THE FOURTH VISION PONTIGNANO CONFERENCE ON THE FUTURE OF EUROPE

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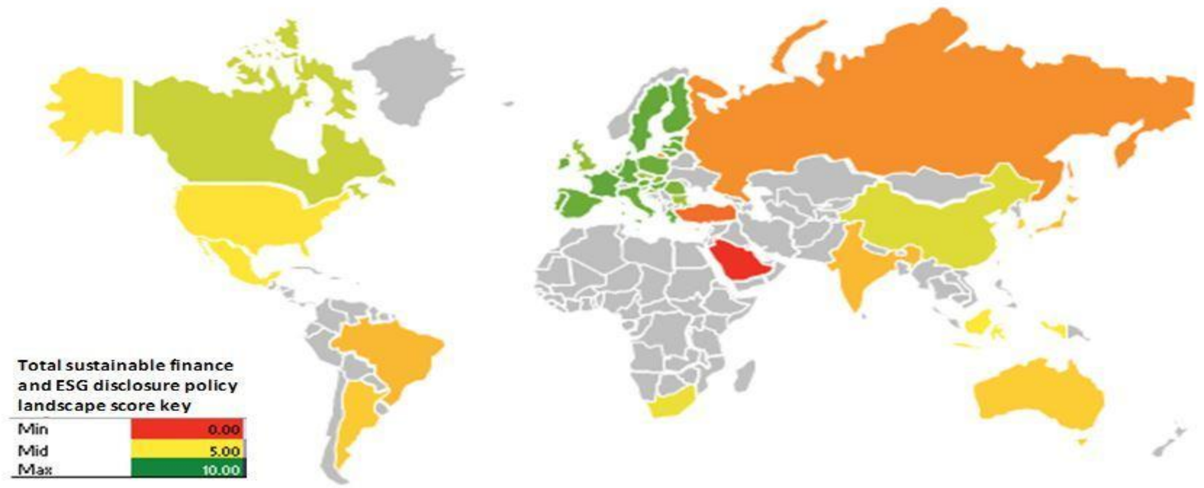
TIME TO LAND IN THE 21ST CENTURY

According to the International Energy Agency (IEA), in order to achieve the decarbonisation targets established by the recent Conference of the Parties, the world should commit about 4 trillion dollars to low-carbon energy every year for the next eight years. Such an effort would require a huge reallocation of investments towards less polluting activities. And yet this could also be the “mission” that sparks innovation in those financial institutions that never really recovered from the 2008 crisis. We already have practices[1] that companies use to include their sustainability assessment in their financial statements. Up until ten years ago, this kind of exercise was mainly used as a marketing strategy. Nowadays, however, the idea that sustainability and corporate responsibility may be the key for financial survival is slowly setting in.

The EU is, however, the first supranational organisation that is developing a full mandatory regulation[2] aimed at measuring how much firms’ balance sheets are exposed to the so-called Environment Social and Governance (ESG) Risks. The authority that will supervise the implementation of the new regulation will be the European Banking Authority (EBA); the Banks will therefore be the instruments to make firms comply, and the regulation will be active from January 2024. This makes the EU the forerunner of sustainable finance, as illustrated in the chart below.

Figure 1: G–20 country scores for sustainable finance and ESG disclosure policies



Source: BloombergNEF, PRI, NGFS, Coalition of Finance Ministers for Climate Action, IPSF, policy documents. Note: only mandatory policies assessed (including comply-or-explain).

Europe is thus leading the path in the fight against climate change also when it comes to regulating firms. And yet the question is: is this enough? What are the risks of being the front runners?

The regulation that the European Banking Union has drafted is indeed the combination of two different methods:

a) On the one hand, the EBA is asking to calculate how banks’ assets are allocated amongst different typologies to borrowers/investments (via loans, bonds or even equity) according to a taxonomy which divides activities according to different levels of capability of creating or alleviating/mitigating climate risks: it is the GREEN ASSETS RATIO (GRA);

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[1] In 2016, The Global Reporting Initiative (GRI), an NGO that collaborates with the United Nations, presented a methodology to ensure how much a company is damaging social value. Two years later, non-financial accounting standards (SASB) were included next to traditional accounting standards. This allowed investors to compare how much different companies include those principles in their actions.

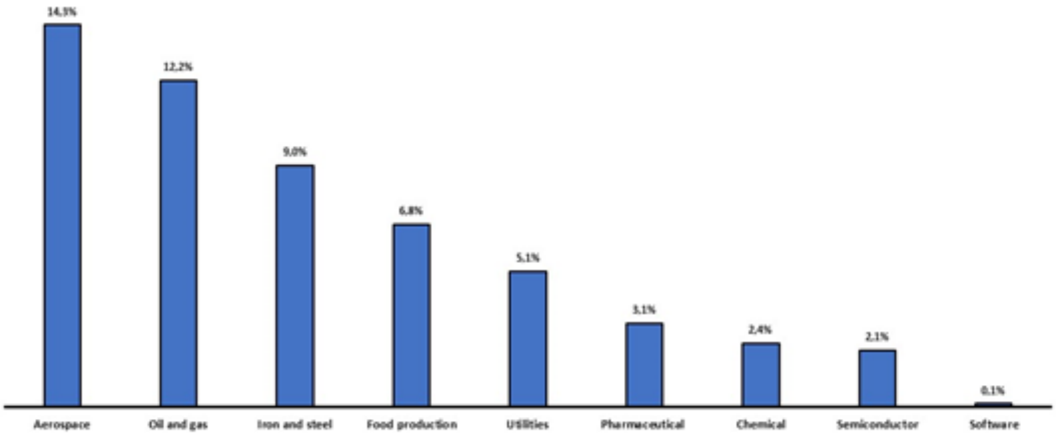
[2] Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR, European Banking Authority, 24th JAN 2022 file:///C:/Users/Francesco/Downloads/EBA%20draft%20ITS%20on%20Pillar%203%20disclosures%20on%20ESG%20risks%20(1).pdf

b) On the other hand, a much more detailed, per company assessment is required and the reference again is to ESG (as well as other more qualitative, voluntary disclosures).

The conceptual problems that also have significant practical consequences are that:

a) There may be contradiction between the two methods: the first risking being too narrow and the second too wide as far as metrics are concerned;
b) The definitions of “activities” according to the taxonomy may be too rigid; as a matter of fact any “economic activity” is a sum of many different ones and technologies significantly change how polluting each activity is;
c) ESG evaluations may be not comparable across industries, as shown in the chart below;

PERCENTAGE OF COMPANIES LISTED WITH A HIGHER RISK IN REGARDS TO ENVIRONMENTAL SUSTAINABILITY. – PER SECTOR (WORLD, ESG INDICATORS)



SOURCE: VISION ON SUSTAINALYTICS DATA

d) Last but not least, the entire system may result in high costs of compliance for firms (especially small and medium ones) and not be effective enough to avoid green washing.

The problem solving group will identify areas of improvement by reflecting on possibilities like: should we embrace a periodic review of taxonomies? Could ESG be simplified by focusing on “environment” (so that implementation is easier both on regulators’ and the firms’ side)? Is the independence of ESG auditors improvable? What about reorienting measurements towards the fossil fuel contents of consumption (as in the “carbon tax”)?

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