ESDN Policy Brief 5

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Recommendations for Strengthening Sustainable Finance for the Green Transformation

Introduction

The European Sustainable Development Network (ESDN) is an informal network of national policymakers and other sustainable development (SD) experts working on SD policies and strategies. The ESDN's main aim is to advance SD and the implementation of the 2030 Agenda at the European, national and sub-national level by bringing together government representatives and expert stakeholders. The ESDN is the largest policy network on SD in Europe that facilitates the exchange of good practices and experiences across Europe by publishing Reports, organizing flagship Conferences, Workshops, and Peer Learning Platforms, which cover topics in sustainable development, of which the Sustainable Development Goals (SDGs) are the recent driving force.

The ESDN Peer Learning Platform

The ESDN Peer Learning Platform was held virtually on 27 November 2020. It was hosted by the Luxembourg Ministry of the Environment, Climate and Sustainable Development. The Peer Learning Platform is an informal opportunity for policymakers to exchange their experience and advise each other. The Platform runs according to Chatham House Rules. While there is a Report from the event, no names are disclosed in order to allow the participants to exchange their experiences more freely.

This Peer Learning Platform focused on two topics. Firstly, the presentations revolved around developing strategies to make financial systems more sustainable and redirect financial flows towards sustainable activities. The second part focused on policy coherence in national budgets, but also with national policies in general. This included a presentation on the sustainability check that is currently being developed in Luxembourg.

Policy Recommendations

The following policy recommendations are based on the presentations and discussions that occurred during the Peer Learning Platform.

1. National Finance Strategies

Develop a national sustainable finance strategy

Governments around Europe are realizing the great advantage and potential of the financial sector in enabling far-reaching changes to the economic system. As public money will by far not be sufficient to finance the green transformation, bringing in the financial sector is crucial. In order to regulate the sector and redirect flows towards green industries and projects, many countries are elaborating, or have established, sustainable finance initiatives.

Since regulation often relies on incentives and voluntary efforts (no country is planning or has the power to prohibit investments into brown industries), it is important to involve the sustainable finance industry and other stakeholders into the process. Here, it is crucial that the stakeholders feel like their concerns are taken seriously and are implemented into the strategy. For example, Austria involved relevant stakeholders through a series of workshops and directly incorporated their inputs into the sustainable finance strategy.

In addition, there often already exists a number of initiatives in any given country that only need to be brought together to be the most efficient. Academia can play a key role in supporting the development of a strategy.

Policy Recommendations

1. **Involve a variety of different stakeholders and implement their inputs into the strategy.**
2. **Analyse which initiatives already exist and integrate them into the strategy.**

Content and implementation of sustainable finance strategies

A national sustainable finance strategy can have different functions. The primary objective is to redirect financial flows towards green and sustainable industries. The government can regulate and mediate the process in a number of ways. It can establish trainings for financial stakeholders, but also increase the financial literacy of lay people. Transparency is a key aspect to create trust in the system and prevent green washing. The government can increase transparency through standards and non-financial reporting. Switzerland, for example has joined the Task Force on Climate-related Financial Disclosures, and it will strengthen regulation around non-financial disclosure in the future.

Furthermore, governments should monitor and track progress and revise the strategy regularly to adapt to new developments. One key instrument is PACTA (Paris Agreement Capital Transition Assessment), which assesses the alignment of financial portfolios with climate scenarios. For example, Switzerland has made use of this tool twice already.

Another way for governments to promote sustainable finance practices is to facilitate knowledge creation and sharing, for example by supporting and funding research and teaching on sustainable finance.

Policy Recommendations

1. **Monitor progress (for example through tools like the Paris Agreement Capital Transition Assessment) and adapt the strategy if necessary.**
2. **Increase transparency, for example through expanding regulation on non-financial reporting.**
3. **Facilitate knowledge sharing by supporting academic research and other knowledge sharing platforms.**

Country Example: Luxembourg

Luxembourg's Sustainable Finance Strategy was launched in February 2021. The Luxembourg Sustainable Finance Initiative (LSFI), a non-profit organization established by different government institutions, is the coordinating entity for elaborating and implementing the Strategy. In a first step, the LSFI mapped out existing initiatives in order to promote them and identify where new initiatives are needed to complement existing ones. A stakeholder mapping helped to identify potential synergies, especially with the financial sector. In the elaboration of the initiative, it was important to always have a different set of stakeholders at the table to benefit from a wide variety of views.

