Promoting sustainable finance through the ESAs package

Summary

- On September 20th, 2017, the European Commission released a proposal for a regulation seeking to amend the mandates, governance and funding of the European Supervisory Authorities (**ESAs Package**)[1]. The ESAs Package is currently under review by the European Parliament and the Council of the European Union. The Commission's proposal sets out to promote more integrated oversight by the ESAs, as well as an update of their supervisory framework, in order to keep pace with new market developments - notably Sustainable Finance and FinTech.
- **To ensure the ESAs fully fulfil their mandate, including in relation to integrating environmental, social and governance (ESG) risks and promoting sustainable finance, the following should be included in the ESAs package:**
  1. The legislation should specify the scope of action[2] the ESAs are expected to take, and the tasks and powers[3] they are expected to have:
     - Fostering supervisory convergence: ensure the consistent implementation of the single rulebook and the effective application of the ESA scope of action;
     - Enhancing consumer and investor protection;
     - Ensuring financial stability by avoiding systemic mispricing by financial markets: develop tools to assess sustainability-related long-term risks, starting with climate-related risks
  2. Additional resources should be allocated to the ESAs to provide them with the capacity to fulfil this mandate.
  3. The governance framework of each ESA should be updated to integrate sustainability issues into internal decision-making structures and engagement practices with a diverse group of stakeholders.
- This briefing sets outs the limitations of the current legislative proposal and puts forward a series of recommendations which could be delivered through the ESAs package to ensure they fulfil their mandate in relation to promoting sustainable finance.

[1] European Commission (2017). Review of the European Supervisory Authorities. Available online: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-536_en
[2] As per Article 1 of the regulation of each ESA
[3] As per Article 8 of the regulation of each ESA

Context

The ESAs package sets out to promote more integrated oversight by the ESAs in order to support the completion of the Capital Markets Union, while also updating the supervisory framework to keep pace with new market developments, notably promoting Sustainable Finance and FinTech.

The Communication[4] part of the ESAs package sets out that integrating sustainable finance considerations into financial supervision will support the EU's ambition to strengthen its leadership on sustainable investment, as first put forward in the Capital Markets Union Mid-Term Review[5].

However, the legislative proposal which accompanies this Communication lacks clarity on the specific actions each of the ESAs should take in this regard. There is a large disparity between the ambition set out in the Communication and the associated detail in the legislative proposal, which only includes a single provision in relation to the tasks and powers (Art.8) of the ESAs - to "*take account of (…) the integration of environmental, social and governance related factors"* [6].

The issue

The final legislation must detail the scope of action the ESAs are expected to take, and the tasks and powers they are expected to have, to integrate sustainable finance considerations into their roles.

The ESAs package foresees that "all the three ESAs will be under an obligation to take account of risks related to environmental, social and governance factors when carrying out their tasks."[7] However, without providing further detail on *how* the ESAs are expected to integrate sustainable finance considerations into their roles, the scope and nature of their involvement is likely to be limited[8] for the following reasons:

- Firstly, the scope and nature of the involvement of the ESAs depends on the tasks entrusted to them in primary legislation. The provision for the ESAs to 'take account of ESG factors' in relation to their tasks does not set out specific tasks or responsibilities and will likely be interpreted differently by each ESA. This will not enable the ESAs to fully fulfil their mandate in relation to promoting sustainable finance. This requirement to specify the tasks entrusted to an ESA in primary legislation has been illustrated in the case of ESMA, in correspondence from this ESA on its role in sustainable finance.[9] Moreover, the ESAs have also the task to give opinions to EU institutions that are proposing or deciding on primary legislation.

