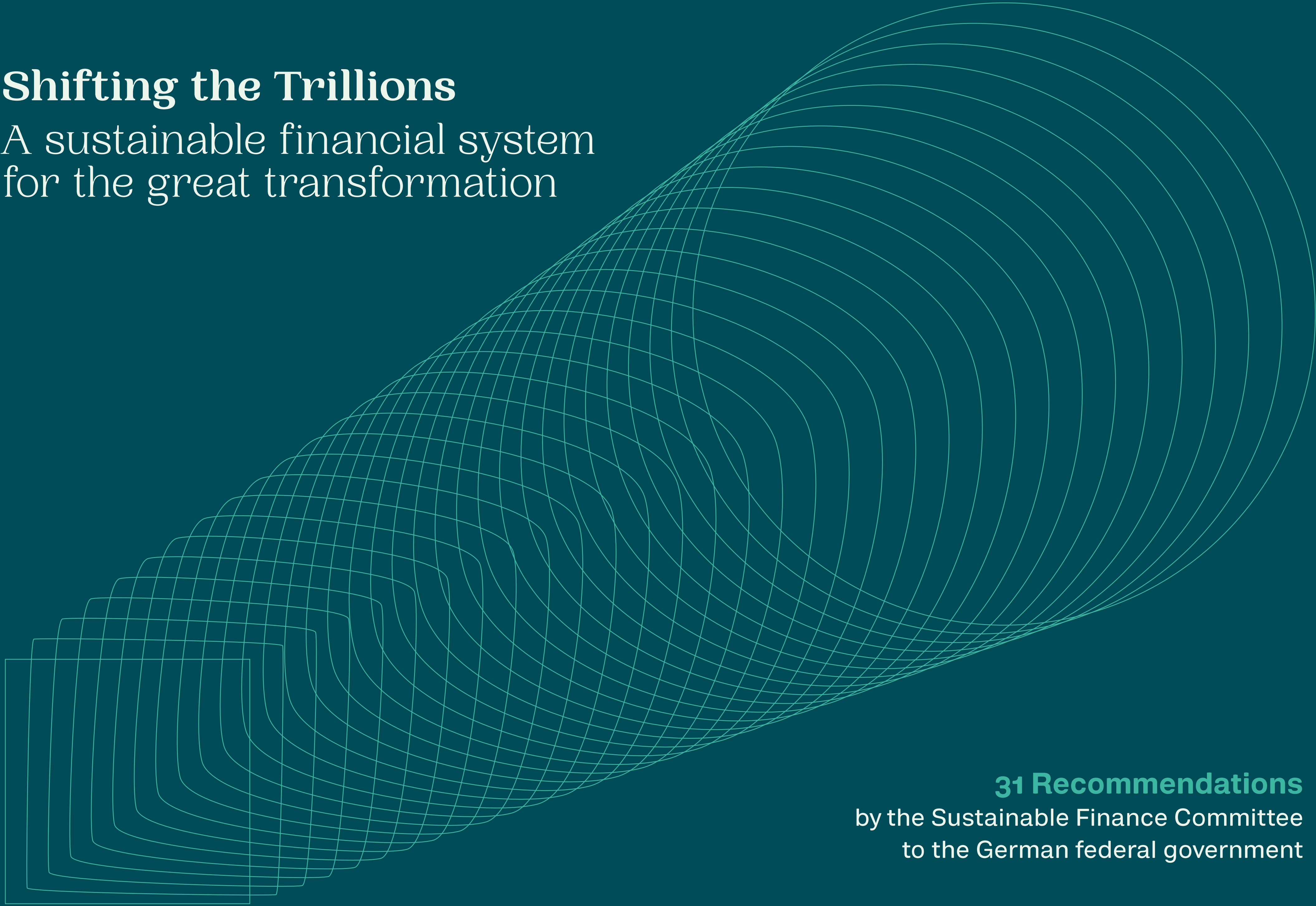
Shifting the Trillions

A sustainable financial system for the great transformation



31 Recommendations

by the Sustainable Finance Committee
to the German federal government

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Foreword by the **German government**

For Germany to have a successful economy that can meet the challenges of the future, it is crucial that companies and financial market participants engage in sustainable business activity. Hence the German government is committed to ensuring that financial market participants incorporate sustainability-related issues into their decision-making processes. This is called sustainable finance, and we want to achieve this by working together with other stakeholders to put the necessary structures and frameworks in place. Especially in recent years, key progress towards this goal has been made at the national, European and global level. Sustainability is playing an ever-growing role in investment and finance decisions.

We would like to express particular gratitude to everyone who contributed with such great dedication to the Sustainable Finance Committee's work over the past year and a half. Efforts to ensure sustainable finance will benefit not only from this final report but also from the active input provided by participants at numerous discussions and workshops and at public events such as the European Sustainable Finance Summit held in September 2020.

When the German government established the Sustainable Finance Committee (SFC), it intentionally selected a heterogeneous and interdisciplinary group of participants who would cover the breadth and diversity of the topic. As an independent body, the Committee identified and discussed key issues and formulated recommendations to make Germany a leading centre for sustainable finance. The Committee made over 30 recommendations that we are reviewing carefully and that will be taken into account in the government's upcoming Sustainable Finance Strategy.

In order to facilitate policy coherence, this strategy is being developed as part of the German Sustainable Development Strategy and will focus on ambitious yet practical options for taking action, particularly in the area of financial market policy. The central priority is to manage the financial risks of the upcoming transformation while simultaneously taking advantage of the opportunities that arise.

We wish you pleasant reading and look forward to the ongoing public discourse.

Jochen Flasbarth
State Secretary
at the Federal Ministry
for the Environment,
Nature Conservation
and Nuclear Safety

Dr. Jörg Kukies
State Secretary
at the Federal Ministry
of Finance

Dr. Ulrich Nußbaum
State Secretary
at the Federal Ministry
for Economic Affairs
and Energy

Foreword by the **Sustainable Finance Committee**

A successful economy needs a financial system that is sustainable and hence fit for the future. To ensure our competitiveness, we need to finance the transformation of the economy: positioning us well in tomorrow's global market while being compatible with the 1.5°C target of the Paris Agreement and the United Nations' 17 Sustainable Development Goals.

The Sustainable Finance Committee (SFC) has taken a holistic approach to the financial system in its 31 ambitious recommendations. Our goal is to make the financial system sustainable and thereby future-proof.

We would like to extend our sincere gratitude to all of the members of the SFC who, despite the Covid-19 pandemic, worked tirelessly on the report in countless meetings and video conferences. Along with their expertise, they contributed a considerable amount of their time and a great deal of passion to achieving results, and in the process built many bridges. Given the many different perspectives and conflicting opinions within the SFC, compromises were sometimes necessary to reach a consensus. Although not all the SFC members will find their views reflected in all of the recommendations, we never lost sight of the goal of driving forward sustainable finance in Germany.

We would also like to thank the observers who became actively involved in the process, and whose knowledge the SFC was able to lean on time and again.

A special thank you goes to the SFC's secretariat, whose calm and efficient coordination of all of the processes and different topics ensured that the SFC could carry out its complex work effectively.

Thank you to all the ministries involved for their support over the last 1 ½ years and for their always valuable assistance.

We urge all policy-makers to take on board these recommendations, which are based on practical experience, and implement them without delay. This report can mark a major turning point on the road to Germany becoming a leading location for sustainable finance.

Thank you for the trust you placed in us and for the always stimulating discussions. We wish you an inspiring read!

Karsten Löffler
Chair of the SFC

Kristina Jeromin
Deputy Chair of the SFC

Shifting the Trillions – A sustainable financial system for the great transformation

The German economy is in the midst of a process of fundamental transformation due to the changing imperatives triggered by the climate crisis, digital technology and globalisation.

Major investments are necessary in order to future-proof production methods and business models and to ensure that Germany benefits from the opportunities that sustainable development offers. The financial sector has a crucial role to play here, because it has to mobilise the funds that are needed to achieve the great transformation. Sustainable finance aims to activate all market forces to ensure the efficient allocation of capital in combination with a robust risk management system.

Our current financial system performs this task inadequately. To ensure that the financial system takes systematic account of sustainability criteria, Germany needs to implement flagship projects and make extensive adjustments to legislative frameworks.

Against this background, the State Secretaries' Committee for Sustainable Development decided on 25 February 2019 to develop a national Sustainable Finance Strategy. To this end, the German government established the Sustainable Finance Committee – which is made up of 38 members from the financial sector, the real economy, academia and civil society – and tasked it with formulating recommendations that would feed into the strategy.

The Committee's recommendations are presented in this report, which urges the financial sector, the real economy and government to collaborate closely in order to advance the transformation. Academia guides the process by putting the transformation of the financial and economic system into empirical terms on the basis of verifiable facts and effective methodologies. Civil society provides important input and promotes the necessary public discourse about potential trade-offs and conflicts of interest.

To become a leading centre for sustainable finance, Germany must base its actions on reliable benchmarks and guidelines. For all of the Committee's recommendations, these are: the 1.5° target set out in the Paris Climate Agreement, the Sustainable Development Goals that form part of the UN's 2030 Agenda for Sustainable Development, and the UN's Guiding Principles on Business and Human Rights.

The recommendations focus on five main priorities:

1. A reliable national and European policy framework that lays a coherent groundwork for promoting sustainability in the financial sector and real economy
2. Integrated and forward-looking company reporting that ensures transparency and comparability, which in turn provide a basis for sustainable investment decisions and comprehensive risk management
3. Research and systematic knowledge-building with a particular focus on the changing skills and expertise that are needed among the people who are responsible for regulation, for the management and supervision of companies, for providing financial consulting services, and in the public sphere in general
4. Sustainable financial products that satisfy growing investor demand
5. Consolidating sustainable finance by building up institutional capacities that can provide continuous monitoring and guidance during the transformation process

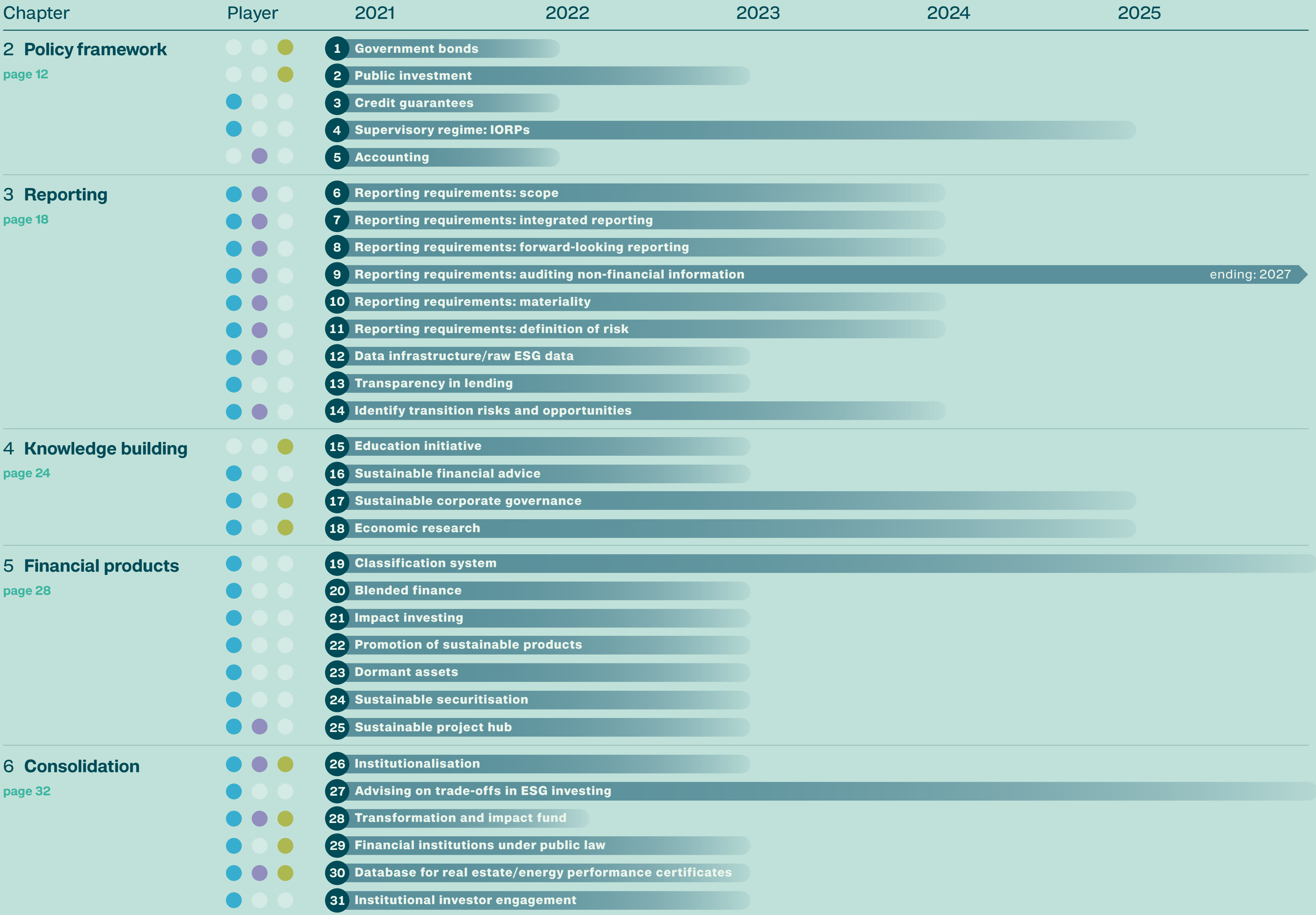
The Committee's recommendations lay out practical, forward-looking approaches that will help the German government formulate its planned Sustainable Finance Strategy. The Committee welcomes the government's plans to unveil the strategy in the first half of 2021.

