Keynote speech at the Launch of the Sustainable Finance Research Forum of the European Commission

27 October

Ladies and Gentlemen,

It is a great honor to address you today at this important inaugural event of the Sustainable Finance Research Forum, in the presence of many distinguished speakers and guests, and alongside **Nobel Laureate Professor Robert Engle**, from whom you will hear later today.

I join you this morning on behalf of the European banking community, to celebrate the foundation of the Sustainable Finance Research Forum and to commit our support to making it a success.

We just heard from supervisors and academics; and in the course of today, we will hear from a cross-section of perspectives, from supervisors to research and finance. All these different areas are needed to combine the forces of research and finance in the service of sustainability.

In my remarks this morning, I will address three questions:

(1) **How do European banks see climate change?**
(2) **What are banks doing about climate change?**
(3) **What kind of research would help banks do more?**

While I focus on climate change, our own work continues to cover, as will that of the Forum, the full spectrum of sustainability, so I will touch upon some of these issues as well.

First: How do European banks see climate change?

The clear answer to that question is that banks recognize climate change as the existential problem it is for our survival on this planet. Banks – their managers, employees, owners, shareholders – recognize this challenge in its full gravity and urgency and are facing it.

Neither is this surprising. There is indisputable scientific evidence that the Earth is changing… because of us. This change puts our planet and people at risk of extinction.

But it is also true that public recognition has been slow in coming. We can all think back on the 2007 Nobel Peace Prize which was shared by the Intergovernmental Panel on Climate Change and former US Vice President Al Gore. This prize established a milestone in human history, giving full recognition to two decades of scientific reports and to the work of thousands of scientists and officials from over one hundred countries. It also gave impetus to a lot more research, shaping policy and change since then.

Today, we all know that the present condition of our planet threatens the basic elements of human life - access to water, food production, health and use of land, just to name a few. Science is clearly telling us how to stabilize and sustain our global growth in a way that is friendly to Earth, our only home. It is up to actions by governments, corporations, and ultimately individuals, to do what is necessary to protect and maintain the quality of our existence.

Recent events - the **pandemic, extreme weather events around the world, and the present war** - only reinforce what we know: that our economic and social systems must become truly sustainable.

- ❑ Europe is still recovering from the disruptions caused by the **pandemic**. Production bottlenecks, increased costs, and reduced supply as well as demand have had a range of effects on different sectors. European companies are emerging from COVID-19 with significant levels of debt and limited capacity for investment.
- ❑ At the same time, the **extreme weather events** – droughts, hurricanes, landslides – have led to devastating losses of lives, scarcity of agricultural produce, as well as disruption of energy production, for example with lower levels of water that go into hydroelectric energy production. These events come on top of the chronic weather effects of climate change, and have a profound impact on where and how people can live on this earth.
- ❑ Finally, the **war in Ukraine** is causing extreme civilian harm and hampering the post-pandemic recovery. Higher oil and gas prices, volatile energy costs, weakened demand and faster inflation are increasing companies' indebtedness and intensifying financial distress.

These accumulative crises – both caused by climate change and other geopolitical forces – are having a profound impact on people – and as I just said, they do reinforce the sustainability agenda – but at the same time they make it more difficult to achieve it. Here, I see two important challenges:

(1) First, the current energy crisis is obliging our economies to re-model our energy supply strategies to achieve energy resilience, our global welfare and strategic planning to decently sustain the world's growing population while at the same time supporting struggling businesses and households. **What we need here is to remain focused on staying on track for our long-term goals.**

(2) Second, the hardships created by the economic downturn of the current proportions make it difficult for stakeholders from one region of the globe to sense a common cause with stakeholders from another region. This is reinforced by the tendency to address things that are within reach, rather than far and distant in time or place. **What we need now is empathy, togetherness and the will to change. We need to find the collective courage to pursue the common objective for a sustainable world globally**.

So, in short, banks recognize climate change as an existential risk, they recognize the challenges brought on by the current context, and are willing to do what it takes to stay on track for saving our planet and people while overcoming the short term challenges.

Now I turn to my second question: What are banks doing about climate change?

To answer this, I want to unpack two points:

- ❑ **First of all, what do we, as banks, think we can do to make a difference?**
- ❑ **Secondly, to what extent are we making a difference?**

First of all, what difference do banks aim to make?

Banks have always played a crucial role in society, building trust and long-term relationships with customers, helping them to finance their needs and make the best financial decisions possible. Long before many corporations started to adopt purpose-based strategies, banks knew that their core business – financial intermediation – was intricately involved in meeting societal needs, making a difference for job creation, distribution and management of risks, savings, and ultimately financing the engine that helps employees, employers, and suppliers build a vibrant economy.