[4] Ibid
[5] European Commission (2017). Midterm Review of the Capital Markets Union Action Plan. Available online: https://ec.europa.eu/info/sites/info/files/communication-cmu-mid-term-review-june2017_en.pdf
[6] A new paragraph is added to the Regulation for each of the ESAs (under Article 8 - Tasks and powers of the Authority): "When carrying out its tasks in accordance with this Regulation, the authority shall take account of technological innovation, innovative and sustainable business models, and the integration of environmental, social and governance related factors".
[7] European Commission (2017). *Review of the European Supervisory Authorities.* Available online: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-536_en
[8] This has been presented in the case of the European Securities and Markets Authority, who have previously stated their role in sustainable finance depends on both "the tasks entrusted to us by EU primary legislation" and the fact that their "resources are commensurate to [their] current role and tasks".
[9] European Securities and Markets Authority (2017) *ESMA's role in sustainable finance - Response to Letter.* https://www.e3g.org/docs/2017_Jul_ESMA_Reply_to_stakeholders_on_sustainable_finance.pdf

- Secondly, it would be difficult to allocate the correct level of funding to each ESA in order to integrate ESG risks into all of their activities without specifying the tasks each ESA is obliged to carry out. Therefore, it is likely that the ESAs would remain underfunded[10] and unable to meet the desired obligations.

- Thirdly, the governance structures of the ESAs, as presented for the case of ESMA[11], do not lend themselves to addressing sustainability issues. This is due to the internal decision-making structures and stakeholder engagement practices which tend toward little to no participation of persons with expertise on sustainability issues.

The final legislation must be updated to reflect recent developments on the role of the ESAs in Sustainable Finance presented by the European Commission and European Parliament.

Since the publication of the ESAs package, there have been three developments in the EU which call on the ESAs to do more to integrate sustainability in to their role: the final report by the HLEG published in January 2018; the European Parliament's own-initiative report on Sustainable Finance in March 2018; and the European Commission's Action Plan on Sustainable Finance in March 2018:

- On 31 January 2018, the HLEG published its final report with a recommendation to *"include sustainability in the supervisory mandate of the ESAs and extend the horizon of risk monitoring"* [12]. This set out three dimensions including clarifying how the ESAs should interpret the inclusion of sustainability in their mandate with a list of new areas of activities and focus for the ESAs.

- On 2 February 2018, the European Parliament published its draft own-initiative report (**INI**) on Sustainable Finance[13], to be voted on in the April plenary. While not a legislative report, the INI serves as an important indication of the European Parliament's positioning on the ESA package, as well as on future legislative proposals outlined by the Commission in this area listed below. The draft INI foresees roles for the ESAs in the following areas:
    - the development of model mandates between asset owners and asset managers in order to guide implementation of investors' duties, including outlining clear expectations on the transmission of end-investor preferences;
    - the establishment of an accreditation process for a "Green Finance Mark" by certifying agents supervised by ESMA;
    - the incorporation of ESG risks in client suitability guidelines and the introduction of a monitoring system for the assessment of material ESG risks;
    - the verification of portfolio alignment with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD)[14], that put emphasis on forward-looking climate scenario analysis.

---

[10] European Commission (2014). *Report on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS). Available online:* http://eur-lex.europa.eu/resource.html?uri=cellar:52c42d53-1ef0-11e4-8c3c-01aa75ed71a1.0002.02/DOC_1&format=PDF

[11] CDP, CDSB, ClientEarth, E3G, Finance Watch, ShareAction and WWF (2017) *The role of ESMA in sustainable finance*. Available online:https://www.e3g.org/docs/Briefing_paper_-_ESMAs_role_in_sustainable_finance_6-7-17.pdf

[12] High-Level Expert Group on Sustainable Finance (2018). *Financing a Sustainable European Economy: Final Report*. Available online: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

[13] European Parliament (2018).(*2018/2007(INI)) Report on sustainable finance.* Available online: http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-618.012&format=PDF&language=EN&secondRef=01

[14] TCFD (2017) *Final Recommendations.* Available online*: https://www.fsb-tcfd.org/publications/final-recommendations-report/*,