The Committee states that its proposals pertaining to company reporting and information infrastructure (chapter 3) have a particularly important role to play in advancing sustainable finance and recommends that these proposals be given priority in terms of the timing of implementation. It identifies the greening of government bonds as a particularly effective instrument (chapter 2) and also recommends the swift implementation of measures to promote the greening of public investment (chapter 2) and to institutionalise sustainable finance (chapter 6).

The permanent and systematic incorporation of sustainability criteria within the financial system will require comprehensive efforts. These efforts cannot be restricted to Germany but need to be embedded within the context of European and international developments.

Now is the time to lay the groundwork for making Germany a leading centre for sustainable finance. The recommendations presented in this report are an important start. Our agenda is ambitious and must be implemented swiftly and resolutely during the current legislative period and beyond.

The Sustainable Finance Committee's Recommendations



Key players responsible for implementing the recommendations: **Financial Sector** **Real Economy** **Government** | **Scientists** and **civil-society** accompany and support the process

The Sustainable Finance Committee of the German Federal Government

31

— 2021 —

Recommendations

1 Sustainable finance as the key to the great transformation

The Sustainable Finance Committee's report uses the term "transformation" in the sense of the "Great Transformation". It refers to a "comprehensive restructuring of technology, economy and society in order to cope with the social and environmental challenges of the 21st century." (Wuppertal Institute for Climate, Environment, Energy, 2018). The main report of the German Advisory Council on Global Change (German abbreviation WBGU) "World in Transition – Social Contract for a Major Transformation" already referred to the term as a central leitmotif in 2011.

The following recommendations address the economic, environmental and social requirements of the transformation in equal measure. The Paris Climate Agreement, the 17 Sustainable Development Goals (SDGs) and the United Nations Guiding Principles on Business and Human Rights (UNGP) are the guiding principles for all recommendations.

Key elements of this transformation include:

1

Using science to establish objective standards and balance interests

2

Providing reliable procedural guidance for the goals and measures derived from them

3

A systemic approach

4

A stronger weighting of structural knowledge, future issues, forecasts and scenarios in decision-making processes

5

A fair distribution of opportunities and risks between business and society

The transformation of all economic and social sectors in line with social, economic and environmental sustainability requirements is the principal task of our time. The United Nations has addressed this global challenge in two key agreements: the Sustainable Development Goals (SDGs) of the 2030 Agenda and the Paris Agreement. Both are fundamental guidelines for action for Germany.

Germany has committed itself under international law to implementing the goals of the Paris Agreement. Germany also intends to make a significant contribution to the implementation of the goals of the European Green Deal to achieve climate neutrality in the EU by 2050, to establish an efficient circular economy, and to protect **biodiversity.**

The World Economic Forum's 2021 World Risk Report underscores the urgency of decisive action: According to the WEF, six of the ten most important risks of our time are **sustainability risks.**[1] Dealing with this issue requires more than just a partial rethink in individual sectors of the economy. What is needed is concerted action in the spirit of the "Great Transformation".

1 Cf. The Global Risks Report 2021, 16th Edition, p. 12 https://www.weforum.org/global-risks/reports.

[1] Global Risk Landscape 2021: Top Risks by Impact:

1. Infectious diseases
2. Climate action failure
3. Weapons of mass destruction
4. Biodiversity loss
5. Natural resource crises
6. Human environmental damage
7. Livelihood crises
8. Extreme weather
9. Debt crises
10. IT infrastructure breakdown

Sustainable finance in the framework of an environmental-social market economy

The transformation of the economy requires a stable political framework which takes into account the special characteristics of Germany as a place to do business. These include strong, sustainable industrial production, a clear focus on small and medium-sized enterprises, a competitive innovation landscape, and a sustainable financial sector with an effective promotional banking sector. Further development of the successful model of the social market economy requires long-term, environmentally responsible action. This is the stable foundation from which national and international sustainability goals can be achieved in cooperation with all social groups.

Germany's innovative power and position as a leading exporter give it the potential to launch key technologies and resilient business models. These qualities are enhanced by farsighted regulatory guidance, forward-looking incentive schemes, and reliable means for measuring progress.

Public acceptance of the transformation can be ensured only if the transition to new forms of economic activity and job security is organised in a socially responsible manner, and only if its promise of prosperity keeps in mind the interests of both present and future generations, while also taking into account the limits of the planet's resources.

Biodiversity is defined as the variability among living organisms of any origin. This includes the diversity of species and of ecosystems. In 2019, the Global Assessment Report by the Intergovernmental Science Policy Platform on Biodiversity and Ecosystem Services (IPBES) warned: The biodiversity, quality, and regenerative capacity of ecosystem services, which are key to the survival of humankind, are deteriorating dramatically.

Previous programmes on sustainable finance addressed conservation of biodiversity only in rudimentary form. The Dutch Central Bank (DNB) has estimated the financial-system risks of neglecting biodiversity at €510 billion and stressed the impact of the financial system on biodiversity. No comparable analysis is yet available for Germany.

Investing for the future

On the basis of the above, the Sustainable Finance Committee (SFC) makes the following recommendations to the German government for redirecting financial flows into sustainable investments: from the sustainable renewal of existing infrastructures to the development and expansion of urgently needed emerging technologies, to the restructuring of value chains which are problematic from an environmental or human-rights perspective.

The financial sector has a leveraging effect in accelerating the science-based transition towards climate-neutral, resource-efficient, and socially responsible economic activity. To finance the objectives of the European Green Deal, investments of at least €1 trillion will need to be mobilised across Europe by 2030.

The German government intends to transform the country into a leading location for sustainable finance. The Sustainable Finance Committee believes that, to achieve this, it is necessary to give greater weight to long-term sustainability requirements compared to short-term decisions, and to introduce additional instruments for a forward-looking risk assessment. The aim is to go beyond simply meeting national commitments under the Paris Agreement and 2030 Agenda. The goal is to ensure that Germany actively drives forward the Great Transformation in close consultation with its European and international partners.

The key role of the private sector

On its path to sustainability by 2050, the German government has the strategic opportunity to put forward its own ideas and contributions and act as a driving force in shaping the European Green Deal and the European Sustainable Finance Strategy. This requires open markets which do not favour any particular technology while remaining rooted in sound science and geared towards transformation. This is because financing and successfully implementing the transformation will depend to a large extent on the private sector. Market incentives and due diligence must be designed in such a way as to price in the long-term social and environmental impacts of business activities and giving them greater weight in decision-making.

New transparency requirements

Sustainable financial management makes forward-looking decisions on the basis of appropriate financing and investment criteria. This makes it a driver of transformation. Fundamental to this is the availability of meaningful information for all market players. In addition, we need instruments that will ensure that we can reliably assess what has been achieved now and in relation to our targets.

The current practice whereby corporate reporting generally focuses on the past must be expanded to include elements addressing the future. This includes reliable outlooks on milestones, medium- and long-term strategies and implementation pathways which go beyond mere descriptions of the status quo and short-term objectives. The more reliably potential transitory, social and physical opportunities and risks are factored into decision-making, the more resilient the financial and real economy will become. This requires comparable data and reporting formats, coherent methodologies, and the use of forward-looking scenarios.

Consistent action

The recommendations of the present report are primarily addressed to Germany's federal government, both in its role in taking part in creating EU legislation, and as the player responsible for forging the framework needed for the transformation within Germany. Nevertheless, the transformation will require joint action by all stakeholders in the real economy, the financial sector, academia, and civil society. Financial market stability and economic prosperity depend crucially on our long-term ability to reconcile entrepreneurial growth with the protection of our natural resources, ecoystems and decent working conditions. More and more companies are recognising the opportunities that this offers for profitable growth and sustainable jobs.

Functioning risk-based supervision systems and a broad consideration of ecosystem services in pricing mechanisms are indispensable for the success of this project. The following recommendations, therefore, are not solely aimed at the niche market of impact-oriented investors. Rather, they pursue a strategy of making sustainability mainstream that aims to embed sustainability in the breadth of the market and provide all stakeholders with a high level of guidance and reliability.

Different perspectives in the real and financial economy must be taken into account, along with the special concerns of small and medium-sized enterprises. The SFC's aim is to reconcile, on the one hand, financial industry stakeholders' justified interest in the widest possible availability and transparency of data with the equally justified demands by many stakeholders of the real economy on the other hand, who ask for reliability and a sense of proportion when additional regulations and increased reporting requirements are introduced.

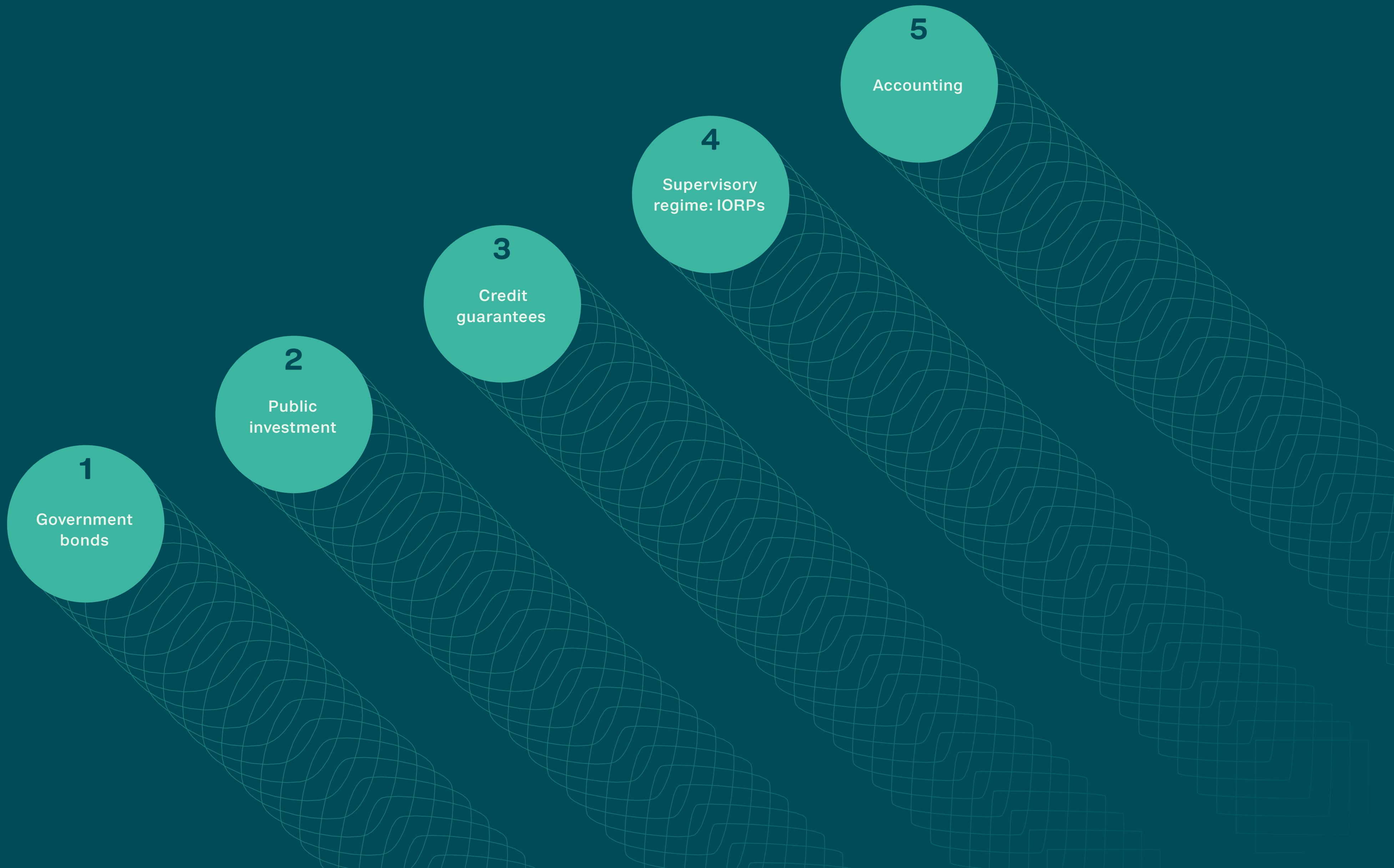
If Germany is to become a leader in sustainable finance, it is key that all stakeholders interact and cooperate within a coherent framework:

- With financial reporting which allows for the systematic account and comparison of forward-looking environmental, social, and governance criteria as fundamental opportunity and risk indicators
- With minimum requirements which provide reliability and guidance in the measurement, validation, and classification of raw sustainability data
- With a system infrastructure which provides all information relevant to investment or financing decisions in a reliable manner

This final report by the SFC divides the 31 recommendations for action into the next five chapters:

1. **Reliable policy framework**
2. **Forward-looking integrated reporting**
3. **Systematic knowledge building**
4. **Financial products with an impact on sustainability**
5. **Consolidating Sustainable Finance**

2 Reliable policy framework



A sustainable transformation requires a reliable political framework in Germany and at the European level.

