Opinion by the Czech National Bank

on the „Interim Report of the EU HLEG on sustainable finance“

The CNB’s general position on sustainable investment and its regulation

The CNB is aware of increased interest in sustainable investment in the context of efforts to meet the obligations stemming from international agreements on the climate and sustainable development and of the related political intention to mobilise financial sector resources for this purpose.

In recent years, greater awareness of sustainable investment has led to higher interest on the part of institutional and individual investors in green bonds, but also in shares, alternative investments and investment funds with ESG elements. As global financial institutions are increasingly responding to the increase in investor demand, the recommendations of the Commission’s HLEG expert group, like those of the FSB TCFD, can be regarded not only as an important contribution to increased awareness of the entire financial sector on the issue of sustainable finance, but also as a step towards potential greater adaptation of the financial system from the perspective of ESG principles, including its regulation.

The CNB believes that the issue of sustainable investment will be increasingly promoted in the years ahead given the comparative stabilisation of the global financial system and continued political efforts to achieve the goals of the Paris Agreement. These endeavours are likely to have a significant impact on the current functioning of the financial system.

On the one hand, we can say that industry activities using facultative standards and codes of conduct have worked well so far in this area. The CNB can therefore support the expansion of the existing good experience of (global) financial institutions with sustainable investment and the introduction of ESG factors into investment in this “voluntary” form. However, the CNB also believes that steps consisting in direct or indirect interventions by politicians or regulators in the behaviour of financial institutions in order to promote policy objectives by weakening free market principles should not be supported in this area in the future.

The CNB’s position on selected recommendations of the Interim Report

The CNB is aware of the interest of market participants in investments with ESG features and welcomes discussion which will help to clarify how these investments are to be treated, including proper implementation of ESG investment strategies and transparent communication.

In general, the CNB strives for financial market regulation fostering prudent conduct of supervised entities and consumer protection, supporting natural market behaviour of economic agents and remaining predictable to the greatest degree possible. In recent years, financial market institutions have had to adapt to new European legislation focused on preventing crises in the financial system, higher transparency of the accounting system, more objective ratings and more transparent financial instruments. Full implementation of some of these rules has yet to be completed, so it is still too early to make a comprehensive evaluation of their impact. In the medium term, therefore, we do not consider it to be very appropriate to submit further proposals for major changes to EU financial market legislation, as expanding the regulatory framework for some types of exposures/investments could deflect existing regulation from its originally intended course. Prudential regulation of financial market entities should not be a tool to support selected branches or entities in the economy for which it has not been proven that they are associated with a lower degree of risk to financial market stability, financial market participants or e.g. a lower degree of uncertainty for investors. We prefer industry initiatives supporting justified changes in relevant corporate internal rules and codes of conduct in this market segment which respect some ESG principles as opposed to a direct change in regulation. The industry's steps taken in the area of sustainable investment so far can be regarded as beneficial.

According to the CNB, some recommendations in the Interim Report are ambitious, especially mandatory inclusion of sustainability criteria in all decision-making processes and investment decisions of financial institutions (e.g. in the area of fiduciary duties of owners and asset managers) and the duties of supervisory authorities (e.g. SREP). This could have significant impacts on the functioning of the financial system as a whole, posing increased risks to financial market stability, investment decisions and consumer protection. In this sense, some inappropriate measures could be counterproductive in respect of the current objectives of financial market regulation. ESG principles and their application cannot be assessed in a situation where the financial system is still partly absorbing the crisis of 2008–2012. The proposed measures must be assessed with regard to potential and considered changes in the financial market conditions, e.g. as considered in the current stress-testing of financial market institutions. Maintaining the competitiveness of institutions operating in the EU is another necessary criterion. However, the assessment must be based mainly on the fact that the fundamental free market principles must by no means be weakened. Substantial interventions by the state in the decisions of financial institutions and investors could disrupt these principles and have potential negative consequences. Potential forced marked reorientation of economic agents on selected long-term criteria could, among other things, lower their solvency and reduce financial market liquidity.

The CNB would support the recommendation regarding the introduction of a transparent classification of sustainable investment, although it is aware of possible problems in creating correct and exhaustive definitions of all categories of sustainable investment. A standardised list of sustainable investments could be beneficial to investors, especially in a situation where doubts arise whether some projects labelled as sustainable are truly sustainable and whether such a label is not used merely as a marketing tool by financial institutions.

The CNB could support further standardisation on the green bond market. However, a potential legislative solution should not deliberately favour a certain type of investment, e.g. via lower capital requirements, or substantially limit financial institutions or investors in their choice of investment opportunities. Investment decisions must continue to be based primarily on economic incentives and stimuli rather than be determined by legislation. The CNB prefers industry initiatives leading to changes in relevant corporate internal rules and codes of conduct in this market segment as opposed to a direct change in regulation.

Furthermore, the CNB would not support potential recommendations concerning changes to the accounting framework, as the primary goal of financial reporting (financial statements, corporate reporting) is to provide information for the economic decisions of the users of financial statements, especially investors, enable them to reliably predict a company's future cash flows and provide information about its financial situation and financial performance. This information should not be distorted by other factors, especially political ones. Recommendations aiming to restrain fair value measurement, in particular as regards equity instruments and structured instruments (e.g. complex lending structures) cannot be beneficial from the long-term perspective.[1]

[1] Potential constraints on identifying and resolving existing losses on investments, especially for pension funds, insurance companies and similar institutional investors, may have significant adverse effects in the long run. Pension scheme planholders and insured persons in the investment (saving) phase will be satisfied by

In addition, the CNB does not regard as very beneficial the extension of integrated reporting, as a further increase in obligatorily disclosed information may cause the main performance and financial indicators to become obscured. We consider the current reporting requirement to be very extensive and regard any further increase as undesirable.

The CNB does not deem greater involvement of the European supervisory Authorities (ESAs) in promoting ESG features to be necessary. Likewise, it does not regard promoting ESG features in the relevant ESA Stakeholder Groups as appropriate.

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information that their investments (made through management companies – institutional investors) are not declining in value and are beneficial with regard to the ESG features, but when the payment phase begins (when the pension, rent etc. is calculated), they may be significantly disappointed, or even incur a damage, as the portfolios may not be able to generate sufficient cash flows to cover claim payments. As regards portfolio managers, a shift away from fair value measurement of portfolios has a positive effect in stabilising the asset management fees derived from the non-declining value of the assets managed. The recommendations in the area of accounting will thus in fact contribute to a situation where the costs related to sustainability of the European economy will be shifted to the future generations of households (pensioners, insured etc.), which may have far-reaching social and economic consequences.