- On 8 March 2018, the European Commission published its Action Plan on Financing Sustainable Growth[15], which foresees the following specific actions concerning the ESAs:
  - Under Action 4, *"Incorporating sustainability when providing financial advice"*, the European Commission will invite ESMA to include provisions on client sustainability preferences in its guidelines to the suitability assessment of products under amended delegated acts for MiFID II and IDD;
  - Under Action 6, *"Better integrating sustainability in ratings and market research"*, the European Commission invites ESMA to assess the extent to which environmental, social and governance considerations are taken into account in the credit rating market, as well as include environmental and social sustainability information in its guidelines for disclosure by credit rating agencies;
  - Under Action 8, *"Incorporating sustainability in prudential requirements"*, the European Commission will invite EIOPA to provide on the impact of prudential rules for insurance companies on sustainable investments, with a particular focus on climate change mitigation;
  - Under Action 10, *"Fostering sustainable corporate governance and attenuating short-termism in capital markets"*, the Commission invites the ESAs to collect evidence of undue short-term pressure from capital markets and corporations, especially as those relate to portfolio turnover and equity holding periods for asset managers, as well practices in capital markets that generate undue short-term pressure in the real economy;
  - In regard to the implementation of the Action Plan, the European Commission calls on the ESAs to provide direct support to its implementation by performing specific tasks. Notably, the ESAs should:
    - "provide guidance on how sustainability considerations can be effectively taken into account in relevant EU financial services legislation and help to identify existing gaps."
    - "promote convergence on the implementation of sustainability considerations in EU law."
    - "play an important role in identifying and reporting on the risks that sustainability factors pose to financial stability. This could be done through the development of a common EU methodology for relevant scenario analyses, which could later evolve into climate/environment stress testing."

Framing the discussion

Sustainability and the mandates of the ESAs

The inclusion of sustainability-related functions to the ESAs' current tasks does not so much constitute an expansion of their mandate, as it does a formal recognition of the centrality of managing sustainability-related risks in the promotion of financial stability, risk assessment methodologies and high standards of investor and consumer protection.

[15] High-Level Expert Group on Sustainable Finance (2018). *Financing a Sustainable European Economy: Final Report*. Available online: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

A risk-based approach towards discharging these mandates must necessarily include sustainability considerations:

- The "Future Horizons" report[16], an expert paper commissioned by the UK's Financial Conduct Authority and authored by the UN Environment Programme, emphasizes the false assumptions which hinder sustainability-related factors in risk-based approaches to regulation and supervision. For one, the paper confirms that asset prices are already being influenced by climate risk, contrary to popular belief that this would be a remote eventuality, and secondly, maps how financial policymakers are already having to respond to the implications of climate change to their core prudential and market development goals. Reforms in the real economy are necessary to manage an orderly transition to a low-carbon economy, but so are reforms in regulation and supervision.
- Both physical (i.e. flooding, droughts, storms, etc.) and transition risks (i.e. shifts in asset value and costs for businesses and citizens in the transition to a green economy and society) resulting from climate change have the potential to cause significant detriment to investment portfolios if not properly safeguarded against, with wider impacts towards financial stability, economic development[17] and social upheaval.
- The long-term horizon of pension beneficiaries makes them particularly vulnerable to long-term risks resulting from climate and wider sustainability-related risks. The duty of loyalty, which forms a core component of acting in the best interest of clients and beneficiaries and is present in a number of EU legislations[18], requires of trustees and contract-based pension providers to act impartially. This would imply adherence to the principle of intergenerational equity, ensuring the assets of both current and future beneficiaries are safeguarded against detriment and loss.
- Insurance companies are significantly lagging behind pension funds in their addressing of sustainability-related risks. According to the Asset Owners Disclosure Project, an analysis[19] of 116 insurers with $ 15.3 trillion in investments has found that only 1% assess the risks of stranded assets. In comparison with pension funds, low-carbon investments represent an average of only about 0.8% of insurance portfolios, in comparison to 3.5% of pension portfolios. This translates to about $30 billion of insurance assets compared to $93 billion of pension assets. Additional research by Lloyd's[20] has shown that even when insurers price environment-related risks in their insurance policies, they do not do so in their investments. The aforementioned figures and conclusions are alarming and should alert supervisory authorities to the very real danger of how both pension and insurance coverage adequacy may be additionally threatened by sustainability-related risks.
- Worryingly, the processes in place to supervise and identify system-level risks (for example, stress tests) are focused on short-term time frames (one to three years), and heavily rely on historical data. As pointed out by Mark Carney, Governor of the Bank