Implementation in line with the goals of the Paris Agreement, the Sustainable Development Goals of the 2030 Agenda, and the European Green Deal requires a coherent policy strategy, as expressed, for example, by the establishment of the German government's climate cabinet. Further steps are needed – in particular, systematic and structural integration into the financial system. A sustainability strategy for the financial system designed at the European and national levels should permit objectives, implementation pathways, and measures to be coordinated between key players during implementation and evaluated continuously. These players are:

1. **The political sphere** with its many roles, including public financing
2. Companies in the **real economy**
3. **Financial sector** players

Scientists and **civil-society** groups should accompany the process throughout with their expertise. The successful transformation of the financial sector will require a scientific foundation and broad social acceptance.

Consistent action

Political decisions, regulatory frameworks, and smart incentives could encourage markets, consumer choices, innovations and market initiatives to orient themselves towards sustainability. To achieve this, policy-makers must make use of interdepartmental steering options, both at the federal level, including subordinate authorities and institutions, and at the local level, where this should be done via federal cooperation at the *Land* and local-authority level. In implementing the mandate, the German government and its subordinate authorities, such as the Federal Financial Supervisory Authority (BaFin) and the Federal Environment Agency *(Umweltbundesamt)*, should also bring their policy goals to bear within European and international bodies and supervisory authorities (such as the EIB, AIIB, EBRD, BIS, ESAs, EEA) and in international development cooperation. This includes designing corporate governance guidelines and oversight regulations in such a way as to systematically reflect sustainability-related risks and opportunities, and strengthen decisions geared to long-term needs. This approach must be adequately reflected in the development of capacities within the decision-making, management, and supervisory bodies of enterprises of the real economy and financial sector.

The public sector as a role model

As a stakeholder in the financial market and by virtue of its role in determining the policy, management, and investment of public funds, the public sector has a key function in guiding the markets and setting an example. As part of the Paris Agreement on climate change, the German government has committed itself to making financial flows consistent with a pathway towards continuous emission reductions and increasing resilience to climate-related risks[1]. Public authorities at federal, *Land* and local-authority levels should align their actions in such a way as to help achieve the overarching sustainability goals. In this, they should take into account any conflicts between different dimensions of the goals and reconcile those differences in a process that involves the respective stakeholders.

The public sector's function as a role model is based on its responsibility for

- Direct capital management and investment (investment criteria, investment strategies)
- Raising capital (including by issuances)
- Incentives for the provision and mobilisation of capital and the assumption of risk (hedges, guarantees, incentive schemes)[2]
- Creating frameworks for subordinate institutions, including KfW and institutions established by public law
- The establishment of criteria and conditions for export promotion and protection
- Safeguarding financial market stability

Fiscal policy and monitoring of financial flows

If consistent policy is to function as a guiding principle, it must include other areas of policy which have a decisive impact on a sustainable transformation, such as fiscal policy, research funding, and the design of funding programmes. This is a challenge for the public sector:

- To record the compatibility of capital flows in Germany and the EU with the Paris Agreement in an annual monitoring report. This report could be based on the monitoring model used by the Bundesbank to map the financial flows of German players and financial flows in Germany
- To ensure that all public sector financial commitments are compatible with the UN Guiding Principles on Business and Human Rights
- To provide consistent incentives linked to specific goals in federal tax policy and internalize externalities in costs
- To carefully consider the implementation of sustainability requirements in the development of federal and *Land* budgets and to make this transparent

1 Set out in Article 2.1 c of the Paris Agreement

2 While maintaining or adapting budgetary prerequisites for hedges and guarantees

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- To push for research funding oriented towards the implementation of the Paris climate goals and the SDGs of the 2030 Agenda

- To coordinate the initiation of development programmes within the federal framework to provide funds for the transformation of the real economy (especially in shaping the policies of promotional banks)

The following recommendations by the SFC are intended to guide political decisions across government departments towards expanding the volume of projects and schemes that can be financed in such a way as to keep pace with the growing interest in sustainable investments and financing.

1 Government bonds

The state has an important role to play in funding, setting the conditions, and acting as a role model. The state's policy framework must be in line with the EU Green Bond Standards that is likely to be adopted. The German government should work towards complementing these environmental standards by developing additional social and governance criteria. Federal spending should demonstrably align with the objectives of the Paris Agreement. This fact should be illustrated by concrete references to "milestones" and transformation pathways in local-authority, regional, and national economic activities.

The SFC recommends that the federal government and the *Länder:*

- **Set a climate target for federal and *Land* budgets, expressed as a percentage of climate protection investments in total expenditures (recommended starting point: 40%)**

- **Perform monitoring and annual reporting of climate protection investments from the budget using a climate tracking approach derived from the EU Taxonomy Regulation. The German government's planned climate reporting should be reviewed in this context for its compatibility and compliance with its climate targets**

- **Extend monitoring and reporting on the implementation of the goals from the European Green Deal and the SDGs**

  With a sustainable emissions strategy and the necessary budgetary policy and reporting practices, the public sector can send an effective signal to other market participants. The SFC also considers it necessary to use the existing federal-*Land* working group of finance ministries (with the possible participation of development agencies) to further develop existing frameworks and coordinate them within the federal framework.

In the interest of coherent European policy, the SFC recommends that the German government actively advocate the following at EU level:

- **An ambitious implementation of the EU Green Bond Standards and their further development in line with the EU taxonomy; the German government should contribute to market development in the area of social bonds**

- **The review of the involvement in the European Semester, in particular in the Budgetary Surveillance and in the monitoring of the implementation of the national energy and climate plans in the framework of the EU Energy Union-Governance**

2 Public investment

Like any form of investment, the investment of the federal government's and *Länder's* special funds, such as the federal government's pension reserve, is, like any form of investment, exposed to long-term sustainability risks or has sustainability-related effects. These must be systematically identified and evaluated so they may be properly taken into account in investment decisions. Conversely, without a firm grasp of the environmental and social impacts of the relevant portfolios, it is impossible to influence the course of sustainable development. The investment policy of the federal and *Land* governments is not yet contributing to achieving the goals of the German Sustainable Development Strategy, the Paris Agreement or the European Green Deal. An adjustment of the standards, methods and instruments currently implemented and used by the federal government and the *Länder* is therefore necessary, especially as a signal to other mar-

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ket participants. The SFC sees an immediate need for action in that the approaches of the federal government and the *Länder*[3] need to be better coordinated and in that the state must articulate more clearly how it sees itself as an active investor.

The SFC recommends that the federal government:

- Develop an ambitious strategy for the investment policy of the above-mentioned special funds, but at the very least, of the following[4]:

  - Federal Pension Reserve
  - Federal Pension Fund
  - Pension Fund of the Federal Employment Agency
  - Long-term Care Social Insurance Fund

  The mandatory application of sustainability criteria supplements requirements for the applicable asset liability management. The strategic decision-making process with regard to investment strategies of the federal government, *Länder* and local authorities should be accompanied by a corresponding institutionalisation[5]. In particular, an interdepartmental expert unit should be set up at a suitable position in either the German Ministry of Finance or in the German Ministry of Interior, Building and Community to coordinate the administration of the investments from a single source on behalf of the federal government. The investment strategy should meet the following minimum criteria:

  - Compatibility with the climate goals of the Paris Agreement, the climate and environmental goals of the EU Green Deal, the UN Guiding Principles on Business and Human Rights and the implementation of the 2030 Agenda as based on human rights

  - Integration of an engagement strategy[6] including annual disclosure of all relevant activities. Engagement can be exercised in dialogue with invested companies and via proxy voting

  - Amendment of the Civil Service Pension Reserve Act *(Versorgungsrücklagegesetz)* to include sustainability as an investment principle

  - Disclosure of the sustainability profile of the portfolios[7] on the basis of robust and forward-looking key indicators, such as businesses' greenhouse gas footprint and their impact on the temperature rise, as well as the use of standards and procedures, such as the Net-Zero Asset Owner Alliance, or the Principles for Responsible Investment (PRI).

The German government should maintain a website which continuously reports on the further development of its investment strategy and its impact and which compares them with other European and international approaches. The website should include reporting on the extent to which the objectives of the investment strategy have been achieved. All other government agencies – including within the federal framework – should be encouraged to strive for a comparable level of reporting.

With regard to the Civil Service Pension Reserve Act and the implementation of the strategy by the Bundesbank, the SFC also recommends:

- The revision of the investment principles on the basis of the Sustainable and Responsible Investment Guide of the Network for Greening the Financial System (NGFS)

- Enabling the interdepartmental investment committee to benchmark investment principles in a way which aligns with leading countries on the international stage. This may include analyses and comparisons with progress in implementation by other government stakeholders in Europe

- Reviewing and, where possible, expanding the allowable asset categories in the Civil Service Pension Reserve Act beyond bonds and stocks, taking into account the current passive asset management approach

3 Credit guarantees

As an instrument of economic development, foreign trade promotion is an important lever of successful transformation. It should therefore be expanded to include additional sustainability-related aspects. This includes:

- The adjustment of credit and export guarantees compatible with the Paris Agreement

- The assumption of guarantees and liability waivers[8] in connection with loans for the financing of transformation projects abroad (as an extension of the existing instrument of untied financial loans)

3 More intensive efforts are already being made at the level of the *Länder* and in individual investment vehicles of the federal government, such as the German Nuclear Waste Disposal Fund.

4 The strategy should also include real estate assets via the Institute for Federal Real Estate *(Bundesanstalt für Immobilienaufgaben)* in relation to the real assets managed there, e.g., real estate and its decarbonisation requirements.

5 Active participation in exchange, especially in international forums and formats, is also advised.

6 Cf. Recommendations regarding the Engagement Platform, Stewardship Code, etc. in this report.

7 Cf. the Bank of England's set of indicators. The Bank of England's climate-related financial disclosure 2020; cf. https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2020/climate-related-financial-disclosure-report-2019-20.pdf

8 Within the framework of an instrument to be redesigned under the name "Climate UFLs".

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The alignment of the federal government's foreign trade promotion with Paris climate goals and SDGs should be reviewed in forward-looking procedures, which should be developed and implemented for this purpose as soon as possible. This also requires action at OECD level and when granting export credit guarantees. Conversely, this also means that no guarantees will be given for projects which run counter to the above objectives.

For implementation purposes, the composition of the Interministerial Committee (IMC) should be expanded to include the German Ministry for the Environment, Nature Conservation and Nuclear Safety as the fifth member of the IMC.

To accompany this, the SFC recommends:

- Developing a robust strategy to manage stakeholder engagement. This should be done on two levels:
  - At the national level, the German government should develop a dialogue with industry and with exporting sectors on how the promotion of climate-friendly products and solutions can be effectively organised
  - At an international level, the German government should drive an increase in demand for products with particular sustainability benefits in purchasing countries, and should urge other export credit agencies to do the same. Further, it should urge the EU to transfer European targets for compliance with the Paris Agreement, which will apply from 2030, to the level of the OECD. This would mean the exclusion of any coverage for exports which are incompatible with the above objectives

Stakeholder-specific and cross-sector recommendation:

In Germany, it has become apparent in the recent past that participants in the financial system are setting different goals and implementing different measures to achieve a sustainable transformation. To ensure a coherent approach among public sector players, public-sector banks, insurance companies, KfW, Deka Bank, Euler Hermes Kreditversicherung, etc. should, at least, be called upon to sign the German financial sector's voluntary commitment or to join corresponding national and international initiatives – unless they have are already entered equivalent voluntary commitments. By doing so, these institutions and companies can document the alignment of their business policies with the Paris climate goals and (if applicable) with more far-reaching goals, and show that they are willing to actively develop them further, implement them at the operational level, and disclose what actions they have taken. They must report on the achievement of their objectives. Some banks at the *Land* level have already set a good example in this respect.

The role of public financial institutions in the context of institutional consolidation of the impact of sustainable finance is addressed later in Chapter 6 of this report.

