Final Response 15 July 2020

**EUROPEAN COMMISSION CONSULTATION DOCUMENT**

**CONSULTATION ON THE RENEWED SUSTAINABLE FINANCE STRATEGY**

**Question 1**: With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate and environmental-related challenges, do you think that (please select one of the following):

- Major additional policy actions are needed to accelerate the systematic sustainability transition of the EU financial sector.
- Incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.
- No further policy action is needed for the time being.

**Question 4:** Would you consider it useful if corporates and financial institutions were required to communicate if and explain how their business strategies and targets contribute to reaching the goals of the Paris Agreement?

- Yes, corporates;
- Yes, financial institutions;
- Yes, both;
- If no, what other steps should be taken instead to accelerate the adoption by corporates and financial sector firms of business targets, strategies and practices that aim to align their emissions and activities with the goals of the Paris Agreement? [BOX, 2000 characters]
- Do not know.

FIA response:
FIA members expressed a preference to analyse the impact of the implementation of current rules and regulations in relation to the goals of the Paris Agreement. Rather than requiring financial institutions and corporates to publicise their business strategy, we recommend encouraging such communication on a voluntary basis first, before considering further regulatory obligations.

**Question 5:** One of the objectives of the European Commission's 2018 Action Plan on Financing Sustainable Growth is to encourage investors to finance sustainable activities and projects. Do you believe the EU should also take further action to:

Encourage investors to engage, including making use of their voting rights, with companies conducting environmentally harmful activities that are not in line with environmental objectives and the EU-wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law, with a view to encouraging these companies to adopt more sustainable business models: scale from 1 (strongly disagree) to 5 (strongly agree). 3

- Discourage investors from financing environmentally harmful activities that are not in line with environmental objectives and the EU-wide trajectory for greenhouse gas emission reductions, as part of the European Climate Law: scale from 1 (strongly disagree) to 5 (strongly agree). 2

In case you agree or strongly agree with one or both options [4-5]: what should the EU do to reach this objective? [BOX, 2000 characters]

FIA response:
FIA members believe that policy should aim at encouraging market participants to contribute to a more sustainable environment instead of focusing on discouragement policies. A positive and encouraging approach would be more effective, and will likely produce similar or better results, without disrupting markets, by allowing for an appropriate transition to more sustainable activities.

If investment in or financing of potentially harmful activities were discouraged as such, companies that have assets that are not yet, or are perceived not to be, in line with environmental objectives (e.g. coal-fired power plants) will find it very difficult to obtain financing for their commercial groups. Finance is required for their day-to-day operations, but also to adapt their business and transition to a more sustainable business model. Also, companies may have already begun the transition, but the economy relies on a certain product output that perhaps is not yet one hundred percent achievable through sustainable resources, therefore a transition period is required to develop sustainable technologies. As example, in June 2020, the UK stated that it was able to rely entirely on sustainable resources to produce power for a period of 2 months[1]. While this is an encouraging development, it also shows that we are not yet in a position to be able to rely solely on renewable sources in order to provide end-users with the standard and quality of life they are used to and thus discouraging or prohibiting investors from financing in current technologies may lead to severe market disruption and a negative impact on end-users and the economy as a whole.

Encouraging investment in sustainable activities and technologies, however, will further the objectives of the Paris Agreement and enable the market to adapt businesses and to phase out less sustainable processes and technologies.

**Question 6:** What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?

- [BOX, 2000 characters].

FIA response:

**Opportunities**

Well-functioning, well supervised markets carry the potential to foster and promote market evolution by increasing capital flows into the markets through greater liquidity and providing efficiencies to price discovery and management of inherent market risks.

1. Development of new products

[1] https://www.bbc.co.uk/news/science-environment-52973089

Markets have already begun a transition to more sustainable products with the various exchanges having listed sustainable contracts in parallel or in addition to traditional contracts. However, there is room for more products and innovations. Markets react to supply and demand from investors and market participants, who have recently been much more focused on sustainable products.