[16] Financial Conduct Authority (2017). *Future Horizons.* Available online: https://www.fca.org.uk/publication/research/future-horizons-report.pdf

[17] See: De Nederlandsche Bank (2017). *Waterproof? An exploration of climate-related risks for the Dutch Financial Sector. Available online: https://www.dnb.nl/en/binaries/Waterproof_tcm47-363851.pdf?2017110615*,TCFD (2017) *Final Recommendations.* Available online*: https://www.fsb-tcfd.org/publications/final-recommendations-report/*, Bank of England (2017). *The impact of climate change on the UK Insurance Sector.* Available online:https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/impact-of-climate-change-on-the-uk-insurance-sector.pdf?la=en&hash=EF9FE0FF9AEC940A2BA722324902FFBA49A5A29A. See Autorité des marchés financiers (2018). *Plan stratégique de l'AMF.* Available online: http://www.amf-france.org/en_US/Reglementation/Dossiers-thematiques/l-AMF/Plan-strategique-de-l-AMF/priorites-de-supervision-2018-de-l-autorite-des-marches-financiers

[18] European Commission (2015). *Resource Efficiency and the Fiduciary Duties of Investors.* Available online: http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf

[19] Asset Owners' Disclosure Project (2016). *Global Climate 500 Index.* Available online: http://aodproject.net/wp-content/uploads/2016/07/AODP-GCI-2016_INSURANCE-SECTOR-ANALYSIS_FINAL_VIEW.pdf

[20] Lloyd's of London (2017). *Emerging Risk Report 2017, Innovation Series. Stranded Assets: the transition to a low-carbon economy. Overview for the insurance industry*. Available online at:https://www.lloyds.com/news-and-risk-insight/risk-reports/%20library/society-and-security/stranded-assets

of England[21], for climate-related risks, these processes are likely to systematically miss long-term, non-linear, or non-cyclical risks. This is a concern for the orderly functioning of financial markets given the implications in terms of systematic long-term risk mispricing. If one of those risks materialises faster than expected, it might also have an impact on financial stability. The ESAs should create processes to identify those sustainability-related risks, assess their magnitude and review risk management system across the investment/lending chain to evaluate the risk of systematic mispricing.

- Increasingly, the material risks of financing activities that do not respect social and human rights become more visible, reducing the value of investments[22] and potentially making some of them stranded assets. For instance, selling unhealthy consumer products using palm oil that is produced in breach of rights of workers and communities together with environmental damage[23], have led to action by policy makers[24] and consumers.

This selection of evidence is only a fragment of the research conducted on the interplay between sustainability, financial stability, and consumer protection, emphasizing the need for intervention at the level of EU supervisory and regulatory oversight. We believe that the Commission's proposed actions for the ESAs in the context of the Action Plan, as well as those recommended below, are central to ensuring stable, transparent and resilient financial markets, geared towards ensuring highest level of protection to consumers and investors.

Climate scenario analysis by NCAs. Climate scenario analysis has been conducted by three NSAs in Europe to date[25]. It has also been tested by a range of financial institutions (about 200 investors and 20 banks to date), on a voluntary basis. Two approaches emerge:

• A first 'exposure analysis' relies on an analysis of the exposure of financial institutions to 'high-carbon sectors' (energy, power, etc.) and sectors exposed to physical risks (agriculture);

• A more sophisticated approach, called 'scenario analysis', relies on the use of *forward-looking, geo-located, physical asset level data* (e.g. investment plans associated with power plants) matched with owners and related financial securities. The assets and investment plans of the entities included in the portfolios of regulated entities are then compared with decarbonization roadmaps (e.g. IEA) and risk maps (e.g. risk of flood). The output indicators can show:

- The extent to which current assets and investment plans align with policy objectives (e.g. climate and SDG commitments) and financial markets are potentially 'building' a risk of disruption in the medium-term;
- The maximum value at risk if policy goals are implemented, both from a macro- and microprudential perspective;
- Whether the risks are expected to affect the short, medium, or long-term cash flows derived from the assets.