Effective energy and sustainability policy

To make sure that environmental and social costs are included as "externalities" in investment, production and consumption decisions, market mechanisms and regulatory frameworks are needed. Instruments such as carbon pricing, energy taxation, and standards for products and efficiency, as well as law regulating the supply chain which would hold German businesses liable for offences by their suppliers, could ensure that product prices will reflect social and environmental costs. This helps to ensure that sustainable investment, production, and consumption decisions also pay off economically. To this end, sustainably produced goods must become more competitive – for example by providing information and involving market participants –, while obstacles to making more sustainable decisions should be removed.

The SFC recommends that the federal government:

- **Support the competitiveness of investments in transition technologies by using contracts for differences as a national hedge against price developments in CO_2 and renewable technologies. For capital-intensive investments, especially in industry and in the energy sector, it is critical to include future carbon costs in addition to current costs. This is associated with considerable uncertainties regarding future regulatory and price developments.**

  In the context of carbon pricing, one oft-cited concern is the danger of domestic companies falling behind less ambitious players in global markets, or migrating. These relocations of industrial production would mean that emissions are merely shifted, not reduced. To counteract this effect, some CO_2 certificates have so far been issued free of charge. However, the free allowances, along with imported goods whose price does not reflect CO_2 costs, mean that only part of the CO_2 costs are included in product prices. Current reform efforts at the EU level aim at strengthening the effectiveness of the carbon price signal. This is to be done through a European border adjustment mechanism. In particular, the option of a supplementary climate surcharge on imported goods is not yet being discussed with sufficient clarity. Furthermore, the research and commercialisation of sustainable technologies and business models need to be promoted more extensively. This is particularly true under

conditions of highly fragmented value chains, limited effectiveness of patents, and high capital intensity. This highlights the limitations of the model of effective carbon pricing. On its own, this instrument does not create sufficient framework that can allow for a rapid transition to new production technologies. A policy framework which also turns environmental and social sustainability into an economic growth driver can emerge only with a combination of interventions intended to guide and regulate, of incentive systems, of changed consumer behaviour, and of good competitive opportunities.

4 Supervisory regime: IORPs

As pension funds or pension systems, Institutions for Occupational Retirement Provision (IORPs), are long-term investors with low liquidity and lapse risks. This predestines them to choose long-term and more illiquid forms of investment on the asset side and to hold these positions irrespective of temporary market price risks. Regulatory requirements at the national level currently stand in the way of this. Current requirements for pension funds demand that they guarantee coverage of liabilities by assets at every logical second. The coverage requirements do not take into account the settlement period of the contracts.

The investment list of the Investment Regulation, in conjunction with ordinances on mixing and spreading investments, establishes a framework for the pension funds' investments. Newer investment opportunities such as infrastructure investments, which are becoming important in the context of financing the transformation, are not included as an independent asset class. Instead, they are allocated to an investment type as defined by of the Investment Regulation and thus count towards the mixing ratio applicable to this investment type, irrespective of their risk content. Thus supervisory provisions induce competition between assets for the same mixing ratio, which limits the volume of long-term investments that could support the transformation.

While Basel III and Solvency II require supervisory harmonisation at EU level, the IORP II Directive, taking into account the different structures of occupational pensions across the EU and the role of national labour and social law, merely sets EU minimum requirements. This creates legislative leeway which can be used to adapt coverage requirements for pension funds in favour of a longer-term orientation.

The SFC recommends that the federal government:

- **Examine the extent to which there is scope to**
  - **Not gear supervisory coverage requirements to a specific reporting date, but rather base them on the execution time and the disbursement dates of the contracts spread over decades**
  - **Extend the Investment Regulation's investment catalogue to include specific asset classes whose investment limits should reflect the actual risk content**
  - **Use the investment list in conjunction with specific investment limits as a basis for specific investment risks within the relevant stress test (to be defined in more detail by BaFin)**
  - **Shift the focus of the stress test, in the sense of a changed coverage requirement, from market price risks to credit default and counterparty risks**

5 Accounting

Banking regulation is aimed at reducing risks to financial stability. In practice, the monitoring horizon usually does not extend beyond one to three years. This is too short a period to take into account, for example, risks resulting from climate change, or the failure to account for transformation requirements. A long-term view of risk must therefore be integrated into the supervisory processes.

Under the IFRS 9 international financial reporting standards, sustainable instruments are subject to fair value measurement as soon as criteria are used which are not linked to creditworthiness. In practice, credit institutions experience an increase in the cost of loans linked to a company's sustainability performance. While the IFRS permits the use of credit ratings for an at-cost valuation, this is permitted only for factors outside the firm's control, which also includes ESG-relevant criteria. However, the borrowing firm has control over ESG metrics, for example by being able to actively manage its own emissions. Accordingly, ESG metrics should be applied on a par with creditworthiness criteria in all financial market products – not as a substitute for another fully applicable credit assessment, but as a factor that has a neutral impact on the lender's capital cost.

The SFC recommends that the federal government:

- **Adjust legal provisions to eliminate an unintended increase in the cost of sustainable financing as a result of assets having higher risk-weighting. An amendment to IFRS 9 can only be achieved at the global level. For this reason, the German government should lobby in Europe and at the international level for relevant changes – whether within the IASB, the body of international accounting experts, or in the EU's Economic and Financial Affairs Council (ECOFIN).**

3 Forward-looking integrated reporting

6 Reporting requirements: scope

7 Reporting requirements: integrated reporting

8 Reporting requirements: forward-looking reporting

9 Reporting requirements: auditing non-financial information

10 Reporting requirements: materiality

11 Reporting requirements: definition of risk

12 Data infrastructure/ raw ESG data

13 Transparency in lending

14 Identify transition risks and opportunities

To date, corporate reporting has focused on information about past events and the status quo. Even the forecast section within the management report provides only a small part of the information relevant to investors.

To be able to assess the potential for transformation, more attention must be paid to opportunities and risks which lie in the future. This is why forward-looking ESG aspects must be added to the standard set of corporate indicators and combined within an integrated reporting system. Only this approach can foster investment and financing decisions which integrate economic, environmental, and social concerns. Forward-looking reporting and scenario analyses contribute to risk management and corporate resilience. In line with the principle of double materiality,[1] the impact of ESG issues on the reporting company should be considered alongside the impact made by the reporting company –, i.e. the impact that its products, services and business relations has – on the environment and on society.

This approach to reporting enables methodologically sound impact measurements, which in turn allow comparable conclusions concerning the sustainability performance of portfolios, companies, and individual products. This reporting practice allows financial market players to identify which companies are following the transformation path towards achieving the Paris climate goals and the sustainable development goals of the 2030 Agenda, thereby increasing their own resilience and competitiveness. Even the form of reporting of sustainability information can help to systematically improve internal company procedures and processes.[2]

1 "Relevance" and "materiality" are used interchangeably. For more information, see the glossary.

Status quo and regulatory framework

In larger companies in the real and financial economy, reporting sustainability information is often common practice. The starting point here is usually the voluntary application of various standards, mostly international, such as those of the Global Reporting Initiative (GRI), the UN Global Compact (UNGC) or the Greenhouse Gas (GHG) Protocol and others. However, the information has rarely included forward-looking statements, in part because the relevant concepts and standards for recording and analysing them have been developed only in the recent past.

For some years now, there have been legal requirements for so-called "non-financial reporting"[3]. Based on the Non-Financial Reporting Directive, or NFRD,[4] the NFRD Implementing Act has been in force in Germany since 2017. The NFRD Implementing Act introduced relevant reporting requirements into the legislation on commercial balance sheets for capital market-oriented companies, banks, and insurance companies which are defined as "large" by accounting standards, and which have more than 500 employees. In Germany, this rule affects only a minority of companies. It makes sense to extend the reporting obligation to medium-sized and non-capital-

2 Cf. Eccles, Robert G., Ioannou, Ioannis, and Serafeim, George: Management Science 2014 60:11, pp. 2835 - 2857.

3 The concept of non-financial indices established in legislation is proving inadequate. It negates the value that this type of information contributes to assessing the financial success of a company or project. This is why the term extra-financial information is often used in academic discussions. The Sustainable Finance Committee (SFC) suggests replacing the term non-financial information with another more appropriate term and, in the following, will use "non-financial" only in quotation marks. (cf. Bauer et al. 2007).

4 EU Directive 2014/95/EU, Amendment of Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups. (Text with European Economic Area (EEA) relevance), better known as NFRD: EU Non-Financial Reporting Directive; implemented in Germany by means of the NFRD Implementing Act. A European Commission legislative proposal, currently under review, is expected in the first quarter of 2021.

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market-oriented companies because of the high value added they provide and because of the importance of external financing. This would make relevant "non-financial information" more widely available to the financial market. It would also make it easier for reporting companies to access financing to realize their transformation potential.

Under the current Commercial Code *(Handelsgesetzbuch)*, the non-financial statement can be published either as a separate report or in different forms in the management report. The result is a multitude of forms for such reports, with varying depth and quality.

Important reference points in this regard are provided by the framework for integrated reporting of the International Integrated Reporting Council (IIRC), the recommendations of the FSB Task Force on Climate-related Financial Disclosures (TCFD) and the UN Guiding Principles on Business and Human Rights. The focus here is on structurally harmonised reporting regarding medium- and long-term climate risks and on reporting regarding due diligence requirements for compliance with human rights. However, voluntary and non-standardised implementation of the TCFD recommendations does not generate data that is in itself comparable; furthermore, the implementation of the guidance framework for reporting also varies considerably between companies. This makes it difficult for third parties and regulators to use the reported information for comparative purposes during risk analysis and funding decisions, or as part of a supervisory mandate. We propose changes in reporting standards for medium-sized companies. For German small and medium-sized enterprises (SMEs), the German Sustainability Code has become the standard.

Core reporting requirements

The SFC has identified four core requirements for forward-looking and integrated reporting:

Forward-looking orientation

"Non-financial reporting" should be forward-looking and reflect material medium- and long-term impact on and by the company. In this way, such reporting helps to ensure that investors and other capital providers can deploy capital in such a way as to allow their investment to contribute to the achievement of their economic, social and environmental goals.

Comparability

Effective reporting should enable and facilitate comparative assessment and classification over time and across different companies. This also includes alignment with the long-term goals which a company has set for itself.

Double materiality

In addition to the availability and comparability of information, its double materiality is a decisive criterion. Up to now, the preferred approach has been to report on the impact that external factors make on the company (this is known as the outside-in perspective). In future, the positive as well as negative consequences that corporate activities have for society and the environment (the inside-out perspective) should be taken into account in financial reporting in order to satisfy the increased interest of investors in such information.

Information needs of different stakeholders

In addition to financial market participants, other stakeholders in civil society and academia are increasingly interested in robust corporate information: they wish not only to understand the course of business and its results, but are also demanding information about the social and environmental impacts of a company's operations.

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The following recommendations are intended to promote consistent reporting that is geared towards the target groups' information needs.

6 Reporting requirements: scope

The scope of application of existing reporting requirements is based on primarily on a firm's size or legal form. Some companies which are very important for the reduction of greenhouse gas emissions and the sustainable transformation have not been considered.

The SFC recommends that the federal government:

- Support, at the EU level, an extension of the reporting regulations to all companies with 250 or more employees, regardless of their form of financing

In addition, the SFC recommends that the federal government:

- As part of the revision of the NFRD, work towards the inclusion of small and medium-sized enterprises (as defined under accounting standards) which are relevant to sustainable transformation. Support structures for small and medium-sized enterprises should be put in place via a legislative proposal to amend the Commercial Code

7 Reporting requirements: integrated reporting

Since companies are free to choose where to provide the non-financial statement, it often does not appear in the management report. This hinders the transparent presentation with regard the business model, the risks, and the importance that the "non-financial" aspects have for the economic situation.

The SFC recommends that the federal government:

- Advocate a uniform requirement to report on material sustainability data within the management report and to introduce it into the NFRD revision process at EU level

8 Reporting requirements: forward-looking reporting

Binding forward-looking climate reporting requirements should be based on the TCFD framework and its further development. They require additional specification with regard to the comparable application of scenario analyses, which are aligned with overarching policy goals and which reveal transformation paths at the company level. Companies should assess internal risks and opportunities of their own projects, investments, and business models and then report on the findings in a standardised manner based on common analytical principles. If companies contribute to the creation of an adequate store of information, financial market participants and auditors will be able to assess the impact of climate and sustainability risks, as well as the impact of companies on climate change, the environment and society. This relates primarily to transition and litigation risks, in addition to physical risks.

The SFC recommends that the federal government as a player at the European level, should press for:

- Implementation of mandatory forward-looking reporting requirements under the TCFD framework for companies with over 250 employees (pursuant to the comply-or-explain principle), from the 2022 financial year onwards
- Further specification of mandatory reporting in accordance with the TCFD with regard to scenario analyses
- Implementation of standardised risk reporting
- Consideration of double materiality
- Further development of scenarios based on the other wider objectives of the European Green Deal (i.e., on the circular economy and biodiversity) and related extensions of reporting requirements

9 Reporting requirements: auditing non-financial information

ESG information is not yet as robust and reliable as traditional financial information. This compromises the quality and transparency of reporting and thus detracts from investors' willingness and ability to finance the transformation to sustainable ways of doing business and the establishment of resilient business models.