As an example, Eurex has offered ESG related derivatives on its exchange, especially in climate-oriented aspects. In recent years, increased customer demand for listed ESG derivatives has emerged, with asset managers seeking flexible solutions for liquid and cost-efficient alternatives to manage undesired sustainability risks, trade longer-dated maturities, and to align their ESG investment mandates. In response to the increased customer demand, in February 2019, Eurex introduced ESG index futures relying on benchmarks according to STOXX's exclusion methodology, which aims to provide investable Pan-European and Euro-region benchmarks focusing on ESG, Low Carbon and Climate Impact. Engaging in the ESG approach, Eurex also launched subsequently the first exchange traded ESG index options on a European benchmark, opening the ability for structured products issuers, for example, to hedge their risk books more accurately by deploying derivatives. Eurex is continuously responding to the market demand by expanding its ESG offering by launching ESG futures on further leading ESG benchmarks, as for example on MSCI ESG indexes in March 2020, covering developed markets, such as Japan and US, as well as emerging markets.

Overall, by June 2020, the Eurex ESG traded derivatives increased to 12 different futures and options products and volume amounted to about 600,000 traded contracts, which represents a tenfold number of traded contracts since introduction in Feb 2019, with a capital volume of €7.6 billion. The STOXX Europe 600 ESG-X index future at this stage is by far the most popular, with more than 580,000 contracts in the first half of 2020, capital volume of €7.5 billion and open interest at a value of €550 million end of June.

Another example is the Euronext Eurozone ESG Large 80 index[2]. The futures contracts were launched on June 1st with the support of market makers deeply committed to the development of sustainable finance (BNP Paribas, Optiver, DRW, Societe Generale). The index applies ESG exclusions to establish an Energy Transition/Climate Change benchmark in the Eurozone with real ESG exclusion.

The increasing proportion of investment practitioners are viewing ESG as integral to their strategies. These new ESG derivatives products provide exchange participants and buy-side firms with additional tools to implement sustainability-driven mandates and complement their efforts on the capital allocation angle, with ESG instruments in the risk transfer markets as well.

These new sustainable investment strategies require products with different and adapted risk-profiles, towards which market infrastructure providers will continue to innovate.

2. Momentum in the financial sector and beyond

With the European Green deal comes an increasing momentum within public and private actors that supports a transition to more sustainable products and policies. This provides the opportunity for the industry but also policy makers to achieve the goals and objectives of the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development.

[2] https://www.fia.org/articles/euronext-launches-futures-new-esg-index

Increased awareness will also result in sustainable business models in operational, financial and impact terms, as well as a better understanding and steering of own economic activities and better risk management.

Markets will innovative towards this demand for sustainable alternatives with adapted risk-managing products. The financial policy framework should use this momentum to ensure markets can adjust efficiently.

There will be opportunities not just for new products but also for investments in new technologies, and for Europe to attract capital from investors.

Disruption of markets will be inevitable, however, by carefully calibrating the transition to a more sustainable economy, the impact of transition risks will be significantly lower than the impact of climate risk. Any market disruption should be proportionate to the climate risks society is facing and measures should minimise the negative impact on end-users, while still achieving a more sustainable real economy.

**Challenges**

1. Identifying climate-related risks

Many of FIA's member firms are active, or support firms that are active, in physical commodities and related derivatives markets, which are directly impacted by climate and other environmental factors. Climate change thus poses a range of challenges for FIA's member firms, from operational, technological, to legal, regulatory and reputational, extending to all areas of the world where firms operate. In many cases, the challenges are just recently emerging and, as such, are not yet fully understood or even readily identifiable. The first step in being prepared is to identify the nature and scope of climate-related risks. Once identified, the risks can be studied and better understood. And, once understood, the public and private sectors can work together to mitigate them. Although the impact of climate change is not yet fully understood, this does not release the industry and regulatory authorities from acting on risks that are identified.

2. Global level playing field

Financial markets are global. Market participants can make use of arbitrage opportunities and conduct their trading and hedging activities where they are most effective (cost, liquidity, availability of products). Supply chains are also global. It will be challenging for Europe's policy makers to ensure similar standards are applied globally to avoid industry or market participants moving to other regions that have different standards, which would reduce the effectiveness of ESG policies in Europe, lead to a loss in liquidity and higher prices for end-consumers.

