The role of banks in Europe's Green Deal

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The Just Transition Mechanism addresses the socioeconomic impacts of the transition, focusing on the regions, industries and workers who will face the most pressing challenges. The overall mobilization of at least **150 billion euros includes three pillars**: a new Just Transition Fund, a driver for investment; a specific scheme, which encourages investment; and the Public Sector Loan Facility, created with the EIB.

The grant, available to all member states, focuses on the most carbon-intensive regions and those with the highest number of fossil fuel jobs. Member states can access it by drawing up territorial plans for a just transition for the period up to 2030, identifying the territories to receive the most support. **However, these territorial plans should, in our opinion, not only be concerned with creating new jobs in the green economy, but should ALSO support employment tout court,** preventing the transformation, made necessary by the Green Deal, to become indirectly an element of premature expulsion from the world of work of *"no green aged workers"* and consequently leading to a generational jump without intergenerational solidarity. Investment in new technologies must be encouraged and supported, also through major financial policies. The homologating thesis that economic reforms, social progress, and digitization linked to the Green Deal necessarily result in loss of social cohesion, generational dumping between categories of workers, and reduction of the total employment balance must be disdainfully rejected and fought through the action of the social partners at every level. Other employment dumping to be tackled is the one that can be introduced by reward or penalty tax policies, which today are normatively different from country to country, and if adapted ad hoc by each country without an overall vision of inclusive development, can in itself widen, even dramatically, the perception and especially the extent of the social problem. Finally, it is necessary to avoid "passing on" the costs of expulsion processes to the public flexicurity network.

The European Commission's tasks on the issue will probably be more limited in scope than what is a cause for our concern. It will most likely focus on the financial instruments to be put in place, and the role of the banks will be central in this regard. However, we need to put in place collective negotiations with the possibility of creating new jobs related to the green economy, and this is certainly useful and indeed necessary. But it is not enough. In economics, it is well known, "there are no free meals," and it is therefore necessary to avoid "negative externalities," namely to prevent the social bill - in terms of negative employment balance and premature loss of experiential know-how, as a result of the green transition - from being loaded on public accounts or, worse, dumped on families and individuals, generating new poverty. It is therefore necessary for the social partners, at the highest level (starting with the European sector federations and the EWCs of European multinationals) to be the main, forward-looking players in the game of change.

In our view, along with the territorial plans, it will be necessary to develop **(national) plant plans**, or better yet, **company plans at the European level**, in the EWC fora, where they exist. The way forward is through negotiation protocols and collective agreements (TCA, TFA, etc.), which must be promoted and addressed in a perspective that is also green, both sustainable by the people and attractive to the companies involved, in short: without a leap in the dark.

The other aspect to be explored is **the reform of the directive on non-financial information of large companies,** extending the contents of the mandatory annual declaration to specific areas of social dialogue, such as safeguarding employment in the green transformation of companies.

The scope of the research, however, cannot disregard considering the mechanisms for transmitting liquidity to enterprises interested in the green transition: credit itself, and the actors who activate these mechanisms by providing credit: Banks.

The question to be asked is: “**how will banks finance the green transition”?** Bank financing is called upon to support the "Green New Deal" of our economic model but to guarantee results in this regard tools are needed to target and measure the results achieved. Green credit to families and businesses will be called upon to support the shift in business behaviour and actions, as well as consumption, toward a sustainable economic model. But, to do so, we will need clear definitions and measurable standards that, like other areas of "green" (think of the criteria for inclusion in ESG indexes), are still lacking to date.

Credit to families: the real estate division

At the European level, several banking institutions have already been participating for some years in working groups to define rules in the area of "Green Mortgages". With an initial project, EnMaP (Energy efficiency Mortgage Action Plan), in which CRIF participated, banks have been working on the idea of loans that offer rewards in terms of pricing or loan-to-value when improvements are made in a property's energy efficiency. EnMaP identified a minimum threshold for improvement, 30 percent, and a tool, namely the APE, or Energy Performance Assessment in the European taxonomy. A second call, EnDaPP (Energy Efficiency Data Protocol and Portal), also with input from CRIF, aims to define rules for recording and sharing data on energy efficiency financing.

Credit to companies

If we also include credit to companies in the perspective, banks will be called to an important task in the coming years: to finance the transition of our economic model to sustainability. Especially after the Coronavirus emergency made the topic of green even stronger in public opinion and on the governments' agendas. If this transition has to go through finance, big European companies can reason about bonds and financial markets, but for companies, and especially SMEs, the main route will remain bank credit. And here we have to ask**: why should the banks give favourable conditions to customers who make green investments?** The answer is: because they benefit from them. In fact, in the short term, it allows it to support companies towards a path of greater resilience to market shocks and greater prospective profitability of the business, thanks also to the financial contribution of the numerous funds made available by the EIB (European Investment Bank) and EIF (European Investment Fund). In the medium to long term, a revision of the weighting factors for these loans should be envisaged with Basel IV. Finally, let's not forget that the sustainable finance mechanism envisages the possibility of developing the market for Green (Covered) Bonds as an additional means of supplying cheap liquidity.

That being said, there should be a system for monitoring the progress in financing sustainable enterprises, so as to assess the contribution, which is fundamental, of the banking system to the creation of the monetary resources needed by companies. To do this, the route of highlighting, in the documents attached to the financial statements of banking companies, the amount of loan disbursement by class of sustainability of the enterprise could be used. In this way, the time series of the percentage of loans to more sustainable enterprises could be compared. At the same time, one can also plan to disseminate the figure of the number of financed enterprises by degree of sustainability.