The SFC recommends that the federal government:

- Gradually introduce an obligation to audit "non-financial information" in management reports and to campaign for such an obligation at the EU level
- Work towards strengthen international ESG auditing standards

The SFC recommends that the Government Commission on the German Corporate Governance Code:

- Make clarifying additions to existing corporate governance requirements to include sustainability aspects, so as to improve the reliability of "non-financial information"

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10 Reporting requirements: materiality

Companies have leeway in determining materiality. This can result in necessary transformation processes not being properly identified, initiated, and implemented. The heterogeneity in corporate reporting of "non-financial" performance indicators impairs how well investors and other stakeholders can compare reported information. This hinders the efficient use of capital for environmentally and socially sustainable business activities.

The SFC recommends that the federal government:

- Actively engage in the process of reviewing the NFRD and advocate a redefinition of the concept of materiality towards an "either-or" relation
- Establish congruence in the revised NFRD between the most important performance indicators thus far termed "non-financial", and the technical assessment criteria of the EU taxonomy

11 Reporting requirements: definition of risk

The prevailing method of reporting on risks uses a concept of risk which is understood and applied in an inconsistent manner. Because this method of reporting mainly operates from an outside-in perspective, it does not meet the expectations of all stakeholders. In addition to presenting sustainability-related outside-in risks, companies should also report on the social and environmental risks their business activities can be found to pose when considered from a sustainability perspective. Where reporting requirements for the financial and real economy are inconsistent, inefficiencies and information asymmetries can arise.

The SFC recommends that the federal government:

- Update and specify the term main risks (section 289c (3) sentence 3 of the Commercial Code) using different perspectives (outside-in or inside-out). The presentation of the main risks should focus on the nature of the risks, the measures the company has decided and implemented in order to mitigate such risks, and to what extent these measures, once applied, have achieved their objectives

The SFC recommends that the Government Commission on the German Corporate Governance Code:

- Formulate the concept of inside-out risks in such a way as to allow them to be applied more usefully and unambiguously. In this context, the concept of risk should include all material risks in full

12 Data infrastructure / raw ESG data

Quantitative or qualitative sustainability information has so far only been partially accessible. The procurement of ESG data is either complicated or involves high costs. For smaller and medium-sized financial services providers, therefore, there are procedural and financial barriers to integrating ESG raw data and ratings into investment decisions, product lines, lending, and risk management. Reporting on sustainability risks is rarely machine-readable and barely comparable with other information. This makes it difficult to incorporate ESG-related information into investment decisions.

The SFC recommends that the federal government:

- Advocate the immediate extension of the European Single Electronic Format (ESEF) to include "non-financial information". This is seen as a prerequisite for more efficient data access and the development of a raw database for European ESG
- Advocate a central, public and freely available digital database for standardised ESG raw data in a human- and machine-readable format

As a framework for potential KPIs, the SFC proposes the systematisation into E, S, and G, which is established on the capital market. This in turn can be broken down into different categories and KPIs.

The aim is to provide companies with guidelines stating which KPIs can be reported on as a minimum standard. Alternative and additional KPIs are useful and desirable.

13 Transparency in lending

Up to now, credit institutions have not been obliged to record the sustainability impacts of their lending activities. Consequently, most are not in a position to report transparently on this subject. Both at the individual loan level and at the loan portfolio level, credit institutions cannot access structured information on sustainability risks, external sustainability effects, and deviations from targets with regard to their exposures. Nor can the conformity of the loan portfolio with global sustainability goals be verified. Without systematic collection of relevant information at an institutional level, it is impossible to assess the systemic sustainability risk of the entire credit sector.

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The SFC recommends that the federal government:

- Create a mandatory provision with sustainability-related disclosure requirements for the lending business, based on the Disclosure Regulation and taking into account the principles of proportionality and materiality

- Review the complementary use and the expansion of reporting requirements established under supervisory law/for statistical purposes

- Introduce the national initiative into the European discourse and strive for an EU-wide provision

14 Identify transition risks and opportunities

To date, there is no information available at company level that quantifies transition risks and opportunities in a reliable and comparable manner. To collect this information, a uniform stress test scenario could be used. This would enable rating agencies and financial institutions to consider transition risks and opportunities for real economy companies (and buildings) in their risk management. These institutions are not yet in a position to do so.

The SFC recommends that the federal government:

- Require large real-economy companies and owners of leveraged buildings to disclose their dealings with a standardised policy scenario. The companies should be required to report on the impact which a sudden policy change to achieve climate neutrality as early as 2035 would have on their key economic indicators, and what strategies the companies would use in response

- Take into account the policy scenario for the stress test under Pillar 2 under Solvency II in 2022 by BaFin/Bundesbank and the European Banking Authority (EBA) respectively

- Working with EU partners, develop an EU-wide implementation for a single policy scenario as a basis for risk management under Pillar 1 of Solvency II, so that transition risks and opportunities are considered when determining capital requirements

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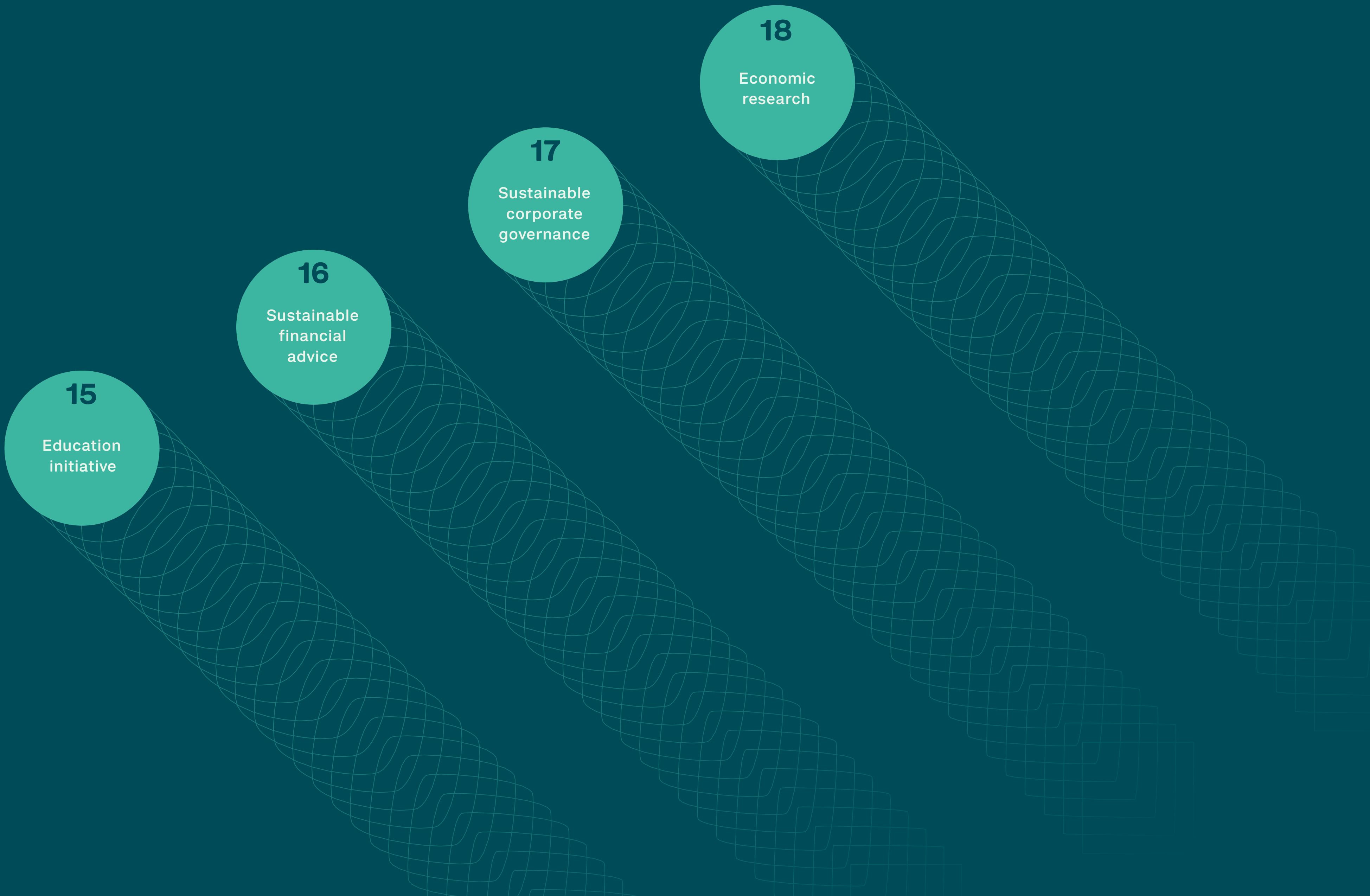
4 Systematic knowledge building



Environmental and social sustainability interact closely with economic cost and benefit potentials. Calculating these in a forward-looking manner is complex. The transformation in the real economy and financial sector therefore goes hand in hand with the generation and communication of relevant research findings, necessary decision-making aids, and additional management skills.

A deeper understanding of the dynamics and systemic interactions of sustainability targets, opportunities, and risks in global financial markets is crucial to this endeavour. Further research into the corresponding interrelationships, modes of operation, and interactions should therefore be promoted.

This includes the expansion of opportunities in the school sector, in research, and in teaching, as well as training and further education to expand access to necessary qualifications. This strategy will enhance skills in dealing with sustainability-related information and strengthen a forward-looking opportunity and risk culture. In addition, special attention should be paid to measures that will foster the transformation, such as incentive and sanction mechanisms, minimum supervisory requirements and EU minimum standards, in the following fields of action:

- Professional qualification
- Qualification of management, boards of directors, and supervisory board members
- Further training opportunities for employees, particularly in the areas of consulting, asset management, and accounting
- Capacity-building in ministries, agencies, and supervisory authorities

Measures must be geared towards improving skills in assessing sustainability-related information in a broad manner and systematically integrating them into all investment and financing decisions. All players in the financial sector and real economy should be made aware of how the materiality of sustainability risks, transformation, sustainable financing, and sustainable investment interrelate and interact. To this end, it is advisable that relevant content be included in school, vocational training, and university curricula. The business associations and chambers of commerce in Germany are already making an important contribution with their own initiatives to the development and transfer of knowledge among their member companies. Fostering a deeper exchange between the different approaches promises to create synergies.

Thanks to its strength in basic research, Germany benefits from important prerequisites for developing as a leader in sustainable finance. Only when there is a transfer of knowledge between research and application will the requirements for and effects on the transformation process[1] in politics, economy, and society become clear. This is particularly true with respect to understanding the interdependencies between reporting, performance indicators, eco-labels, and risk and return indicators. The goal must be to translate this basic knowledge quickly and reliably into existing investment and management processes.

1 Climate change-related impacts include physical and transitory risks as well as changing patterns in demand, new technologies, and litigation risks.

The effects of financial market products and investment strategies (their impact and outcome effects) have not yet been thoroughly investigated. In particular, there is not enough data to help measure how well such products leverage the transformation of the real economy. Accordingly, scientific measurement methods should be developed to distinguish the effects of various ESG approaches in the financial market and thus create greater market transparency. What is needed is a method to systematically capture the impact and outcome effects of financial market products on both the debt and equity side.

The SFC recommends that the federal government:

- Promote relevant research, including accompanying dialogues between stakeholders.

15 Education initiative

Sustainable financial literacy is key to building a resilient financial sector. If forward-looking decisions and results are to be achieved, knowledge of the concepts, goals and content of the sustainability transformation is essential. Such knowledge and skills must be established and maintained across society. This will allow small investors, too, to become drivers of a sustainability transformation.

This requires courses, teaching materials, and media in the academic field, in vocational training, professional development courses and in general educational institutions. To this end, existing initiatives in research and teaching should be better coordinated and expanded. The German government's support for professional and commercial associations offers starting points for this, as do existing departmental research plans, ongoing climate action initiatives, and the activities of the Federal Agency for Civic Education and its equivalents at the *Land* level.

The SFC recommends that the federal government:

- Combine activities and plans within an education initiative. This includes, among other steps:
  - A recommendation by the federal government to the *Länder* to include sustainable financial literacy in the core curricula of subjects such as politics and economics and social studies
  - Producing and distributing target group-oriented teaching materials geared to a variety of educational institutions and stakeholders
  - The involvement of associations, non-governmental organisations, and educational institutions in a sustainable finance campaign. Here, it is worth thinking about establishing a link with the German Council for Sustainable Development's Regional Hubs for Sustainability Strategies (RENN).
  - Discussion of the topic within the framework of the National Action Plan Education for Sustainable Development (ESD) or a successor programme
  - Inclusion as a special topic in the activities of the Federal Agency for Civic Education
  - The continual updating and development of the Deutsche Bundesbank's existing information on the topic
  - Inclusion of the topic in the Federal Government's departmental research plan for the environment
  - Embedding sustainability requirements in the German Sustainability Code for universities and scientific institutions.

