://ec.europa.eu/info/files/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en

[8] https://susproc.jrc.ec.europa.eu/Financial_products/docs/20191220_EU_Ecolabel_FP_Draft_Technical_Report_2-0.pdf

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN

[10] https://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CELEX:52019XC0620(01)&from=EN

[11] https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:52018DC0097&from=EN

Another significant step, that allowed tackling sustainability with a global focus, was taken in October 2019 when the EU launched an international platform on sustainable finance (IPSF), together with countries that produce half of the global GHG emissions in total. It focuses on environmentally sustainable initiatives, particularly in the areas of taxonomies, disclosures, standards and labels, which are fundamental for investors to identify and seize green investment opportunities worldwide.

The regulation of the three European supervisory authorities ESMA (securities and markets), EIOPA (pensions and insurance) and EBA (banks) was revised in 2019. Starting from 2020, they must consider environmental, social and governance factors in their activities and have developed sustainable finance action plans... and they are all on the road to EMAS!

Even if private funds will be required to shift to a more sustainable economy, the European Investment Bank (EIB) leads the way and has taken new steps with it's revised climate strategy in the end of 2019:

- The EIB will end financing fossil fuel energy projects from the end of 2021;
- Future financing will accelerate clean energy innovation, energy efficiency and renewable energy sources;
- EIB Group financing will unlock one trillion euros of climate action and environmental sustainable investment in the decade to 2030;
- EIB Group will align all financing activities with the goals of the Paris Agreement from the end of 2020.

The EIB Group has evaluated GHG emissions of the project it finances (with a public methodology revised in 2018) and publicly reporting on its internal carbon foot print for more than ten years. The EIB Group became EMAS registered in March 2019 and awarded with an honourable mention in the 2019 European EMAS Awards. Unfortunately, not all its building nor its lending activities are part of the scope... Yet?

Conference on Sustainable Management for the Agenda 2030

In November 2018, a conference hosted by the German Environment Ministry explored the role of businesses in achieving the global sustainability goals. One focus was EMAS and sustainable finance. In a lively workshop with representatives of SMEs and financial institutions, environmental experts and ministry staff, four key elements for sustainable finance were identified:

1) Implementation of a uniform standard approach to calculate the environmental impact of an organisation for better comparability of non-financial information

2) A mandatory environmental report within an organisation's annual report to increase the non-financial data basis for investors

3) More precise classification of an organisation's environmental risks and efforts to reward organisations in their transition to sustainable management. This classification system could be combined with a benefit programme. Low-risk companies such as EMAS-registered businesses could be rewarded with lower interest rates on financial markets.

4) Advancement of EMAS to an indicator for sustainable management, e.g. as a means for investors to assess default risks

RELEVANCE OF SUSTAINABLE MANAGEMENT FOR SUSTAINABLE FINANCE AND THE (POTENTIAL) ROLE OF EMAS

Since the entry into force of EU directive 2014/95/EU and its national implementations, non-financial reporting has been a higher priority.

Large companies which are mostly subject to national CSR Directive Implementation Acts (e.g. as in Germany) can base their reporting on national, European or international frameworks. EMAS (among other standards and guidelines) is recognized as a framework to report about environmental issues[12].

The EU Commission also emphasizes the importance of EMAS in their Guidelines on non-financial reporting, which have been developed to make the implementation of the EU directive easier.

Environmental assessment according to EMAS (Annex I) is recognized as a methodology to perform the materiality assessment. Also, for assessing sector-specific issues, the EMAS Sectoral Reference Documents are named[13]. Furthermore, the amended Annex IV of the EMAS regulation offers opportunities to include an EMAS environmental statement in a business's sustainability reporting.

Studies about the established practice of non-financial reporting reveal that EMAS has not yet held any importance in non-financial reporting according to CSR-RUG[14].

Relevance of sustainable management for sustainable finance and the (potential) role of EMAS

Sustainable management is an important component of sustainable finance since a corporate strategy geared towards ecological (and social) criteria reduces commercial risks. The implementation of a management system that ensures the registration, prevention and reduction of environment-related business risks increases the security of investments for financial market participants. In addition, sustainable management requires the establishment of processes and responsibilities for continuous improvement and the integration of relevant stakeholders. Therefore, sustainable governance structures support the future viability of companies, and thus also the security of investments.

EMAS organisations already fulfil qualifications in terms of the ecological dimension of sustainable management. They implement a management system that allows them to identify environment-related risks or opportunities and to continuously improve their environmental impact. Moreover, by using EMAS these organisations ensure their compliance with environmental legislation and receive external verification by an environmental expert who is approved for their sector.

So far, EMAS has played a rather negligible role in sustainability assessments of rating agencies or institutional investors. But this might change in the immediate future if companies and finance explore the potential of EMAS.

FURTHER LITERATURE AND WEBSITES

Action Plan: Financing Sustainable Growth

International platform on sustainable finance (IPSF)

European Commission's legislative proposals on sustainable finance

Hub for Sustainable Finance Germany

EMAS Conference Sustainable Management for the Agenda 2030

[12] In the case of EMAS as an eco-management standard, this concerns the content-related aspects of non-financial reporting.

[13] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2017:215:FULL&from=DE

[14] https://econsense.de/app/uploads/2018/06/Studie-CSR-RUG_econsense-DGCN_2018.pdf

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