In the high-level International Climate Risk Conference for Supervisors, the Governor of the Banque de France, François Villeroy de Galhau, stated: "we should develop forward-looking carbon stress tests for both insurance companies and banks".[26]

[21] Mark Carney (2015), Breaking the tragedy of the horizon – climate change and financial stability. Available online: https://www.bis.org/review/r151009a.pdf
[22] See for instance : Chain Reaction Research, *Revenue at Risk vs. Palm Oil NDPE Sourcing*, August 2017. Available online: https://chainreactionresearch.com/2017/08/23/2017-indonesian-palm-oil-sector-benchmark-revenue-at-risk-vs-palm-oil-ndpe-sourcing/
[23] Assessed for example in the documentary *See the impact*. Available online: http://forestsandfinance.org/
[24] In January 2018 the European Parliament agreed to reduce palm oil in biofuels. See: https://www.euractiv.com/section/agriculture-food/news/eu-parliament-ends-palm-oil-and-caps-crop-based-biofuels-at-2017-levels/
[25] The Dutch central bank, the Bank of England, as well as the Swiss Government (2° Investing Initiative (2017), *Out of the fog - The compatibility of Swiss pension funds and insurances with the Paris Agreement*. Available online: http://www.transitionmonitor.com/en/publications/). Other NCAs are considering it

Recommendations

In addition to the tasks set out in the Commission's Action Plan, ESAs should undertake various activities (either for ESAs generally or for individual ESAs as specified) within their general mandate:

1. The legislation should specify the scope of action the ESAs are expected to take, and the tasks and powers they are expected to have

- **<u>Fostering supervisory convergence: ensure the consistent implementation of the single rulebook and the effective application of the ESA scope of action</u>**

1. **All ESAs** should actively monitor and advise about the consistency of NCAs on how relevant financial institutions are implementing ESG integration. In the European supervisory framework, the ESAs are responsible for cooperating with the ESRB, including for cross-sectoral consistency and avoiding regulatory arbitrage related to sustainable finance. They should contribute to common regulatory and supervisory standards by national supervisory authorities and a Union supervisory handbook practices for national competent authorities (NCAs) and colleges of supervisors who are supervising individual financial institutions.
2. **All ESAs** should make regulatory ESG data publicly available. The transfer of ESG data from the market, to NCAs and then to the ESAs should be done in a simple, standardised, transparent format. ESG-related regulatory reporting should be standardized for consistency and comparability purposes.
3. **All ESAs** should release guidelines for remuneration structures linked to sustainability-related incentives for those professional categories directly involved in risk-taking and risk-management within financial institutions.
4. **All ESAs** should "provide opinions" [27] to the European Commission, Parliament and Council regarding drafting primary legislation relating to the development of an EU sustainability taxonomy, while respecting the competence of NCAs for direct supervision of financial institutions.
5. **ESMA and EBA** should ensure, in the review and coordination of financial education and literacy programmes launched by NCAs, that both consumers, savers and potential investors, starting from a young age, are educated in how risks related to the non-mitigation of sustainability-related factors influence the financial system. All basic financial literacy programmes should include information on how the financial system impacts and is impacted by climate change, the environment and social sustainability issues, and ESMA should facilitate information exchange and learning platforms between NCAs on the topic.
6. **EIOPA** should set up tools such as the use of social media and wider digital tools for engaging with and consulting with beneficiaries and guidance on their use further developed.[28] The role of financial innovation in promoting sustainability is crucial.
7. **All ESAs** should undertake an initial mapping exercise on how social sustainability-related issues relate to prudent risk management of financial institutions, particularly as it relates to forward looking scenario analysis and stress-testing.