Sustainable finance can only become mainstream if a holistic approach is taken, sustainable investments are sufficiently attractive and – most importantly – appropriately priced according to market developments. In this sense, it will be essential that financial policy complements and likely amplifies the actions already taken by energy and climate policy.

The EU should build on its successful leadership around initiatives such as the Emissions Trading Scheme and the recently adopted Taxonomy, to aid international coordination around common standards, frameworks and taxonomies.

3. Harmonisation

In the absence of harmonisation of ESG standards applying to different industries, market participants and associations have started to create their own standards. For example, see Annex C in the World Federation of Exchanges' paper on sustainability for a list of just some of current sustainability standards[3]. Having to follow a variety of standards depending on the market location is challenging for producers and market participants alike, especially as there is a risk of conflicting standards. Compliance with many different standards will be a challenge for the industry and harmonisation of such standards, ESG data commonality and the alignment of legal frameworks (taxonomy, climate benchmarks etc) will be a challenge for policy makers and undermine the effectiveness of the sustainable finance movement.

Our members also note that greenwashing still undermines efforts to mainstream sustainability in the financial sector. For example, there are multiple ways in which the impact of a sustainability-linked product is evaluated and in addition, impacts are often not explicitly captured in the evaluation. That means that claims about sustainability benefits could be made without being substantiated by a transparent and rigorous evaluation of impacts.

**Question 9:** As a corporate or a financial institution, how important is it for you that policy-makers create a predictable and well-communicated policy framework that provides a clear EU-wide trajectory on greenhouse gas emission reductions, based on the climate objectives set out in the European Green Deal, including policy signals on the appropriate pace of phasing out certain assets that are likely to be stranded in the future?

- Please express your view by using a scale from 1 (not important at all) to 5 (very important).
- For scores of 4 to 5, what are, in your view, the mechanisms necessary to be put in place by policy-makers to best give the right signals to you as a corporate or a financial institution? [BOX, 2000 characters]

FIA response:

For FIA members, predictable and well-communicated policies are extremely important. FIA members need sufficient lead-in time to be able to adapt their commercial, operational and legal processes to new regulation and policies.

This underlines the importance of this renewed strategy consultation and, for example, the European Climate Law, which shows the potential to coordinate efficiently several EU initiatives. The Renewed Sustainable Finance Strategy should first and foremost ensure that financial initiatives effectively complement each other, and secondly, amplify the European climate actions and goals.

Certainty for investments through a reliable and effective CO2 price as well as through sector-specific policies for implementing non-disruptive roadmaps and objectives would be helpful measures. For instance, market participants require clear signalling from policy makers regarding which assets and technologies will be phased out and when (including a sufficiently long transition period), to improve predictability, avoid market disruption, allow budget considerations, and a timely assessment of stranded assets.

The policy framework should be technologically neutral. Explicit endorsement should be given to

[3] https://www.world-exchanges.org/our-work/articles/wfe-sustainability-commodity-derivatives-white-paper

any technology with a potential to reduce CO2 emissions. No technology or activity that has the potential to contribute a combination of avoided abatement costs should be ruled out upfront.

The concept of "stranded assets" is not wholly consistent with the desire to be technology-neutral and not factual but rather speculative. Ultimately, the goal is to lower carbon emissions by any technology possible.

For example, some may regard gas infrastructure as possible future stranded assets; however, the existing gas transmission and distribution networks support the integration of renewable energy both in electric form (e.g. via power to gas) and gaseous form (biomethane, hydrogen, synthetic methane) into the energy system.

We recommend the European Commission use market-based policy signals such as EU ETS to help operators decide to comply or buy allowances for high fossil fuel CO2 emission assets that may be stranded in the future. This makes for an inclusive and technology neutral approach under the EU ETS cap.

Overall, FIA members support a process similar to the one followed for current European legislation, i.e. the use of public consultations and public hearings/meetings with stakeholders, enabling a dialogue with the industry impacted by new climate-related policies and phasing out of assets. In this sense, we welcome the European Commission's transparent dialogue with stakeholders, enabling a dialogue with those directly or indirectly impacted by the new policies and market developments.

