CDP Europe on the European Commission's Action Plan: 'Financing Sustainable Growth'

The European Commission's Action Plan: Financing Sustainable Growth is the concrete legislative roadmap towards a European sustainable financial system. It aims to (1) reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (2) manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and (3) foster transparency and long-termism in financial and economic activity.

This Action Plan builds upon the recommendations of the High-Level Expert Group on sustainable finance (HLEG) that identified two urgent imperatives: (1) improving the contribution of finance to sustainable and inclusive growth by funding society's long-term needs, and; (2) strengthening financial stability by incorporating environmental, social and governance (ESG) factors into investment decision-making.

CDP strongly welcomes and supports the European Commission's ambitious agenda to operationalize the objectives of the Paris Agreement and the Sustainable Development Goals by managing the European financial system more sustainably.

Our recommendations are based on analysis of the 2017 voluntary disclosure of:

- 573 European[1] publicly listed companies, representing 82% of the total European market capitalization in CDP's high impact sample[2], plus 1195 of their suppliers for Climate Change, 392 for Water, and 21 for Forests;
- Their disclosure via the CDP platform is driven by institutional investors with assets of US$ 87 trillion and companies and government bodies with over US$ 3 trillion in spending power;
- 118 European cities and 49 European regions.

[1] EU 27, plus Norway, Switzerland, Iceland and Lichtenstein, excluding UK.
[2] CDP's high impact sample includes 1,323 companies with a primary listing in continental Europe, selected by their market capitalization, out of 1800+ companies globally representing 47% of global market cap. For more information, see our 2017 European Natural Capital report.

Action 1: Establishing a EU classification system for sustainable activities

CDP welcomes the development of a EU taxonomy that will create a common understanding of what is 'sustainable' among private and public market actors. This classification system should enable investors and purchasing organizations to understand the level and the timeline of positive and negative impact of business activities on climate change mitigation and adaptation, environmental and social objectives. By assessing not only what is sustainable but also what is unsustainable, we can ensure a transformation of all sectors and businesses and drive technological innovation. Clarity on the timeline of targets against the same baselines will help to mitigate short-termism and foster long-term business planning and investments.

The Commission's approach of ongoing monitoring of the taxonomy will allow for its development – as for climate and environmental objectives – in line with the latest science, to ensure the required level of effort, and in line with investor and business-driven solutions to ensure quick and effective uptake by the private sector.

This will be an essential step in driving capital flows into sustainable business activities in need of financing, while decreasing parallel financing of business activities that are harmful to the climate and environment, and which therefore negate the positive impact of sustainable finance.

Action 2: Creating standards and labels for green financial products

Climate change is a key environmental concern for many investors and increasingly seen as a real long-term investment risk. At the same time, the investment fund industry – worth € 10 trillion in Europe (EFAMA 2017) – can turn into a significant lever for the transition to a low-carbon economy. However, millions of private and institutional investors need better tools to assess the climate impact of their funds.

CDP welcomes the Commission's action on facilitating market participants', especially retail investors' and consumers', ability to invest in 'green' projects, assets or business activities. However, we are concerned with the focus on creating tools that are limited to defining 'green' financial products. This will only drive a small market which cannot absorb large capital shifts in the short term and will not deliver the holistic approach needed. We strongly recommend fostering a systemic approach; which means tools and assessment that aim to drive change across all sectors and companies.

For these reasons, CDP together with ISS-Ethix Climate Solutions developed Climetrics, which creates transparency on climate-related impacts in the European investment fund industry for the first time.

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Climetrics is the world's first and only independent and publicly available tool that rates thousands of funds available in Europe for their impact on climate change. The rating holistically evaluates a fund's portfolio companies for their carbon emissions, climate change disclosure and management performance, deforestation impact and application of green technologies. The rating enables investors to easily assess and compare the impact of their fund investments on climate change – across the full universe of European funds – encouraging growth in fund products with a positive impact on the transition to a low carbon economy. Top ratings can be viewed for free online at climetrics-rating.org

Action 3: Fostering investment in sustainable projects

There is an urgent need to align the "billions to trillions" infrastructure agenda with the Paris Agreement and the Sustainable Development Goals, and to ensure that private capital invested in public infrastructure and private businesses is exclusively directed towards responsible and sustainable projects and companies.

CDP welcomes that greater advisory capacity shall be provided at regional and local level to promote projects with a positive climate, environmental and social impact. EU Member States' capacity to drive finance into sustainable infrastructure should be supported by the following key services:

- Require proactive disclosure of all Public Private Partnership (PPP) project and contract data throughout the planning and delivery of the PPP in an open data format;
- Capacity building among local and national authorities on ESG criteria and facilitate collaboration between national authorities and local authorities when translating their goals;
- Technical assistance for public authorities to develop bankable green projects that attract private sector investments, and guidance on how to lower lending risks for sustainable projects;
- Support Member States' national authorities to incorporate their National Determined Contributions into public investment plans, so that local authorities such as cities can also benefit from low-cost investment into sustainable projects, such as those provided by development banks.

Action 7: Clarifying institutional investors' and asset managers' duties

Investors use the CDP scores and analyses of corporate climate and environmental performance and targets to understand and mitigate risk within their investments and to seize opportunities. Investors achieve two key outcomes: (1) improving financial decision making and (2) increasing corporate engagement.

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CDP highly welcomes that the Commission's legislative proposal will aim to explicitly require institutional investors and asset managers to integrate sustainability considerations into the investment decision-making process and to increase transparency towards end-investors on how they integrate such sustainability factors in their investment decisions, in particular concerning their exposure to sustainability risks.