16 Sustainable financial advice

The mandatory query concerning sustainability preferences in client advisory services (amendment of MiFID II Regulation 2017/593, Art. 1, 9 and 10), which will shortly be introduced, will lead to a further increase in interest in sustainable financial market products. Studies show that private customers prefer to invest their money in sustainable investments. Yet it is often impossible to do this owing to a lack of information or insufficient education about existing products. This underlines the importance of informed, high-quality advice for the success of sustainable finance. Nevertheless, sustainability issues have not yet been integrated into the training of banking and insurance professionals. Nor do school curricula cover sustainable financial literacy. As a result, there is a need to establish qualifications with regard to sustainability issues in customer advising.

The SFC recommends that the federal government:

- Establish a minimum level of compulsory annual training for financial and insurance advisors
- Work towards integrating sustainable finance into the training curricula for bankers and insurance brokers.

  Training courses should be adapted to the legal requirements of MiFID II and the Insurance Distribution Directive (IDD) that are applicable to insurance and financial investment intermediaries, namely as a component of the proof of expert knowledge for financial investment intermediaries pursuant to section 34f (2) no 4 of the Trade Regulation Code (Gewerbeordnung), or for insurance intermediaries pursuant to section 34d (9) sentence 2 of the Trade Regulation Code. The federal government should define the following mandatory thematic priorities:

- dealing with sustainability aspects in risk management
- requirements for sustainable products (e.g. loans for energy-efficient construction)

17 Sustainable corporate governance

To date, there are no uniform regulations on the sustainability competencies required in key corporate positions. Training courses on sustainability topics which offer corresponding qualifications do exist but are not widely accepted or officially certified. Too rarely do companies themselves undertake to establish qualification requirements for sustainability criteria in their statutory bodies. Without sufficient competencies related to sustainability criteria, companies' forward-looking risk assessment, and thus their readiness for transformation and resilience, is limited. Furthermore, the lack of sustainability competencies affects companies' willingness to counteract negative impacts of business activities on the SDGs.

The SFC recommends that the federal government:

- **Invite the Government Commission on the German Corporate Governance Code (DCGK) to develop minimum standards for the sustainability competencies of corporate officers in management boards, supervisory boards, and key committees which comply with the future EU legal framework on corporate sustainability and "non-financial" reporting**
- **Codify these minimum standards in law, declare them binding in guidelines for the DCGK and BaFin, and ensure that they are adhered to**

The SFC recommends that companies:

- **Adapt their internal organisation and their oversight and risk management processes with regard to sustainability factors and ensure that the responsible individuals in management and supervisory bodies have the appropriate competences**
- **Introduce sustainability-related remuneration to encourage the achievement of sustainability targets**

18 Economic research

The assessment and pricing of physical and transitory risks and opportunities is an essential prerequisite for all economic activity. Existing studies on climate change, biodiversity, and complex supply chains, for example, require continuous updating and regional and sector-specific differentiation. Based on the impact assessment carried out by the European Commission in the context of the European Green Deal, it should be possible to consolidate data to a sufficient extent so that financial decisions can be made on a solid foundation. With the SFC, the federal government has created initial approaches for further intensifying the dialogue between research, finance and the real economy. International initiatives, such as the United Nations Environment Programme Finance Initiative (UNEP FI), are also pursuing similar networking strategies. Corresponding approaches and programmes need to be further developed at the national and EU level.

Even within the sciences, there is little contact between disciplines such as finance, economics, and business administration, on the one hand, and transformation-related research and climate science, on the other.

Insurers, investors, and companies depend on reliable forecasting models. Scenario analyses can help to sound out the possibilities and limits of insurability and to assess the plausibility, as well as the risks and opportunities, of transformation strategies at the level of individual sectors and companies. Such analyses promote forward-looking action across the board. This, in turn, is also necessary in order to develop effective policy frameworks.

The SFC recommends that the federal government:

- **Evaluate the current state of research, work towards eliminating any gaps in knowledge, and make research findings available to practitioners. This task should be coordinated by a central body at the national or European level. The following options are possible:**
  - **Establishment of an interdisciplinary science platform**
  - **Integration into the Federal Environment Agency's information infrastructure KomPass**
  - **Creation of a counterpart to KomPass at the European level**

  The simultaneous pursuit of different research approaches should ensure the independence, quality, and robustness of the results. To enable the targeted use of research, the financial sector and other relevant stakeholder groups should be involved in research at an early stage. Insurers, for example, already provide their customers with individual tools that give an overview of specific environmental risks. Examples include the "Natural Hazard Check", the "Flood Check" or "ZÜRS Geo" with its functionalities for localisation. These tools already point to the need to take precautions against a wide range of risks. They can gradually be extended to cover further physical and transitory risks and additional industries and sectors.

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5 Financial products with an impact on sustainability

19 Classification system

20 Blended finance

21 Impact investing

22 Promotion of sustainable products

23 Dormant assets

24 Sustainable securitisation

25 Sustainable project hub

The transformation will depend on a significant increase in capital mobilisation through investment and financial products for private and institutional clients. Private customers in particular hold great potential: Half of private investors in Germany express interest in sustainability in their investments.[1]

The obligation to ask about the customer's sustainability preferences in client discussions (MiFID II), which will likely become mandatory in the future, will further increase interest in sustainable investment products. Sustainable investments, which currently have 5.4% of the total German fund market, are still not particularly well represented. Even if institutional investors and asset managers are increasingly integrating ESG criteria into their investment processes, the potential of the capital market has yet to be fully realised.[2] This is demonstrated by the fact that the first issuance of German green government bonds in September 2020 was five times oversubscribed.[3]

The aim must be to meet demand and also to mobilise capital with additional sustainable financial market products. To this end, barriers should be removed and transparency ensured. To enable the qualitative assessment of all financial market products, it is also necessary to have transparency regarding which positive sustainability effects have been achieved in real economic terms and which negative effects on the environment and society have been prevented. Some information is currently provided by sustainability seals such as the FNG seal or the Austrian Eco-label. The EU Ecolabel for financial market products, which is planned as part of the EU action plan, is intended to establish a uniform standard throughout Europe, particularly with regard to environmental sustainability requirements.

Redirect financial flows

A product range which is accompanied by transparent information on (in addition to sustainability risks) positive and negative sustainability impacts in particular enables investors to make investments in line with their preferences. Transparency provides incentives to redirect financial flows, thus helping to achieve the United Nations' Sustainable Development Goals (SDGs) and the goals of the Paris Agreement. The contribution of financial market products to the transformation can be assessed if comprehensive data on their volume and sustainability quality are collected and published. This means that sustainability reporting requires both qualitative and quantitative criteria and measurement methods.

Effectively contribute to the transformation

Financial market products can contribute to the transformation of the real economy by investing in transformative companies and projects. This effect can be measured. This is, firstly, a question of financial materiality, i.e. the impact on the financial value of the investment (outside-in perspective). Yet materiality in the sense of sustainability is also about the impact of the investment object on the environment and society (inside-out perspective). It measures the actual social and environmental improvement, i.e. the impact in terms of international and national sustainability goals.

Transparent transformation processes ensure planning certainty for companies and investors. Sustainable financial market products make a contribution in this respect. With effective sustainability criteria and coherent implementation, the German government can make Germany and the EU into a leading location for sustainable finance. To this end, the SFC recommends the following measures:

1 Gutsche, G, Ziegler, A, Zwergel, B, Klein, C, Characterizing German (Sustainable) Investors, Corporate Finance, 2017, pp. 77-81. A private customer survey furnishes additional proof: Sustainable Finance, PwC, September 2020, https://www.pwc.de/de/nachhaltigkeit/privatkundenstudie-2020.pdf. According to a 2017 study by the National Climate Initiative (NKI), approximately 40% of investors are interested in sustainable investments, https://nk-institut.de/allgemein/repraesentative-befragung-des-nki-grosses-interesse-der-privatanleger-an-nachhaltigen-kapitalanlagen.

2 FNG Special: Responsible Investments 2020, 2022 The growth opportunity of the century, PwC, 2020.

3 According to the Sustainable Investment Forum (FNG) market report, the market share of sustainable investments was only around 5% in 2019. FNG Market Report Sustainable Investments 2020, p. 9., http://fng-marktbericht.org/wp-content/uploads/2020/05/FNG_Marktbericht2020.pdf

19 Classification system

Customers interested in financial market products are lacking a system for classifying the specific sustainability opportunities and risks of an investment when making their investment decisions.

The SFC recommends that the federal government:

- Establish a system for classifying the sustainability of all financial market products based on the logic of the EU Disclosure Regulation and to task an independent project team consisting of various groups of stakeholders with the further refinement of the system. By creating such a system, Germany would set an example for Europe which could set a precedent. The classification system should transparently present sustainability opportunities and risks to customers on a simple scale of 1 to 5. The scale should reflect the extent to which a financial market product implements sustainability criteria. The scale will allow customers to assess whether the financial market product's sustainability impacts and its contribution to the transformation process suit their sustainability preferences.[4]

20 Blended Finance and 21 Impact investing

The rapid expansion of a sustainable product range has so far been hindered by regulatory and practical barriers to steps such as the conversion of existing financial market products to a sustainable model, or the launch of new financial products which place particular emphasis on sustainable investment.

The SFC recommends that the federal government:

- Identify, analyse and remove barriers to make it easier for financial market participants to expand their sustainable product range in order to help meet growing demand
- Particularly with regard to impact-oriented investments in products which offer social or environmental added value (impact products), to design the regulatory framework in such a way that such investments become as easy to make as they are in some other European countries. Impact financial products make a particularly significant contribution to achieving sustainability and climate targets. The regulatory framework for microfinance products can act as a blueprint for amending the provisions of the Capital Investment Code *(Kapitalanlagegesetzbuch)*. If they were expanded to include the possibility of investing in impact products, they would facilitate increased investment in the areas of renewable energy, social housing, and sustainable infrastructure. Corresponding rules for domestic alternative mutual funds should be created for impact products. Removing barriers would also make Germany more attractive as a destination for German providers of impact-oriented financial investments (impact-investing providers)
- Enable regulated impact funds in Germany to use a blended finance model. The funds would report their sustainability impact in a suitably transparent and understandable manner. These funds would combine public with private capital and mobilise primarily private-sector financial resources for the transformation and the achievement of sustainability and climate goals. The aim must be to make such impact-oriented financial investments accessible to a broad range of customers, increasing the attractiveness of Germany as a financial location. Greater diversity and a wider selection of impact funds based in Germany would help to achieve this goal

22 Promotion of sustainable products

State subsidies for fully funded private pensions, known as Riester plans, and employees' savings schemes (vermögenswirksame Leistungen) are not linked to effective sustainability requirements. Furthermore, there is no specific government support for sustainable capital investments which support the transformation.

The SFC recommends that the federal government:

- Make state subsidies for new Riester and employee saving scheme contracts conditional on fulfilment of explicit sustainability criteria. Up to now, Riester plans have only been required to provide information on whether ethical, social, and environmental concerns are taken into account in the investment. If the amounts paid in are to effectively contribute to the transformation, they must be tied to effective sustainability criteria. This requires an adjustment of the eligibility conditions. The aim is to only subsidise products that comply with Articles 8 or 9 of the EU's Disclosure Regulation when new contracts are concluded. The reform of the Riester pension scheme offers a starting point in this respect
- Exempt from taxation, up to a certain maximum amount, income from investments in investment products considered sustainable under the Disclosure Regulation

Implementation of the recommended measures should increase both demand for and familiarity with sustainable financial market products.

4 By contrast, the EU taxonomy and the EU Ecolabel for financial products, which is likely to be based on it, are transparency systems which currently assess (only) the positive environmental performance of financial products.

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23 Dormant assets

Further financial resources can be mobilised through sustainable investment of dormant assets. Dormant assets can be used to build up a social impact fund which can promote funding opportunities in the area of social entrepreneurship. Innovative solutions for social tasks and problems can thus be developed in a targeted manner, supporting the social sustainability dimension. The fund's mission would be to help achieve concrete sustainable development goals.

The SFC recommends that the federal government:

- Adapt the legal framework accordingly

24 Sustainable securitisation

The lending sector is an effective lever for enabling investments to achieve sustainability and climate goals. Sustainable securitisations, for example, can provide investment incentives while at the same time spreading risks. They could also accelerate accurate pricing of sustainability-related financing risks by underpinning the process with additional data and creating incentives to apply the logic of the EU taxonomy to lending. As part of the adaptation of the current supervisory framework for securitisation, a sustainable orientation of bank lending to enterprises, in particular SMEs, should be promoted.

The SFC recommends that the federal government:

- Support the European Commission's proposals expected as part of the new sustainable finance strategy to be announced in spring 2021

- Issue a corresponding oversight mandate to the EBA

25 Sustainable Project Hub

Despite growing demand on the investor side, there is currently only a limited volume of investable and bankable sustainable projects. This volume should be increased to avoid a bottleneck or a bubble on the financial markets.