---

[26] François Villeroy de Galhau, Governor of the Banque de France, 6 April 2018. Available online: https://www.banque-france.fr/sites/default/files/media/2018/04/06/06.04.2018_discours_fvg_international_climate_risk_conference_for_supervisors.pdf

[27] As per Article 1 of the regulation of each ESA

[28] See ShareAction (2018). *Pensions for the Next Generation: Communicating What Matters.* https://shareaction.org/wp-content/uploads/2018/03/NextGenerationPensions.pdf

8. **ESMA** should require all EU-registered Credit Rating Agencies to consider ESG-related risks when assessing credit-worthiness of issuers of debt obligations, debt instruments and the servicers of underlying debt; and provide an opinion whether and how sustainability rating agencies need to be subject to integrity and other basic standards of rating agencies, accreditation and supervision.

Specific development of Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) under ESAs existing tasks (Article 8):

9. **All ESAs** should conduct a mapping study to identify the potential changes in existing and potential level 2 (RTS and ITS) and level 3 regulations related to the integration of sustainability issues.
10. **All ESAs** should be required to systematically check that their draft RTS and ITS are in line with the EC's sustainability impact assessment of legislative proposals, as well as with ESG related provisions in preambles, as per the European Commission's 'sustainability test'. ESAs should also ensure that their non-binding measures, guidelines and recommendations take account of sustainability related market development, business models and the integration of ESG-related factors.
11. **EIOPA and ESMA** should develop, depending on the Level 1 mandate of the upcoming legislative proposal, their expertise related to sustainability issues in order to provide comprehensive guidance to NCAs and market participants in the discharging of investors' duties. This could include the release of regulatory technical standards and guidelines on the following topics:
    - stewardship and engagement with investee entities;
    - engagement with and disclosure towards end-investors;
    - disclosure between asset owners and asset managers;
    - internal governance structures of institutional investors, so as to ensure the beneficiary long term interest is more adequately represented in risk management;
    - the development of mandates between different market participants to ensure responsibilities concerning ESG are clearly transmitted across the investment chain, including towards investment consultants and proxy advisers.

- **<u>Enhancing consumer and investor protection</u>**

ESAs should enhance consumer protection though avoiding greenwashing practices, avoid reputational risk, and promote the development of orderly markets:

1. **EBA and ESMA** should avoid greenwashing and abusive marketing practices linked to the banking and investment industry by undertaking analysis of ESG and sustainability products and their marketing, and provide opinions to the European Commission, Parliament and Council on the management of these products, as well as their effect on consumers and impact on reaching ESG policy objectives
2. **EBA and ESMA** should monitor and assess the reputational risks and risk of disorderly market developments of ESG-related products and their marketing.
3. **EBA and ESMA** should develop common methodologies for assessing the effect of ESG-related products or distribution processes on the financial position of, and information to, customers and investors.
4. **All ESAs** should release warnings and recommendations about the creation and distribution of unsustainable products.

- **Ensuring financial stability by avoiding systemic mispricing by financial markets: develop tools to assess sustainability-related long-term risks, starting with climate-related risks**

ESAs put in place a monitoring system to assess material ESG risks beyond the short term timeframe, starting with climate-related risks, while expanding to wider environmental and social risks:

1. **All ESAs**[29] should start in 2018 an operational EU-wide pilot on climate scenario analysis, building on existing best practices from national financial regulators.[30]
2. **All ESAs** should provide guidance on how to meaningfully use forward-looking climate scenario analysis for financial institutions, and recommend standardized climate scenarios, including a well below 2°C scenario that is consistent with the Paris Agreement. This would significantly simplify and accelerate the use of such climate scenario analysis by financial institutions.
3. **All ESAs** should join the Central Banks and Supervisors Network for Greening the Financial System[31], a voluntary forum that gathers several Central Banks and regulators globally to exchange on sustainability and climate issues.
4. **All ESAs** should devise a process for how stress-testing for financial institutions and scenario analysis on environment and social issues beyond climate change can be developed overtime.
5. **ESMA** should assess the mismatch between time horizons and the liabilities to end-investors, in order to avoid capital misallocation and market inefficiencies, building on Action 10.2 of the Commission's Action Plan on Sustainable Finance. The ESAs should publish such an assessment within one year, and subsequently monitor it. The ESAs should also develop an understanding of the problem of short-termism and seek ways to attenuate its impact on the financial sector.