**Question 13:** In your opinion, which, if any, further actions would you like to see at international, EU, or Member State level to enable the financing of the sustainability transition? Please identify actions aside from the areas for future work identified in the targeted questions below (remainder of Section II), as well as the existing actions implemented as part of the European Commission's 2018 Action Plan on Financing Sustainable Growth.

- [BOX, 2000 characters]

FIA response:

We believe that incremental additional actions may be needed in targeted areas, but existing actions implemented under the Action Plan on Financing Sustainable Growth are largely sufficient.

The taxonomy, sustainable finance disclosure regulation, and climate benchmarks, all representing cornerstones of EU action, have recently been adopted and now we need to observe how these frameworks work in practice, if there are gaps, and where synergies can be increased.

The review of the NFRD will be key to ensure ESG data availability and enable a proper use of the Taxonomy framework. In this regard, standardising financial and sustainability reporting to arrive at "integrated reporting" and expanding the scope of NFRD also to non-listed companies would be important.

Future policies could include:
(1) more transparency;
(2) improved granularity to boost transition efforts; and

(3) clear guidance from policy makers on which assets and technology should be phased out and when, to improve predictability and a timely assessment of stranded assets.

Finally, we believe that global coordination will be key to the success of any policies, not only to ensure a positive global impact on our climate, but also to avoid arbitrage opportunities or the industry moving away, thereby jeopardising the commitment of EU citizens and dislocating markets. This could, for example, entail work on a global approach on the sustainable finance taxonomy, building on the EU framework and EU leadership within this field. The European Union should also increase dialogue at the global level on non-financial reporting standards to ensure consistency.

**Question 14:** In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

- Yes/No/Do not know.
- If yes, please explain how it should be structured and what type of ESG information should feature therein. [BOX, 2000 characters]

FIA response:

We believe it would be beneficial to provide a golden source for data, as it will improve transparency. However, there are already a number of reporting obligations in place; data gathered under those existing regulations should be used as much as possible and any further reporting obligations should be consistent with current requirements to avoid duplicative or conflicting requirements.

There are numerous private entities collecting and selling ESG data to users. This creates concerns among market participants, since this data could be mis-classified or mis-used outside the context in which this data was provided. This practice also contributes to the inconsistencies of data across entities, risking misleading comparisons.

As there is currently a proliferation of reporting standards in ESG reporting, the potential added value of setting up a specific and dedicated mechanism may be valuable to ensure alignment. It must though be well-designed with a high level of flexibility and integrity to ensure enhances confidence.

**Question 33**: The Climate Benchmarks Regulation creates two types of EU climate benchmarks - 'EU Climate Transition' and 'EU Paris-aligned' - aimed at investors with climate-conscious investment strategies. The regulation also requires the Commission to assess the feasibility of a broader 'ESG benchmark'. Should the EU take action to create an ESG benchmark?

- Yes/No/Do not know.
- If no, please explain the reasons for your answer, if necessary. [BOX, 2000 characters]
- If yes, please explain what the key elements of such a benchmark should be. [BOX max. 2000 characters]

FIA response:

The impact and development of existing benchmarks and disclosure requirements should be monitored and assessed before making additional policy decisions.

However, we fully acknowledge the EU climate benchmarks (CTB and PAB), which are regulatory driven, are not the only ESG benchmarks in the market. Currently, a multitude of ESG benchmarks with different objectives are also being offered, which are only subject to ESG transparency obligations. With a high degree of subjectivity in ESG labels, it might not always be possible for the end investor to compare such benchmarks due to the different ESG data which might be used by benchmark administrators.

It could be beneficial to make those benchmarks broadly comparable by, for example, setting a range of objectives for ESG benchmarks with minimum standards. Such objectives should be able to encompass a range of ESG benchmarks without reducing the scope of potential future innovations. Potentially, these objectives could also be defined with reference to the EU Taxonomy, which is currently lacking in the other two types of EU climate benchmarks, e.g. an ESG benchmark fulfills the standard, if it is taxonomy-aligned to a certain defined extent.

**Question 35**: Do you think the existing capital market infrastructure sufficiently supports the issuance and liquidity of sustainable securities?

- Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree).
- For scores of 1 and 2, please list the main problems you see (maximum three). [BOX, 2000 characters].

FIA response: 4

**Question 36:** In your opinion, should the EU foster the development of a sustainable finance-oriented exchange or trading segments that caters specifically to trading in sustainable finance securities and is better aligned with the needs of issuers?

- Yes/No/Do not know.
- If necessary, please explain the reasons for your answer. [BOX max. 2000 characters]

FIA response:

We believe that existing venues are equipped to offer sustainable products. Existing EU venues have begun offering products that contribute to sustainable development, facilitate management of climate risk and incorporate carbon reduction in investment strategies, as well as allow the tracking of companies' sustainable performance. They can also launch parallel products, e.g. adding a more sustainable version of an already existing product alongside it.

In addition to capital market infrastructures, we note that derivatives exchanges increasingly engage in sustainable finance to address the increased demand in sustainable products from an exchange traded derivatives point of view. Collaboration among benchmark providers, and market participants, has resulted in successfully introducing sustainable derivatives products. Derivatives exchanges are playing an important role in developing exchange traded derivatives contracts to support sell- and buy-side firms with additional tols to implement sustainability-driven mandates and complement their efforts on the capital allocation angle, with ESG instruments in the risk transfer markets as well. The derivatives have a clear potential to optimize allocation of capital to support or complement investment into sustainable projects and activities and represent a flexible solution to attend the demand from investors towards new sustainable investment strategies, but also at the same time manage undesired sustainability risks, trade longer-dated maturities, align their ESG investment mandates and to manage the granularity of the client's risk exposure while reducing trading costs.

The EU could foster the development of new products by coordinating efforts globally and providing globally harmonised ESG/sustainability standards. Trading venues could also be encouraged to increase transparency, i.e. ESG aspects could be disseminated by trading venues to financial market participants/clearing members.

**Question 47:** Do you think that an EU framework for supply chain due diligence related to human rights and environmental issues should be developed to ensure a harmonised level-playing field, given the uneven development of national due diligence initiatives?

- Yes/No/Do not know.

**Question 48:** Do you think that such a supply chain due diligence requirement should apply to all companies, including small and medium sized companies?

- Yes/No/Do not know.
- If yes, please select your preferred option:
  - All companies, including SMEs.
  - All companies, but with lighter minimum requirements for SMEs.
  - Only large companies in general, and SMEs in the most risky economic sectors sustainability-wise.
  - Only large companies.
- If necessary, please explain the reasons for your answer. [box max. 2000 characters]

FIA response:

As we experience many national initiatives with regard to due diligence requirements, an EU standard will most like imply less complex and burdensome work of handling different national definitions and processes.

A level playing field across the global supply chain would be required for due diligence requirements to have a significant impact. We refer to existing examples in metals markets, e.g. the Responsible Sourcing policy of the London Metal Exchange[4] or the LBMA Good Delivery Rules [5] as global due diligence requirements that include ESG factors.

Any due diligence requirements should include a proportionality factor to avoid onerous burden on smaller companies, where such burden is not justified by the benefits of the due diligence. We reiterate that the effectiveness of the requirements will significantly increase if

[4] https://www.lme.com/en-GB/About/Responsibility/Responsible-sourcing
[5] http://www.lbma.org.uk/good-delivery-rules

applied on a global basis across the entire supply chain.

As noted in in our response to other questions, we encourage the harmonisation of any sustainability standards. For example, under the UN Guiding Principles on Business and Human rights, due diligence requirements should apply to all companies, but should recognise how companies meet these principles will differ by size of the company, as SMEs will have less capacity.

**Question 53:** Do you think that all financial products/instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities?

- Yes/No/Do not know.

If no, please explain what you would consider to be the most impactful products/instruments to reallocate capital in this way.[box max. 2000 characters]

Firms globally are showing more and more appetite to consider ESG objectives in their sustainable investment strategies. ESG objectives are being integrated across tangible and intangible assets and within core business activities.