The Strategy is based on three pillars:

1) Awareness and promotion;
2) Unlocking potential and knowledge-sharing; and
3) Measuring progress.

2. Labelling Sustainable Financial Products

There are both national and EU level initiatives to label sustainable financial products more clearly and increase transparency. It is important to distinguish between two types of sustainability labels. On the one hand, there are the Environmental, Social and Governance (ESG) Labels, which label products that adhere to minimum standards regarding these three areas. On the other hand, impact labels describe products that actually mobilize capital towards green or social objectives.

Clearly defined labels and standards can be an important tool to increase transparency and avoid greenwashing. The two initiatives presented at the Peer Learning Platform (the Luxembourgian LuxFlag, and the Belgian Central Labelling Agency) agreed that more work needed to be done to define standards and make data accessible.

Policy Recommendations

1. **Create labels with transparent and clear standards in order to avoid greenwashing and to increase trust with consumers.**
2. **Increase transparency, for example through expanding regulation on non-financial reporting.**
3. **Involve many stakeholders in the creation of the label to avoid creating a niche, but involve also more conservative investors.**
4. **Keep the exclusion of certain industries or sectors as limited as possible to not hinder them in transitioning, but also preserve high standards.**

Country Example: Belgium

The Central Labelling Agency (CLA) is a private initiative from within the industry, as the initiators no longer wanted to wait for a public

initiative. The label is reviewed every two years in order to keep it dynamic. The objective is also to gradually raise the standards. The label defines a minimum of standards, but companies are encouraged to go beyond these standards. This accounts for the different flavours of sustainability. For example, a product can focus more on the social or more on the environmental aspect, but will still adhere to minimum standards on the other aspect. The supervisory board of the CLA, which supervises the process of development and labelling, is independent. Half of it consists of independent members, for example ESG experts, academics and governmental agencies. The other half consists of financial industry representatives.

3. Sustainable National Budgets

Policy coherence is one of the core principles of sustainable development. Policies in different sectors need to align in order to not undermine progress made in one sector by a counterproductive policy in another. Aligning national budgets with the principles of SD and the SDGs is a crucial aspect of achieving policy coherence. Training civil servants in the Ministry of Finance, but also other ministries, can help to not only spread awareness, but also increase the capacity of ministries to design policies in line with SD. Another way of ensuring policy coherence is a sustainability check, where all new draft laws have to pass certain sustainability criteria in order to be passed.

The Coalition of Finance Ministers for Climate Action is another way for different silos of governments to get involved. Co-led by Finland and Chile, it encourages governments to align their budgets with the Paris Climate Agreement and mainstream climate and economic policies. The Coalition also serves as a platform for exchange and peer learning.

Governments can set an example as a responsible financial market actor. The German government has defined one of the four pillars of its sustainable finance strategy to develop fiscal policy that reflects the practices that it wants to promote in private markets.

Policy Recommendations

1. **Train civil servants in all individual line ministries to be able to ensure that new policies are in line with SD principles and introduce the SDGs as a priority to line ministries.**
2. **On the international level, make use of existing mechanisms, such as the European Semester, the better regulation mechanism or the Coalition of Finance Ministers for Climate Action.**
3. **Ex-ante sustainability checks of new laws can ensure policy coherence. However, it is important to train civil servants in different ministries on the principles of SD and on the specifics of the sustainability check to help them apply the test in the most efficient**

Country Example: Romania

Romania underwent consultation by the OECD Department on Policy Coherence for Sustainable Development in order to better align its policies with SD principles. One key aspect of ensuring policy coherence is the fact that the Department of Sustainable Development is located in the Prime Minister's Office and can therefore easily bring together different stakeholders, ministries and agencies.

Furthermore, the government has trained civil servants in each line ministry to act as a hub for SD and ensure policy coherence with the SDGs. A key recommendation by the OECD was to incorporate the SD lens into key government documents and processes. A good relationship between the Ministry of Finance and the Department for Sustainable Development is crucial for this.

By 2022, Romania plans to align its national budget with the SDGs. The OECD and the Ministry of Finance worked together to develop a conceptual framework covering the entire budget cycle. This includes budget formulation, budget approval, budget execution, and audit.