But increasingly **many banks are realizing that today, more than ever, they need to identify, assess and shape their impact – to ensure that their actual impact is aligned with their values and purpose.**

What is purpose for a bank? It is what it to achieve for its shareholders, customers, employees and other stakeholders. It is no longer about making the best financial decisions for a given transaction or relationship - but about helping clients reduce negative impact and making the most positive impact possible on both society and the environment. **And this means no more business as usual.**

This approach requires the integration of institutions‘ purpose across all business lines in a holistic way. This differs greatly from what is meant with Corporate Social Responsibility – which was deemed ancillary to core business. Now, we are talking about **adapting sustainable business strategies for companies and for banks**, and having a new attitude towards societal engagement.

And can that make a difference? The answer is yes. A single bank, and the collective financial world, can make a big difference. If a critical mass in the financial markets believes that companies must take steps to manage their vulnerability to present and future risks, the companies that do so will be more prized by investors, and trade at higher multiples. Similarly, credible transition plans of companies aligned with net-zero objectives will be perceived as risk mitigators and treated accordingly in banks' lending processes. In this context, **banks have a unique position to work with their clients and accompany them on their transition journey**. Besides providing finance and managing risks, banks have the opportunity to play a fundamental role in **disseminating good culture and appropriate knowledge to help companies and consumers to embrace the needed steps to pursue our common goals.**

At the same time, banks (or even the entire financial sector) cannot make the world sustainable, in the absence of the right underlying political and economic decisions.

With that limitation in mind, let me turn to the second part of my question: So, what are banks doing about climate change?

The short answer is that banking sector is making tangible progress on this front. What was unthinkable just a couple of years ago has become the norm. **Climate is a key priority for European banks**. This is due to a number of internal and external factors: peer pressure, regulatory pressure, risk considerations, maintaining profitability and looking for new markets and opportunities but also and most importantly, as I have mentioned earlier, **to better reflect societal objectives in banks‘ business strategies. For this to become reality what is needed is clear organizational purpose and a holistic approach across all business lines.**

Now to be more concrete, most banks in Europe made public net-zero commitments, and are publishing interim sector-specific targets, mainly in the energy sector. This is already starting to be reflected in lending and capital allocation. Banks are reaching out to clients – for now, mainly in the priority sectors (energy, transport, agriculture…), **engaging with them on transition plans and targets.** This is both about financing as well as advisory services – as banks will need to manage risk and deliver on their commitments. Banks are also beginning to embed climate risk into their risk management. We have very recently surveyed almost 30 European banks – only 7 % of these stated that they did not yet start the process of embedding climate risk. Of course, integrating long term risks into the existing prudential framework is not easy and we will be working with the ECB on practical and pragmatic approaches, as methodologies will be under development and data availability will be improving, building on lessons learned from the recent ECB climate stress test and climate risk thematic review. However, it is important that progress is made at the global level to avoid jurisdictional fragmentation.

Many large banks have joined initiatives such as the Net Zero Banking Alliance (NZBA), the Partnership for Carbon Accounting Financials (PCAF) or the Collective Commitment to Climate Action organized by UNEP FI. **Last year at COP26, financial institutions committed to aligning $130tn of private capital with Paris goals**. 77% of global banks are producing climate-related disclosures, increasingly based on the recommendations of the TCFD. And this is only going to improve as mandatory reporting obligations are being introduced around the globe.

Of course, we are **not there yet and there are number of challenges** related to data availability, and data collection methodologies, but also concerning how to understand the impact of financing decisions on environmental and social objectives. The data challenge is, in my view, common to all and must be addressed. In the absence of reliable and comparable ESG data progress will be unlikely. Only with this data, investors and banks can conduct risk assessments, spot opportunities and support companies in their transition. Only through the collection of data can companies quantify their progress on their goals and have data to drive and inform their decisions. **The data issue must be addressed at a collective level with the help of public authorities and international organizations because it is not efficient to deal with the lack of data on a company-by-company basis**. While good initiatives are underway – including the UNEP data hub or the ESAP in the EU - we need more public databases to become accessible to financial institutions and investors **from all parts of the world as financial markets are global.**

While upcoming legislation in the EU will contribute to an increased availability, reliability and comparability of ESG data, we **need to aim for international convergence to the maximum extent possible. Where concepts differ, we need to clearly articulate and understand differences.** Once again, sustainability is a global issue which requires a global solution.