While we agree that securities such as the ones listed above, might at first glance be most impactful for the purposes of capital allocation, we would like to raise awareness that derivatives can complement the efforts to optimise allocation of capital and support the development of sustainable projects and activities. The existing market infrastructure is supporting the issuance and liquidity of sustainable securities. Market participants have already begun a transition to more sustainable products in reaction to the demand from investors, not only in capital markets, but also in derivatives.

Mainstreaming ESG is key, this includes applying ESG factors and considerations to a broad range of financial products, such as liquid ESG benchmarks derivatives, which are a tool to encourage a transition towards ESG goals and contribute to new investment behaviour.

Sustainable activities and projects have diverging risk profiles, calling for adequate hedging possibilities. Well-functioning derivatives markets are an efficient basis for market integration of, for example, renewable power production. Energy derivatives markets bring together financial and physical players, ensuring the necessary liquidity for a market-based uptake of sustainable activities and projects with diverging risk profiles.

**Question 76:** Do you think the current level of global coordination between public actors for sustainable finance is sufficient to promote sustainable finance globally as well as to ensure coherent frameworks and action to deliver on the Paris Agreement and/or the UN Sustainable Development Goals (SDGs)?

- Please express your view by using a scale of 1 (highly insufficient) to 5 (fully sufficient).
- For scores of 1-2, what are the main missing factors at international level to further promote sustainable finance globally and to ensure coherent frameworks and actions? [BOX max. 2000 characters]

FIA response:

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We believe increased global coordination is required to achieve a level playing field for financial markets. While we support Europe as key actor in achieving a more sustainable environment, the region may lose its competitive edge, industry and market participants, if more stringent requirements only apply locally and are inconsistent across the EU. This, in turn, would reduce the effectiveness of EU measures.

Our members strongly believe that global coordination will be key to the success of any policies, not only to ensure a positive global impact on our climate, but also to avoid arbitrage opportunities or the industry moving away, thereby jeopardising the commitment of EU citizens and dislocating markets.

With the Green Deal, Europe is setting out to intensify its efforts in global climate diplomacy. We welcome this course as it can make a significant contribution to both increasing global climate action efforts and aligning them, thereby facilitating cooperation. The European initiatives in sustainable finance should be added to this spectrum of coordination and the EU should make use of its role in the G20 and COP26 to progress the sustainability agenda.

**Question 82**: In particular, do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (the so-called "brown taxonomy") at EU level, in line with the review clause of the political agreement on the Taxonomy Regulation?

- Yes/No/Do not know.
- If no, please explain why you disagree [BOX max. 2000 characters]
- If yes, what would be the purpose of such a brown taxonomy? (select all that apply)
  - Help supervisors to identify and manage climate and environmental risks.
  - Create new prudential tools, such as for exposures to carbon-intensive industries.
  - Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities.
  - Identify and stop environmentally harmful subsidies.
  - Other, please specify. [box max. 2000 characters]

FIA response:

FIA cautions against any review of the taxonomy that may result in individual futures contracts or the underlying commodities becoming labelled "brown." Such a change could have unintended consequences for producers and consumers, as well as harm the very transition sought to improve environmental sustainability and combat the effects of climate change. Please also see our response to Q5 regarding the negative impact of discouragement policies.

The focus should be on facilitating and encouraging green investments and redirecting capital flows towards, for example, environmentally sustainable activities, based on risk based prudential regulation. A brown taxonomy would be premature at this stage, rather we would see the need for sufficient time and experience of using the taxonomy before any decisions on the revision of its scope. The implementation of the green taxonomy and keeping it sufficiently up to date (as the technical screening criteria are to be reviewed every 3-5 years) is a big task for markets and participants already.

We support the agreement reached by co-legislators including transitional provisions and enabling activities. An easy to use, complete and timely updated EU Taxonomy on sustainable economic activities across the six environmental objectives will likely encourage voluntary uptake by companies or actors currently not obliged to disclose against the taxonomy, where deemed feasible.

**Question 83**: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

- Yes/No/Do not know.
- If yes, what should be the purpose of such a taxonomy? Please specify. [BOX max. 2000 characters]

FIA response:

We believe the approach taken, i.e. focusing on activities on the basis of greenhouse gas emissions and their reduction, is reasonable at this stage. We support the agreement reached by the co-legislators, including transitional and enabling activities, and we believe adding more granularity to the taxonomy would better reflect the diversity various activities and assets have on sustainability and as a result would benefit investors to determine how they can support the transition to sustainable activities. We also support the possibility to propose inclusion of further economic activities and services in the taxonomy to the platform in the future.