To effectively implement and operationalize the Commission's proposal, we see an urgent need to address shortcomings on the corporate disclosure (transparency) side. Investors with fiduciary duties that require them to ensure long-term, low-risk investment strategies do not encounter sufficient information on long-term climate-risk mitigation and adaptation strategies of the companies they invest in. Climate risks or opportunities that are unlikely to materialize over the next few years, but could be significant over longer horizons, tend to be under-priced or underappreciated by investors.

We recommend the following measures to resolve this conflict:

- Companies must be required to disclose their long-term transition plans towards well-below 2 degree Celsius and water-secure scenarios;
- Climate change, water security and deforestation risks are acutely impacting supply chains. The level and detail of disclosure of corporate action to mitigate these risks in their supply chains must be specified in corporate disclosure regulation;
- Committing to EU legislative implementation of the G20 FSB Task Force on Climate-related Financial Disclosures (TCFD) recommendations would provide investors and companies with the regulatory certainty to take the necessary steps on providing consistent information on climate-related financial risk and opportunity criteria around governance, strategy, risk management and metrics and targets.

Action 9: Strengthening sustainability disclosure and accounting rule-making

Corporate reporting on sustainability issues needs to serve investors and stakeholders by assessing companies' long-term value creation and their exposure to long-term risks. Only high-quality, consistent disclosure of long-term sustainability risks across the entire investment and lending chain enables investors to engage with company boards on sustainability issues and to drive sustainability in business operations.

To be useful, disclosures must systematically account for the actual contribution of investments and capital allocation decisions in achieving environmental and societal goals, set out by the Paris Agreement and the Sustainable Development Goals.

CDP is fully committed to supporting the Commission's fitness check of EU legislation on public corporate reporting, including the EU Directive on the disclosure of Non-Financial Information (NFI), to assess whether public reporting requirements for listed and non-listed companies are fit for purpose, as well as the revision of the guidelines on non-financial information.

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The NFI Directive is the key vehicle to provide the information required to drive capital flows towards sustainable investments and business models. We have identified the following elements as crucial to upgrading corporate disclosure requirements under the NFI Directive:

Climate-related financial risk and opportunities

- The HLEG recommendation to endorse and implement the TCFD recommendations at the EU level which would be a major step towards increasing the usefulness and consistency of information available on climate-related risk, opportunities and action of companies and financial institutions;
- Australia, China, France, UK and Sweden have already endorsed the TCFD recommendations. Adoption within legislative actions of the Action Plan would send a clear and consistent message to the business community, while providing enough time to experiment and prepare, and would ensure the pace needed to deliver a financial system that can provide the level of investment required for a sustainable future;
- Business is already adapting to a new disclosure landscape and has adopted reporting frameworks, provided by CDSB, and the CDP questionnaires for many years. Many of these businesses have been vocal in their support for mandatory reporting in line with the TCFD recommendations;
- For the fitness check of corporate disclosure lessons and analyses exist from corporate climate reporting under French Article 173 and through CDP. That context can inform the evaluation of the effectiveness of climate and environmental disclosure by European companies who have reported physical and regulatory risks to their investors for many years. This reporting represents a level of disclosure that includes key elements of TCFD already;
- To ensure a smooth process and quick uptake by the private sector, the measures of the Action Plan can build on the experience within existing TCFD compliant reporting infrastructure and the best-practice guidance already available for and used by the market.

Supply chain disclosure is key

- To meet the challenges of climate change, environmental degradation, resource depletion and social sustainability, disclosure throughout the entire supply chain of businesses is key. It enables purchasing companies to engage their suppliers to identify risks, find opportunities to lower costs and make tangible progress on reducing greenhouse gas emissions, on driving water stewardship and on mitigating deforestation.
- With public procurement and the purchasing of goods and services covering about 14 % of European gross domestic product[3], governments can use supply chain disclosures to align their procurement decisions with the Paris Agreement and the

[3] http://ec.europa.eu/growth/single-market/public-procurement/strategy_en

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SDGs. National, regional and local government agencies should leverage the power of public procurement to drive positive action on climate change and natural resources by encouraging their suppliers to manage climate change, deforestation and water-related risks. This would bring governments accompanying benefits such as increased value chain transparency and enabling active pursuit of the objectives of the Circular Economy.

The benefits of reporting

- Reporting is not intended to be a burden, but an opportunity for companies to receive more, long-term investment, which will allow them to transition to a more sustainable business model.
- The STOXX® Global Climate Change Leaders Index, which is based on the CDP A List, is a unique index including leading companies who are publicly committed to reducing their carbon footprint. It offers investors a fully transparent and tailored solution to address long-term climate risks, while participating in the sustainable growth of a low-carbon economy. The index has outperformed a global benchmark by 26% over 5 years.

Further reading: Guidance and tools

- Introduction to the TCFD recommendations
- Climate disclosure in France
- Climate disclosure in Germany (in German)
- CDP report: Ready or not: Are companies prepared for the TCFD recommendations?
- The "TCFD Knowledge Hub" will provide tools and other implementation resources as well as references and links to other climate-related disclosure frameworks that have incorporated the TCFD recommendations.
- From 2018, corporate climate disclosures made through the CDP platform will generate all the information required for a TCFD-compliant disclosure. Sector-specific technical guidance is available on https://www.cdp.net/en/companies-discloser/disclosure-in-2018

For further information

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