EVENT REPORT

Reframing finance: a systems-led approach to sustainable investment

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Event report

The greening of the financial system is necessary in order to meet our net-zero targets. In early 2024, at this time of writing, we continue to see an outsized investment in high-emitting sectors of the economy at the expense of those sectors aligned with a net-zero pathway. On 20 February, Friends of Europe hosted a policy insight, entitled *Reframing finance: a systems-led approach to sustainable investment*.

This policy insight formed an element of our broader work with the Laudes Foundation and followed two previous working group meetings held by Friends of Europe in winter 2024, where we considered how to align capital with the European Green Deal and how to shift investor preferences towards sustainable options. This policy insight was an opportunity to consider the social and systemic dimensions of the EU's sustainable finance strategy.

Over the last five years, the European sustainable finance framework has made significant developments. Key pieces of legislation have been introduced, including the EU Taxonomy, the Sustainable Finance Disclosure Regulation, the European Green Bond Standard and the Corporate Sustainability Reporting Directive. To keep sustainable finance on track, however, "we need to demonstrate that these measures work and have an impact on the ground," according to **Marcel Haag**, Director for Horizontal Policies at the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA).

Haag remarked that signals from the private sector are generally positive and that the EU taxonomy for sustainable activities is being used in industry but stressed that it is too early to draw firm conclusions. DG FISMA has a number of monitoring tools to assess the applicability of instruments in the sustainable finance framework, and Haag told the audience that the Commission's focus over the coming months will be on ensuring that the framework is applicable, usable and indeed easier to navigate. The view from the European Commission on this occasion was that more work needs to be done in the domain of transition finance.

> *"We need to demonstrate that these measures work and have an impact on the ground*
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> **Marcel Haag**, Director for Horizontal Policies at the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA)

Addressing concerns about whether the EU's sustainable finance framework is appropriate in a time of increased industrial and economic competition, Haag argued that the underlying sound sustainable finance architecture is, in fact, an important asset in boosting EU competitiveness.

Ben Caldecott, Co-Head of the Secretariat at Transition Plan Taskforce and Member of the UK Climate Change Committee agreed with Haag on the imperative of ensuring sustainable finance has impact in the real world and influences the real economy. In this regard, Caldecott argued that transition finance sits at the frontier of sustainable finance.

"Transition Finance is the provision and use of financial products and services to support counterparties, such as companies, sovereigns, and individuals, realise alignment with environmental and social sustainability." – Ben Caldecott

It was lamentable, Caldecott contended, that so much of the Commission's work on sustainable finance had focused on supporting the flow of capital into those areas of the economy already defined as 'green'. Transition finance, in contrast, is concerned with "making sure that incumbent industries and companies can rapidly decarbonise". It is this focus on transitioning those polluting sectors of the economy which Ben Caldecott said, had been lamentably underserved by the sustainable finance policy discourse.

> *"Effective transition finance requires credible transition planning*
>
> **Ben Caldecott**, Co-Head of the Secretariat at Transition Plan Taskforce and Member of the UK Climate Change Committee

Ben Caldecott proposed the introduction of mandatory transition plan disclosures in the EU as a means to accelerate the adoption of transition finance. Such disclosure requirements, which already exist in the UK, could be a powerful method of embedding transition finance in the broader sustainable finance discourse. Ensuring that regulated sectors, government-owned enterprises, and large public and private financial institutions posses high-quality transition plans will be integral to the development of transition finance, and provide a transparent account of how the transition away from carbon-intensive activities is planned.

Member of the European Parliament, **Paul Tang** echoed the call for an increased focus on transition finance and transition plans, which he said are crucial "because it brings the future to the present." He argued that Transition finance has the benefit of clarifying the long-term risks of investment, diminishing the risks of stranded assets during the transition to net-zero, and providing an amenable environment for patient capital to take centre stage in the EU.

During the policy insight, Tang underscored the nexus between the EU's sustainable finance commitments and the competitiveness and resilience of the European economy. He reminded the audience that the delaying the flow of public and private investments in sustainable activities increases economic vulnerability and increases the costs associated with future action.

Transition finance is one approach to reframe the sustainable investment landscape, so too is the adoption of a more holistic interpretation of 'sustainable finance'.

Signe Andreasen Lysgaard, Senior Advisor for Human Rights, Tech and Business at the Danish Institute for Human Rights, highlighted some of the social sustainability concerns associated with the transition which are often overlooked.

There are a significant number of negative human rights impacts associated with the transition to net-zero emissions. From the effects of offshore wind infrastructure off the coast of Columbia adversely impacting the livelihoods of coastal communities, to the spikes in child labour in Zimbabwe associated with an increase in demand for lithium, to forced labour in the solar industry supply chain, Andreasen Lysgaard underscored the wide-ranging nature of such human rights infringements.

In pursuing a systems-led approach to sustainable finance, Andreasen Lysgaard encouraged policymakers and business leaders to learn from these significant errors. She argued that a new mindset is needed to ensure that we do not simply repeat the ways of the past. She urged lawmakers to work towards a more comprehensive understanding of sustainable finance measures, creating more space for human rights considerations and the social dimension in the definition.

Marcel Haag and Ben Caldecott highlighted the benefits of a 'carrot-led' approach to the implementation of sustainable finance measures, and while Signe Andreasen Lysgaard recognised the validity in seeking to make the market work, argued for balance, proposing, "we also need to have the courage to talk about sticks".

The final speaker, **Lucia Silva**, Group Chief Sustainability Officer at Generali, provided insights from the insurance industry's perspective – a key stakeholder in the discussion on a systems-led approach to sustainable investment. Silva organised her remarks around the theme of 'resilience' and highlighted Generali's priorities to address mitigation and adaptation risk, with respect to climate change.

Silva emphasised the need for pragmatism in the pursuit of a systems-led approach to sustainable investment. Accentuating a point made earlier by Marcel Haag, she remarked that 'evidence' that the measures contained within the sustainable finance package are having an impact in the real economy will take time to materialise. Given its recent introduction, Silva questioned whether it was premature for insurance companies to already report on taxonomy alignment in 2024.

Nonetheless, she recognised that, despite inconsistencies, the taxonomy is helping to converge actors across Europe and is successful in its effort to classify activities. Silva argued that, from Generali's perspective, the transition is certainly underway and urged market actors and regulators to be patient in their hunt for material evidence that the sustainable finance framework is operating as intended.

Recommendations

- Continue to focus on the impact of sustainable finance measures on the real economy.
- There is a need for a more comprehensive approach to data availability and less of a focus on disclosure as a solution to the profound data problems in sustainable finance.
- To make sustainable finance work, we need to establish a Capital Markets Union—the space in which capital can freely flow in the EU.
- Ensure that we approach sustainable finance in an integrated manner so that we do not ignore or downplay the role of human rights and social sustainability as part of the equation.

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+32 2 893 98 23
info@friendsofeurope.org
friendsofeurope.org

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