**Question 84**: Climate change will impact financial stability through two main channels: physical risks, related to damages from climate-related events, and transition risks, related to the effect of mitigation strategies, especially if these are adopted late and abruptly. In addition, second-order effects (for instance the impact of climate change on real estate prices) can further weaken the whole financial system. What are in your view the most important channels through which climate change will affect your industry? Please provide links to quantitative analysis when available.

- Physical risks, please specify if necessary [BOX max. 2000 characters]
- Transition risks, please specify if necessary [BOX max. 2000 characters]
- Second-order effects, please specify if necessary [BOX max. 2000 characters]
- Other, please specify [BOX max. 2000 characters]

FIA response:

Financial markets closely reflect commercial practices in the real economy if they are to provide effective and efficient price discovery and risk management.

**Physical risk:** Producers and market participants are subject to climate related events, e.g. rising sea levels or draughts affecting harvests and availability of underlying products.

**Transition risk:** Migrating economies to sustainable products will impact the commercial physical markets and derivatives markets that bring efficiency and smooth price volatility. Migrating from one contract to another can result in lost liquidity, increased price volatility and impacting price discovery. Producers and market participants will need to adapt to new criteria, revised delivery specifications or contract terms. Firms may have assets that will need to be phased out, whereas financing is required to invest in new assets and technologies to comply with new standards.

**Liability risk:** Derivatives markets and their participants may face a set of liability risks resulting from the listing of ESG derivatives, including fraud and misrepresentation. Markets will rely on certifications from producers, processors, manufacturers, and sponsors of indices and benchmarks to name a few.

**Reputation risk:** All market participants will have some measure of reputation risk in the market. Financial firms will seek integrity of their investments; exchanges in their contract offerings; commodity trading houses of their sustainability commitments and production systems; and regulators will seek validation of environmental and sustainability representations prior to approving markets or products for trading.

All of these risks and challenges likely would be more pronounced where there is a lack of harmonisation of standards. Such an environment could lead to market fragmentation, ineffective policy and regulatory arbitrage.

**Question 85:** What key actions taken in your industry do you consider to be relevant and impactful to enhance the management of climate and environment related risks?

- Please identify a maximum of three actions taken in your industry [BOX max. 2000 characters]

**Question 86:** Following the financial crisis, the EU has developed several macro- prudential instruments, in particular for the banking sector (CRR/CRDIV), which aim to address systemic risk in the financial system. Do you consider the current macro- prudential policy toolbox for the EU financial sector sufficient to identify and address potential systemic financial stability risks related to climate change?

- Please express your view by using a scale of 1 (highly inadequate) to 5 (fully sufficient). 4
- For scores of 1-2, what solution would you propose? Please list a maximum of three. [BOX max 2000 characters]

FIA response:

We believe ESG considerations are already being sufficiently considered from a macro-prudential perspective by supervisors and central banks, in particular as part of current and future stress testing. We believe these tools are appropriate for the moment. There is also a need to fully assess the development of the ESG market, once the EU's taxonomy regime is in place, in order to have a better evidence base and understanding of underlying risk related to ESG exposures.

**Question 88**: Do you consider that there is a need to incorporate ESG risks into prudential regulation in a more effective and faster manner, while ensuring a level- playing field?

- Yes/No/Do not know.
- If yes, is there any category of assets that could warrant a more risk-sensitive treatment? Are there any other prudential measures that could help promoting in a prudentially sound way the role of the EU banking sector in funding the transition to a more

sustainable economy? [box max. 2000 characters]

FIA response:

A risk-based prudential regulation can include climate or transitional assessments, reflecting exposure to such risks. However, prudential regulation should not be used to stimulate certain market behaviour. Prudential regulation and supervision are designed to increase the resilience of financial markets and to support the stability of the financial system overall. A green supporting factor or a brown penalising factor that would go beyond a risk-based approach might even transfer climate risk from corporates to the financial sector.