The SFC recommends that the federal government:

- Develop a Sustainable Project Hub. This Hub will develop new financial products and solutions, work on the regulatory framework to trigger additional investments in sustainability transformation projects, identify investable sustainability projects, make available all the relevant information for financing, and help to familiarise financial market participants with new sustainable technologies

- Enable financing for transformation projects in the real economy which so far have not received sufficient support owing to their innovative character

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6 Consolidating Sustainable Finance

26 Institutionalisation

27 Advising on trade-offs in ESG investing

28 Transformation and impact fund

29 Financial institutions under public law

30 Database for real estate/energy performance certificates

31 Institutional investor engagement

The Sustainable Finance Committee understands the recommendations presented in this report to be a first step towards initiating Germany's development into a leading sustainable finance location.

There are many aspects that need to be explored in greater depth, supplemented or further developed. Consolidation understood in this way is intended to set a dynamic in motion which will enable all stakeholders to drive the process forward with an increasing degree of own initiative and new ideas. The goal is to establish long-term decision-making horizons and shape the transformation with a focus on the opportunities it offers. Feasibility, lean structures and reliable coordination are key requirements on this path. This includes

- Implementation that is aimed at broad effectiveness
- Openness to constantly adapting strategies and measures according to the latest scientific findings
- The effective use of all available resources

The effectiveness of sustainable structural change depends on clear quality criteria. It is particularly important to the SFC to

- Strengthen the competitiveness of Germany as a business location
- Identify and resolve possible conflicting goals at an early stage
- Ensure the compatibility of national legislation with European and international regulations
- Make use and further develop the political leeway available to Germany to shape policies together with its international partners
- Coordinate the approach of the federal, *Land* and local governments as part of an joint sustainable finance strategy

Consolidation as a holistic strategy

Many of the recommendations developed in the previous chapters imply consolidation as a central principle of successful transformation:

Chapter 1 emphasizes the importance of continuous cooperation between all stakeholders on the basis of overarching objectives as the cornerstone for resilient markets and the long-term efficiency of sustainable finance.

Chapter 2 underlines the importance of the public sector as a role model in implementing a coherent political strategy. The Paris-compliant design of evaluation and decision-making processes and the ongoing comparisons of current/target states is not a sprint, but a marathon.

Chapter 3 describes the gradual transition from "non-financial" reporting towards the integrated consideration of sustainability data. In order to derive maximum benefit from this in assessing company values, it is essential that further experience-based knowledge be continuously developed.

Chapter 4 calls for the systematic development and availability of knowledge in the field of sustainability and the skills to apply this knowledge. This also means that such knowledge and skills must be structurally embedded in management and in control and advisory bodies.

Chapter 5 turns to the framework conditions for sustainable financial products and thus to the question of how their market weight can be increased and established in the long term through improved transparency and labelling.

What all chapters have in common is that they do not focus on individual measures, but on a process-driven implementation that keeps an eye on the overall picture of the relationships between finance and the real economy, politics and society. In addition to the organization of work structures and responsibilities, institutional consolidation also addresses the question of efficient implementation within established public sector structures. The SFC believes that the following recommendations offer starting points which can send strong signals and have leveraging effect.

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26 Institutionalisation and

27 Advising on trade-offs in ESG investing

To guarantee that the necessary consolidation also occurs at the institutional level, the relevant competencies, responsibilities and resources must be developed in all departments of the federal government. The same applies to the coordination of tasks between the federal government and the *Länder*.

The SFC recommends that the federal government:

- Set up a central coordination office for sustainable finance in the Federal Ministry of Finance and provide it with the necessary resources. This would be an effective way to structurally support cross-departmental action: from the decision of individual market incentives to complex regulatory requirements

- Establish an implementation and stakeholder structure that allows sustainable finance to be embedded in institutions outside the public sector. An independent sustainable finance platform should support and accompany the implementation of the SFC's recommendations. The involvement of stakeholders from the financial and real economy, government agencies, civil society and science can jointly create impetus and practical solutions. The platform is also intended to be a point of contact in the event of potentially conflicting goals

28 Transformation and impact fund

German companies need to make massive investments in future-oriented technologies and in the development of industrial sites. Small and medium-sized enterprises (SMEs) in particular, should be supported due to their role as agents[1] of Germany's technological sovereignty. A transformation and impact fund would offer SMEs alternatives to the established capital markets, to which their access is sometimes limited. This will accelerate the sustainable transformation of the real economy, realise technological potential, and forge transitions to socially and environmentally sustainable economic activity.

The SFC recommends that the federal government:

- Establish such a transformation and impact fund. The existing economic stabilisation and high-tech start-up funds represent initial approaches to equity investment and can be further developed into a broader transformation and impact fund

29 Financial institutions under public law

As described in Chapter 2, the Federation, *Länder,* and local authorities have an effective lever, in their capacities as shareholders or owners of public-sector financial institutions and development banks, to shape and implement their sustainable development goals. So far, it has not been established with sufficient clarity what consequences for governmental and local-authority (financial) stakeholders will arise as a result of the stringent implementation of the requirements of the Paris Agreement including the 1.5°C climate target, the European Green Deal, the 2030 Agenda, the United Nations Guiding Principles on Business and Human Rights, and the German climate strategy. With a view to establishing a reliable policy framework which gives clear guidance, public-sector stakeholders at the federal, *Land,* and local levels should use their scope for action and develop tasks and responsibilities in line with the mandates of the respective financial institutions. Furthermore, all investment calculations should be based on a CO_2 shadow price compatible with the policy objectives.

KfW

The SFC recommends that the federal government:

- Give the German state-owned development bank KfW a mandate to make its financing policy compatible with the Paris Agreement, which would also involve taking exclusion criteria into account. KfW's overall management strategy should be aligned in accordance with this objective. Appropriate transition periods should be used to identify and avoid potential conflicting objectives and countervailing effects. In implementing its mandate, KfW, as a transformative promotional bank, should be obliged to comply with the following federal requirements:
  - KfW should carry out an assessment of the impact of applying the EU taxonomy including the DNSH criteria[2] – in addition to the sector paths – in all business areas. The aim is to formulate plans for the application by management as soon as possible
  - When using funds for projects abroad, KfW should use the climate action goals of recipient countries and their progress in the human rights-based implementation of the SDGs and the Paris climate targets as an important basis for its financing decisions
  - KfW should use its mandate as a transformation bank to cover – within the limits of the legal budgetary framework – transformation risks by means of state guarantees. In this way, it can make an import-

1 German SMEs tend to have specialised products and a strong export orientation.

2 DNSH is short for "do no significant harm". DNSH states that substantial contributions to a particular sustainability objective may only be made if they do not cause significant harm to others. The aim is to ensure that certain social or environmental objectives should only be targeted if they do not conflict with other sustainability objectives in a significant way.

ant contribution to new transformative technologies and strategic projects

***Länder* development banks**

The SFC recommends that the federal government:

- Support the governments of the *Länder* in aligning the funding policies of the *Länder* development banks with the objectives of the Paris Climate Agreement. This recommendation also applies directly to the *Länder* governments themselves

- Apply the EU's Taxonomy Regulation – once it comes into force – as quickly as possible and transform it step-by-step into a minimum standard for sustainable investments

- Enhance the support for transforming business models of *Länder* development banks to focus on financing the transformation in a way that meets with public acceptance. Overall, the development of a phased plan for support policy should be guided by research-based transformation paths for the real economy.

As owners of the *Länder* development banks, the *Länder* should raise the above points at a summit of the federal, *Land,* and local governments and agree on a process for continuous coordination.

Publicly owned regional banks *(Landesbanken)* and DekaBank

The SFC recommends that the federal government as well as the public sector institutions:

- Work towards ensuring that sustainability risks are systematically taken into account in DekaBank's financing. This approach is also appropriate at the *Länder* level with regard to the publicly owned regional banks. The focus should be on the successful transformation to sustainable management and the application of uniform assessment procedures, sector-specific principles and exclusion criteria in the area of financing

- Expand existing SME, corporate client, and local authority advisory services to include advice relating to sustainable transformation

Public savings banks (Sparkassen)

The SFC recommends that the federal government as well as the *Länder:*

- Define the "public interest" orientation of banks more precisely. To this end, section 40 of the Banking Act *(Kreditwesengesetz)* should be amended in conjunction with the savings bank laws of the *Länder* to specify, in an easily comparable manner, a clear relationship to the transformation, to goals (such as climate targets), and to regional implementation requirements

- Possible key issues to be taken into consideration with regard to sustainability impacts in business strategies should include:

  - The introduction of measurable qualitative and quantitative targets that are in line with the objectives of the Paris Agreement, the European Green Deal, and the SDGs

  - Forward-looking and public reporting by all public banks subject to CSR reporting requirements, with the German Savings Banks Association (DSGV) taking the lead for that sector

  - Measurement and tracking of objectives, including reporting on objectives, by institutions subject to CSR reporting requirements

  - Institution-specific timetables for the step-by-step transformation of existing and new business and for reducing financing and investments which do not comply with ESG criteria.

These measures are aimed at embedding sustainability issues in investment and credit advising activities and systematically implementing the relevant criteria in banks' own financial investments.

Public insurers

Because public insurers also have a public service mandate, that mandate should be evaluated in terms of the further development of the public service concept and business model. In this context, the self-identification of these firms as providing reliable insurance protection and sustainable capital investments should be specified more precisely in individual cases.

30 Database for real estate/ energy performance certificates

Embedding economic, ecological and social sustainability in the management and evaluation of companies requires meaningful, standardised data. Their availability is a key element for most of the recommendations in this report. Without a correspondingly dynamic information infrastructure, sustainable finance remains a largely unredeemed promise. This recommendation's focus on real estate is intended as an example. It can be used in almost any other area of the transformation.

It is particularly important that the existing measurement and methodological approaches dovetail in a uniform understanding that provides orientation with regard to the assessment of sustainable financing, and to make these assessments more binding. The

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provision of such data, as a public good, should be organised in a non-discriminatory and cost-effective manner: centralised, digital, and machine-readable. This is not necessarily a task for the government. It may also be appropriate to create private-sector platforms for data, information, and knowledge. In this context, it should be ensured that market-sensitive content is protected and accessible only according to defined criteria.

The SFC recommends that the federal government:

- Develop an information infrastructure for raw sustainability data
- Create a building-energy database
- Integrate building energy quality as a valuation factor within the rules governing building valuation

31 Institutional investor engagement

Investors in Germany, including the public sector, make too little use of their opportunities to influence companies with a view to encouraging them to do business in a more sustainable manner ("ESG engagement"). The full potential to further the transformation is currently not being used because investors shy away from the additional effort and legal uncertainties. An infrastructure for ESG engagement in Germany should remedy this.

The SFC recommends that the federal government and institutional investors:

- Establish a reliable legal basis for collaborative ESG engagement
- Build a platform to encourage collaborative ESG engagement
- Develop a German stewardship code ("code of responsibility") to provide orientation for engagement activities

Sustainable finance as a task of permanent development

Foresight and continuous further development are important elements that help Germany achieve its goal of becoming a leading sustainable finance location. The recommendations developed in the previous chapters provide impetus for this.

Naturally, some of the recommendations are closely linked to further questions of budgetary policy, the use and design of tax incentives or the coherence of support programmes. These links and the resulting cause-and-effect relationships need to be explored further. This also applies to the design of the coordinated cooperation between the Federation, *Länder,* and local authorities.

The implementation of a sustainable financial system will never be completed. It remains the subject of continuous improvement and methodological refinement. Only in this coordinated diversity can it be possible to make a success of the project of the century for society as a whole, to shape sustainable development in its environmental, social and economic dimensions. In order to mobilize the widespread acceptance required for this, the SFC encourages the federal government not to restrict the dialogue on political instruments, level of ambition and methodological frameworks to a few groups of stakeholders, but rather to remain in close contact with all stakeholders in politics and society, finance and the real economy.

In this sense, the Sustainable Finance Committee has demonstrated its dedication . In its many, at times controversial discussions, the range of topics went beyond the 31 recommendations that made it into this report. Much of this is worth discussing further, for example a more in-depth analysis of long-term sustainability risks within the framework of supervisory systems or a comprehensive study of fiscal policy effects. This is linked to the wish that the federal government take these recommendations on in a spirit of cooperation: with foresight and with the involvement of all relevant national and international stakeholders.

Glossary

Asset-Liability-Management (ALM)
Management approach in which risks from the operational area – i.e. procurement, production and sales – and the financial area are coordinated with each other in line with the company's objectives. The management system thus encompasses the management of the assets and liabilities side of the balance sheet.