In short, banks have made great strides in adopting clear sustainability strategies that focus on climate, and these have started bearing fruit in terms of their activities and financing aligning with climate change.

Now, the third and final point I want to cover this morning:

<u>What kind of research would help banks do more?</u>

Of course, we all know why science needs finance, but why does finance need science?

At the European Banking Federation, our objective is to **scale up competences to improve sustainability-based financing.** We are engaging with our banks and providing platforms to share best practices to better understand, analyze and integrate sustainability in their internal and decision making processes**.** We are working with expert groups on all sustainable finance related developments, such as the Taxonomy, including the potential Social Taxonomy and Extended Taxonomy, as well as ESG reporting or climate risk, and we regularly engage with legislators, regulators and supervisors on these topics. While we spend a lot of our time working on regulatory developments, we also see great benefit in complementing the expert groups' work with additional discussions at a strategic level. To this end, at the beginning of this year, we have established a Chief Sustainability Officer Roundtable, which is a platform of about 30 sustainability leaders from banks of different sizes, business models and geographies who meet regularly to generate new insight and explore collective action on sustainability and climate issues.

Someone once said that a fact is information without emotion while an opinion is information plus experience. What I want to say is that we do have lot of experience and expertise in finance and risk management around the table. I do not think anyone will be shocked if I say that bankers are not environmental scientists. So naturally, **one of the main reasons why we welcome the**

Sustainable Finance Research Forum is that it will help the banking industry find, select and interpret relevant scientific research in order to make it a useful input for business decisions. We like to form fact-based opinions….

While not an exhaustive list at all, I would like to highlight a few areas where further research and specific evidence would be helpful.

i. We are currently working with our knowledge partners EY and Enerdata on whether and how the war in Ukraine and Covid impact the execution of the transition strategies and plans of banks. Our upcoming report is based on a survey and workshops we have conducted with EU banks, and the data driven analytical brief on energy that we published based on data from Enerdata in July, which explores how the EU's energy transition could be impacted by the recent crises in the short and long term However **further research to help analyze and provide evidence on how the war in Ukraine and Covid is affecting flow of capital to the transition would be useful.**

ii. While there are analyses available on how financial regulatory measures can help increase the offer of sustainable finance, we are missing analyses focusing on the demand side. We would appreciate **research on how potential changes in other sectorial policies, such as regulatory measures in other industries or changes in tax policies, can affect the demand for sustainable finance.** While the demand from large companies has increased in some segments, we perceive a lack of demand in many segments as well as in retail. Analyses of consumer behaviour will be key to understanding possible drivers. Is it a question of pricing, incentives, economic viability, insufficient stakeholder pressure?

iii. Also, as banks are on the path to fully embrace sustainability, **research will play a key role in providing understanding of the relevance of metrics beyond purely climate related objectives as well as the needed pathways to achieve them.**

iv. Banks as well as supervisors are integrating climate risk into risk management and supervision. As methodological developments are still in early stage, **there is room for further research on climate risk modelling, scenarios and data modelin**g. Given the forward-looking nature of climate risk, **research related to forward looking indicators able to predict financial performance and financial risk of companies based on their ESG**

profile would be most welcome. Scientific evidence could be strengthened and expanded to other activities beyond climate (e.g. sustainable/circular activities)

In the same spirit, I would like to also share another idea with you. I believe a lot of good research already exists, but we in the banking sector are not aware of it. We understood that databases of economic papers already exist, and they are free (e.g. SSRN, IDEAS). However, professionals might not be familiar with these tools and may not be in the position to go through research papers which are typically very technical and aimed at expert audiences in very specific fields. Bankers are also unlikely to be in the position to constantly monitor academic developments. Hence, practitioners would need help to select relevant, sound research, and distil the messages of the papers that are useful for business.

We would therefore **appreciate a database where financial sector professionals could search based on topics that are most relevant for sustainable finance, finding links to most relevant research papers with executive summaries**.

<u>I come to the end of my remarks.</u>

I would like to conclude and make one final point.

We are entering a critical period that will set the tone for the future of sustainability policies worldwide. Positive finance can be the catalyst that will enable these global decisions to flow through into local actions, reducing carbon and safeguarding assets against damage.

I will borrow the words of Fabrizio De André, an Italian poet, singer-songwriter:

'Even if the fear of looking made you bow your chin... you are still involved'.'

We are all in this together. We cannot look away. We do not have time to lose. Climate and biodiversity ignorance has led to high social tension. Our common objectives could only be achieved if we all work together, trust each other and support each other with facts, expertise and experience. I would like to congratulate the European Commission for establishing this important forum. We are ready and looking forward to work together.