However, there is a need to define the tools for measuring "green" (and to qualify the internal "social" of companies as "green")

In other words: if finance is to lead the transition to sustainability we need a European definition that certifies that a funding is consistent with what is set in taxonomy. Financial markets believe that sustainability is, for an equity security, synonymous with resilience, and this idea applies to credit as well. An energy upgraded property reduces CO_2 emissions and, by consuming less, also costs less in utility bills. Then there are the tax incentives for the owner. And, finally, an appreciation of the value of the property, which thus becomes collateral for the financing itself. Looking forward, keeping transition risks well in mind, we can assume that

consumer choices and regulatory change will allow properties with better energy ratings to maintain their value. These are all factors that play into the idea that financing for energy upgrades to a property, residential or industrial, is less risky and thus requires less capital weighting.

ESG rating? It measures risk...

Be careful, however, not to confuse ESG ratings with sustainable financing; we would risk confusing means and ends. An ESG rating, in the credit market, is used in conjunction with a credit rating to support a bank's credit policies: it also serves to mitigate the risk of default. In this sense, it is a powerful tool for banks because it broadens the spectrum of analysis from the financial sphere alone to that of the materiality of the business model characterized by energy and material resources, waste from the production process, human resources, and the composition of the final product, all of which influence the business and the risk of default. Something quite different, for example, from not financing arms manufacturers, which is a policy issue.

... while the green credit finances a project

Different is the case with green financing to enterprises. Talking of a green loan or green sustainability loan means to finance an enterprise that says it wants to achieve a goal and will have to demonstrate that it has done so. The rating is a summary data, here we are talking about ethical and social implications that are important and, finally, measurable and verifiable. Again, it is essential for the bank to work with certifying entities that can assess the actual achievement of the goals.

As stated earlier, it would be important to require banking companies to report, in the documents attached to the financial statements, the number and amount of "green" projects financed.

Banking companies themselves could indicate their internal "green" projects and their funding (not only in economic terms, but also in terms of dedicated resources), meaning "green" objectives dedicated to working conditions such as reduction of consumption in workers' travel as home-work, improvement of logistics and working environment by including "zero km" concepts or eco-friendly work locations, etc.

It is therefore crucial to specify what constitutes a social investment.

Key EU documents, such as the European Pillar of Social Rights and its action plan, the European Social Charter, the EU Charter of Fundamental Rights, and the European Convention on Human Rights, provide solid foundations and inspiration for a social taxonomy. Concerns have been expressed that social issues are regulated at the level of member states and among social partners, not at the EU level. The social pillar aims to remedy this by tending toward a more collective and, above all, supranational approach, harmonizing different national legislations around the guiding values identifying "social sustainability" to be pursued and reported on. Beyond the frame of reference (EU rather than only national), however, **the problem of distinguishing, in practice, social taxonomy from environmental taxonomy remains to be solved**.

There are at least **three reference drivers** in this regard.

1. Economic activities such as job creation are inherently socially beneficial. A social taxonomy must distinguish between these intrinsic benefits and additional social benefits such as improving access to quality health care or securing decent jobs.

2. Environmental goals and criteria can be based on science, but a social taxonomy could be based on relevant international standards such as the International Charter on Human Rights.

3. Environmental taxonomy links criteria to economic activities. However, some social aspects, such as collective bargaining or fiscal transparency, cannot be seen as derivative of economic activities. Rather, they must be linked to the economic entity while remaining independent evaluation criteria.

A proper extension of the taxonomy to social objectives, implementing a taxonomy regulation that requires and implies compliance with international labour and human rights standards by companies that engage in eco-sustainable economic activities, is essential.

The main problem to be solved is that social taxonomy remains to date mainly related to sustainable corporate governance, decent value chains, and sustainable product policy. In practice, it is merely a survey of market sustainability rather than social sustainability (also in terms of inclusiveness) of business choices as such.

The recommendations of the sustainable finance panels refer to documents on social rights in the EU, such as the European Social Charter and the European Pillar of Social Rights. The latter highlights the priorities of the EU's social agenda in the three areas of equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion.

All these aspects will have to be considered, and a distinction will have to be made between the intrinsic benefit of an economic activity or enterprise and additional benefits that contribute substantially to the achievement of social goals. These additional benefits could be training activities aimed at vulnerable groups or the creation of accessible jobs and infrastructure in the most disadvantaged areas. It derives primarily from respect for human rights, including labour rights, through the implementation of due diligence processes, stakeholder engagement, and the operationalization of collective and individual dispute resolution mechanisms. **The taxonomy should also and above all reflect an explicit reward recognition of collective bargaining.** For example, the OECD report "*Negotiating our way up*" sees the mechanism as critical to achieving the three dimensions of the quality of work framework (quality of earnings, labour market security, and quality of work environment) and for growth. Where appropriate, the framework should draw on the expertise of the social partners, both employers and trade unions.

Good sustainable corporate governance should express competencies in the highest governance body: either diversity in the highest governance body (gender, skills, experience, background), including employee participation; or diversity in senior management (gender, skills, experience, background); or executive compensation linked to environmental and social factors in line with corporate´´propriate goals; or anti-corruption and anti-bribery; or responsible oversight; or responsible lobbying and political engagement.

Executive compensation linked to environmental and social factors

One option would be to link ESG factors to the structure of long-term incentive plans and the performance measures to which they are connected, possibly together with claw back or malus measures.

In short, the social taxonomy must consider the broad contribution of companies to society and its social impact on job creation, productivity growth, and the human resource investments companies make for their employees (e.g., compensation, skills development, digital technology tools that improve working conditions, well-being, and job benefits such as pensions and unemployment insurance).

From the introduction of a clear and cogent social taxonomy derives much of the effectiveness of the green transition. The role of collective bargaining in the banking sector, in this sense, is to address both the quality of credit assistance to businesses and families and internal due diligence, supporting a new idea of compliance expanded to include worker participation.