CO_2 shadow price
CO_2 shadow price refers to companies internally setting a uniform CO_2 price or price range as an additional cost factor when evaluating their investments and risks. This amounts to an internalisation of external (climate) costs (see below). The shadow price specifically promotes emission reduction, energy saving, and efficiency, and avoids future emissions.

comply-or-explain principle
According to the comply-or-explain principle, players must indicate whether they agree with a particular legal requirement and intend to implement it (comply), or do not intend to comply with it. Any decision not to comply must be adequately explained.

German Corporate Governance Code
The German Corporate Governance Code is a set of rules consisting of principles, recommendations, and suggestions for the management and supervision of companies who wish to highlight their good corporate governance. The Code obliges firms not only to act legally, but also to behave ethically and responsibly. The Codeis only legally binding for listed companies. Public law, however, often stipulates that the Code be applied to local authority enterprises.

Accounting Standards Committee of Germany
The Accounting Standards Committee of Germany is the national standard setter in the field of corporate accounting in Germany. It is an independent, registered, non-profit association.

German Sustainability Code
The German Sustainability Code is a cross-sectoral transparency standard for reporting companies' "non-financial" sustainability performance. It provides companies of various sizes and legal forms with a framework for reporting on their own sustainability management.

contract for difference
Contracts for Difference (CfDs) are financial products used to hedge a volatile or uncertain price for the protection of both the seller and the buyer. Both sides agree on a CfD price ("strike price") for a certain period of time. If the actual price (for example, of a CO_2 certificate) is lower, the buyer pays the difference to the seller. The reverse also holds. Especially in the field of renewable energies, contracts for difference reduce investment risks and thus financing costs.

"do no significant harm rule"
The "do no significant harm rule" states that substantial contributions to a particular goal may only be made if they do not cause significant harm to others. The aim is to ensure that certain social or environmental objectives should only be targeted if they do not conflict with other sustainability objectives in a significant way.

double materiality
In their reporting, companies are already required to disclose "material" information on how social and environmental developments might have a negative impact on the company's success. This concept, known as financial materiality, relies on an "outside-in perspective". Double materiality expands this reporting requirement to include company activities which affect and endanger social welfare and biosphere sustainability. This concept, known as sustainability materiality, relies on an "inside-out perspective". The term "double materiality" is also sometimes used synonymously in this context.

institutions for occupational retirement provision (IORPs)
The term occupational pension scheme (OPS) refers to the promise of an employer to provide old-age, disability, or survivors' benefits for the benefit of its employees. Institutions for occupational retirement provision, or IORPs, are defined in the European IORP Directive. In Germany, pension funds and pension schemes fall under this category.

EU action plan on "Financing Sustainable Growth"
The action plan on "Financing Sustainable Growth" presented by the EU Commission in 2018 forms the basis for a number of European regulatory projects. Ten packages of measures aim to redirect capital flows towards sustainable investments, manage financial risks arising from sustainability and climate risks, and promote transparency and long-term thinking in finance.

EU Green Deal
The EU Green Deal, unveiled at the end of 2019, aims to make Europe the first continent to become carbon neutral by 2050. This requires sustainable environmental change in the areas of energy, transport, trade, industry, agriculture and forestry, a project which will require an investment volume in the trillions.

European Single Electronic Format (ESEF)
The European Single Electronic Format (ESEF) is an EU-wide uniform electronic reporting format which, since 2020, must be used for corporate reporting by issuers whose securities are listed within the EU. The aim of this XHTML-based digital reporting format is to facilitate accessibility, analysis, and comparability of annual financial reports.

ESG raw data
ESG raw data refers to public, quantitative, and qualitative sustainability information provided by companies. These data are also referred to as "non-financial information" in sustainability reporting.

GHG Protocol
The GHG Protocol (Greenhouse Gas Protocol) is a standard for the accounting of greenhouse gas emissions (carbon accounting) and the associated reporting for companies. It is also increasingly used in the public sector. Development of the GHG Protocol is coordinated by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD). Governments, industry associations, NGOs, companies, and other organisations are involved.

Global Reporting Initiative (GRI)
The Global Reporting Initiative is a provider of guidelines for the preparation of sustainability reports. This international initiative sets sustainability standards for the reporting that is used mainly by large corporations operating at the global level.

Greenwashing
Greenwashing refers to the attempt by companies to give themselves a "green" and responsible public image through marketing and PR measures, without pursuing policies sufficient to warrant that image. The terms "SDG-" and "impact-washing" are also sometimes used.

Great Transformation
See definition on page 9 in Chapter 1.

impact investing
Impact investments are investments that, in addition to generating a financial return, generate and measure demonstrable positive social and/or environmental impacts. The aim of impact investments is to generate additional positive change with regard to international climate and sustainability goals.

internalisation of external effects
An internalisation of external effects (externalities) occurs when social and/or environmental costs previously borne by the general public are integrated into individual economic cost accounting. The aim is to use prices to allocate the external costs arising from environmental pollution and negative social business practices to the polluter (this is known as the "polluter pays" principle). Carbon pricing is a key instrument for internalising external costs.

International Integrated Reporting Council (IIRC)
The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, auditors, academics, and civil society players. Among other things, the organisation develops guidelines and training courses to promote the dissemination of integrated corporate reporting.

sustainability rating
Sustainability ratings of companies, countries, and other investment objects are usually provided by specialised service providers (sustainability rating agencies). The sustainability rating provided by the agencies analyses the issuers' raw sustainability data on the basis of specially defined sustainability criteria and methodologies, evaluates them and thus ensures transparency with regard to their social, environmental and governance performance.

Net-Zero Asset Owner Alliance
The Net-Zero Asset Owner Alliance was launched in 2019 as part of the UN Climate Summit. The initiative unites twelve pension funds and insurers that collectively manage about $2.4 trillion in assets. The members of this group commit to reducing the **CO_2** emissions of their investment portfolios to net-zero by 2050.

"non-financial information"
The term "non-financial information" was introduced by (among other players) the EU directive on "non-financial and diversity information" (Non-Financial Reporting Directive (NFRD)) and encompasses all dimensions of sustainability. *The Sustainable Finance Committee believes the term is misleading, as sustainability-related information can have significant financial implications. For this reason, the term is placed in quotation marks in the report.*

outside-in-perspective/ inside-out-perspective
See "double materiality"

Paris Agreement
The "Paris Agreement" adopted by the global community in 2015 sets the global framework for limiting the increase in the global average temperature to 1.5 degrees. This climate action agreement, which is legally binding, requires the 195 signatory states to pursue national action plans for reducing their emissions and to report on them on an ongoing basis.

Principles for Responsible Investment (PRI)
The Principles for Responsible Investment are a financial initiative of the United Nations. The international investor network PRI follows six principles for responsible investment, which involve incorporating ESG criteria into investment processes and reporting on them on an ongoing basis.

proxy voting
Proxy voting is a form of exercising voting rights in which proxies exercise the rights of shareholders at general meetings. By exercising proxy voting rights, asset managers can influence how public companies design and compliance with sustainability strategies.

German Council for Sustainable Development (RNE)
Created by the German government in 2001, the German Council for Sustainable Development, advises the German government on sustainability issues. It makes recommendations regarding specific fields of action and provides contributions to guide the ongoing development of the national sustainability strategy.

resilience
Resilience describes the ability to deal constructively with sudden negative events such as upheavals, shocks, and crises, and to mitigate their immediate consequences. A sustainable society and economy needs a robust and resilient financial system that provides the flexibility and significant capacity for adaptation and learning required to face such challenges.

SDGs/UN 2030 Agenda
The United Nations 2030 Agenda, with its 17 Sustainable Development Goals (SDGs), is the global community's plan for ensuring the future viability of planet Earth. A life in dignity for all the world's inhabitants can only be achieved if the international community of states aligns its actions with social, environmental, and economic goals and takes ambitious action.

Voluntary commitment by the German financial sector to achieving the goals of the Paris Agreement
In June 2020, 16 members of the German financial sector signed a collective commitment to achieve the goals of the Paris Agreement. In doing so, they committed themselves to aligning their loan and investment portfolios with the goals of the Paris Agreement. The agreement included a commitment to measuring, publishing and setting targets for the reduction of emissions associated with business operations.

Sustainable Finance
Sustainable Finance stands for a sustainable financial system in which environmental, social, and governance criteria are taken into account in investment decisions. In addition to the financial sector, policy-makers, the real economy, civil society, and academia are key players in sustainable finance, pursuing different approaches and instruments to raise the financial resources needed to achieve international climate and sustainability goals.

Task Force on Climate-related Financial Disclosures (TCFD)
The Task Force on Climate-related Financial Disclosures (TCFD) was established by the Financial Stability Board in 2015 to develop recommendations for more effective climate-related reporting. This should enable investors and other stakeholders to better understand the concentration of carbon-related assets and climate-related risks in the financial sector. The TCFD's recommendations were published in 2017.

transformation pathway/ sector pathway
Massive CO_2 reductions are needed to achieve the climate targets set out in the Paris Climate Agreement. The changes required for this are specified in transformation pathways – or, in sector-specific contexts, in sector pathways.

United Nations Environment Programme Finance Initiative (UNEP FI)

The United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between the United Nations Environment Programme (UNEP) and the global financial sector to mobilise the private sector finance for sustainable development. UNEP FI supports and coordinates voluntary commitments in the financial sector, such as the Principles for Responsible Banking, the Principles for Sustainable Insurance (PSI), and the Principles for Responsible Investment (PRI).

UN Global Compact (UNGC)

The UN Global Compact is a United Nations initiative for responsible corporate governance. The signatories of the UNGC undertake to comply with ten principles which address human and labour rights as well as environmental and corruption issues.

UN Guiding Principles on Business and Human Rights

The Guiding Principles on Business and Human Rights were adopted by the United Nations Human Rights Council in June 2011. As an international framework, they formulate requirements for politics and business, and thus for the first time provide a generally recognised frame of reference for the human rights obligations of states and for the responsibility of companies in global supply and value chains. The guiding principles are based on three pillars:

- The state's duty to protect human rights,
- Corporate responsibility to respect human rights and
- Access to remedies for victims of human rights violations.

About the Sustainable Finance Committee

The Sustainable Finance Committee (SFC) advises the German government on the development and implementation of its Sustainable Finance Strategy. It was established by the federal government on 6 June 2019 for the duration of the current legislative period with the aim of pooling expertise and promoting dialogue among relevant stakeholders. The members are practitioners from the financial sector, real economy, civil society, and academia.

The background to the SFC's formation was the decision of the State Secretaries' Committee for Sustainable Development on 25 February 2019 – at the initiative of the Federal Ministry of Finance and the Federal Ministry for the Environment, Nature Conservation and Nuclear Safety, in close consultation with the Federal Ministry for Economic Affairs and Energy – to develop a Sustainable Finance Strategy for the federal government. The aim is to develop Germany into a leading location for sustainable finance.

An interim report was published on 5 March 2020 in order to give the interested public an insight into the status of the discussion within the Committee at that time. The interim report was put up for public consultation. This allowed including various other perspectives in the preparation of this final report.

On this basis, the Committee developed the recommendations in working groups. In order to include the expertise of all members and observers, all recommendations have passed through internal feedback phases. Controversial recommendations were discussed in the plenary, during SFB meetings as well as in workshops. If necessary, they were voted on.

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Kristina Jeromin	Vice-Chair

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Silke Stremlau	Hannoversche Kassen
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Until April 2020:	
Matthias Stapelfeldt	Union Investment Management Holding AG

As of May 2020:

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Dr. Thomas Diekmann	VHV Allgemeine Versicherung AG

Academia

Prof. Karsten Neuhoff	German Institute for Economic Research e.V.
Karsten Löffler	Frankfurt School of Finance & Management gGmbH
Prof. Alexander Bassen	Hamburg University

Civil society/sustainable finance specialists

Dr. Karin Bassler	Arbeitskreis Kirchlicher Investoren in der evangelischen Kirche in Deutschland
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Antje Schneeweiß	Arbeitskreis Kirchlicher Investoren in der evangelischen Kirche in Deutschland
Regine Richter	urgewald e.V.
Matthias Kopp	WWF Deutschland

Observers

Financial industry associations	German Banking Industry Committee German Investment Fund Association (BVI) German Insurance Association (GDV) Arbeitsgemeinschaft für betriebliche Altersversorgung e.V. (aba)
Supervisors/ public authorities/ federal development banks	Federal Financial Supervisory Authority (BaFin) Deutsche Bundesbank Federal Environment Agency KfW Group
Real economy	Association of German Chambers of Industry and Commerce (DIHK) Federation of German Industries (BDI)
Civil society	German Council for Sustainable Development (RNE)

Secretariat

Laurence Trillig
Isabel-Desirée Harnisch

Published by

Sustainable Finance Committee of the German federal government
c/o Federal Ministry of Finance
Wilhelmstr. 97, 10117 Berlin
Germany
www.sustainable-finance-beirat.de
E-Mail: SFB-Geschaeftsstelle@bmf.bund.de
Phone: +49 30 186 82 - 23 44

Design Frank Fienbork, www.fienbork-design.de
Consulting Nick Tewes, www.spaceship-institute.com