2. Additional resources should be allocated to the ESAs to provide them with the capacity to fulfil this mandate and related mandates from upcoming primary legislation

1. **All ESAs** should be allocated with additional resources in the review of the current funding (notably related to the EU budget review) to provide them with the capacity to integrate sustainable finance considerations into their activities and tasks, commensurate with those foreseen above.

[29] In cooperation with the Joint Committee, with participation of the ESRB

[30] See Box. Climate scenario analysis by NSAs in former section. Precedents by NCAs are an opportunity to mainstream best practice at EU level, develop skills and capacity and exchange initial findings in an anonymised way. It should clarify how financial supervisors can use forward-looking climate scenario analysis, build on standardised climate scenarios (notably a well below 2°C scenario), to check portfolio alignment with the Paris Agreement and the climate-related value at risk from financial institutions. This will ensure consistency with the TCFD recommendations. Importantly, such climate scenario analysis (long term-oriented research) is not similar to stress tests (short term shock testing) and thus does not have heavy implications e.g. on capital requirements, so could proceed relatively quickly.

[31] Banque de France (2018). *First meeting of the Central Banks and Supervisors Network for Greening the Financial System (NGFS) on January 24th in Paris.* Available online: https://www.banque-france.fr/en/communique-de-presse/first-meeting-central-banks-and-supervisors-network-greening-financial-system-ngfs-january-24th. A high-level International Climate Risk Conference for Supervisors was held by the NGFS at the Dutch Central Bank on 6 April 2018. See: https://www.dnb.nl/en/news/news-and-archive/Nieuws2018/dnb374348.jsp. In this conference, François Villeroy de Galhau, Governor of the Banque de France, stated: "one of our duties in the NGFS will be to carry out additional work on two key issues: (i) how to translate climate change scenarios into economic scenarios that can be used in our stress testing frameworks, and (ii) assessing the impact of shocks on the probability of default over a much longer horizon than the usual one of one year." Available online: https://www.banque-france.fr/sites/default/files/media/2018/04/06/06.04.2018_discours_fvg_international_climate_risk_conference_for_supervisors.pdf

3. The governance framework of each ESA should be updated to integrate sustainability issues into internal decision-making structures and engagement practices with a diverse group of stakeholders

1. **All ESAs** should integrate sustainability issues into internal decision-making structures and stakeholder engagement practices, in the review of internal governance structures.
2. **All ESAs** should have a certain percentage of representatives in stakeholder groups and related working groups with expertise in sustainability issues in the financial sector, *as well as* stakeholders with stand-alone expertise in social and environmental sustainability-related issues (trade unions, gender experts, environmental organizations, etc,) - as recommended by the Final Report of the HLEG[32].
   In addition, a certain percentage of the budget allocated to these groups should be dedicated to sustainability-focused research.
3. **All ESAs** should improve transparency about the consultations and dialogues taking place in formal and informal settings, and the contacts with the executive management of the ESAs, in the same way as the Commission is reporting meetings with Commissioners and Director-Generals and is using the transparency register for diverse consultation procedures.

For further information:

Sebastien Godinot and Julia Linares
WWF European Policy Office
Economist / Sustainable Investment Officer
Email: sgodinot@wwf.eu, jlinares@wwf.eu

Eleni Choidas
ShareAction
Senior EU Affairs Officer
Email: Eleni.Choidas@shareaction.org

Tom Jess
E3G
Senior Researcher
Email: tom.jess@e3g.org

Myriam Vander Stichele
SOMO
Senior Researcher
Email: mvanderstichele@somo.nl

[32] High-Level Expert Group on Sustainable Finance (2018). *Financing a Sustainable European Economy: Final Report*. Available online: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf