Recommendation of the Council for Sustainable Development
The Federal Government's sustainable finance strategy must break new ground

Berlin, 15 October 2019

The German Council for Sustainable Development (RNE) welcomes the Federal Government's intention to produce a sustainable finance strategy. As part of its efforts to do this, it has set up the Sustainable Finance Committee at the Federal Ministry of Finance (BMF) and the Federal Ministry for the Environment (BMU). A member of the RNE, Prof. Dr Alexander Bassen, has been appointed *ad personam* to the Committee as a financial expert. The German Council for Sustainable Development (RNE) as such has the role of an "observer", which is performed by the RNE office.

Gearing the financial system towards sustainability objectives and measures is a considerable challenge. It is at the heart of the shift towards sustainability which Germany must embrace. This affects all major areas of society including, in particular, transport, construction and the property sector, structural development in rural areas and cities, energy and climate protection, and the food industry/agriculture.

The market and state are not antagonistic components which stand outside the system here: instead, they are closely interwoven in the banking and financial system in general, but even more so in the field of sustainable finance. Market players' personal responsibility and policymakers' rules and requirements define the framework for successful dealings. The key is to strike a good balance between these two components. Sustainable development objectives must ultimately serve as the benchmark. These have been set out by the United Nations in the Sustainable Development Goals (SDGs) and by the Federal Government in the German Sustainable Development Strategy.

This strategy must be further developed. A creative, ambitious approach is needed because the methods and measures employed to date have failed to achieve key goals and/or have proved inadequate.[1]

[1] In June 2019, the German Council for Sustainable Development (RNE) submitted its expectations for the further development of the German Sustainable Development Strategy in a paper entitled Die Strategie muss liefern! Nachhaltigkeitsrat empfiehlt Bundesregierung kreative Konsequenz (only in German). The government will start further developing the strategy on 29/10/2019.

The recommendation below picks up on this idea. With this recommendation[2], the German Council for Sustainable Development (RNE) is building on its living document, which was initiated in 2017 by the RNE members Dr Achim Steiner, Prof. Dr Alexander Bassen and Prof. Dr Günther Bachmann, Secretary-General of the RNE. Since then, it has been further developed at RNE round tables, via the practice of reporting in line with the Sustainability Code, by the Hub for Sustainable Finance (H4SF) and by means of discussions within the RNE itself. Now, the good and fruitful discussions within interested circles must have a political effect. This includes translating them into a productive, credible and results-driven governance system for the dialogue which has been institutionalised in the Federal Government's Sustainable Finance Committee.

As in 2017, sustainable finance – just like sustainability strategy in general – needs to gain a broad social resonance. Market players and NGOs, policymakers and regulators must contribute within their own specific remits. In the German Council for Sustainable Development (RNE), stakeholders from these fields work together in the form of an intermediary consultation. The RNE has a special responsibility as a multi-stakeholder body which strives for a holistic view, understands and weighs up stakeholders' interests, and addresses both deficits and unexplored opportunities.

I. Where the Federal Government needs to take action

1. Establish sustainability as a budgetary principle:

Sustainability is often cited as being a guide for policy. However, there are deficits in the implementation of important sustainability goals. As well as having consequences for specific ministries, this must impact on financial strategy for federal spending. Sustainability must become the criterion for setting the national budget and therefore also the basis of assessment for both the budget committee and the audit offices.

If the 2020s are to be successfully used as the decade of SDG implementation (in which case, this really must be done consistently), all spending must be geared towards the Sustainable Development Goals (SDGs) and the objectives of the German Sustainable Development Strategy. Explicitly giving sustainability constitutional status would be helpful and would provide legal certainty. This matter is high on the political agenda at the German Bundestag.

2. Make German Bunds sustainable bonds:

We recommend further developing German Bunds so that they have an impact which contributes towards achieving sustainability goals. Green and sustainable bonds in particular are desperately needed in order to expand sustainable infrastructure for the rail network, power grids and digitalisation – especially in the light of climate legislation and state restructuring aid (coal transformation).

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[2] The key starting points for the Federal Government's action on sustainable finance were set out in an RNE recommendation to the State Secretaries' Committee for Sustainable Development in January 2019. This Committee then drafted the Federal Government's resolutions on sustainable finance (only in German) in late February 2019, which will be implemented in the coming months.

The Federal Government should present impact studies for the financing of the SDGs and include sustainable investment standards in this, such as the FNG mark or comparable approaches.

3. Invest state assets sustainably:

The Federal Government, the Länder and municipalities have considerable pension reserves and special assets for civil servants' pensions. For instance, the Federal Government has special assets for federal pension reserves and the federal welfare fund worth 17.53 billion euros.[3] These assets should gradually be invested so as to make a positive contribution towards achieving the SDGs.

The Federal Government applies the highest standards to its fund for nuclear waste management, including with respect to sustainable asset management. We welcome this. Greater clarity concerning investment criteria and reporting is needed for this to serve as a good example.

4. Help digital solutions for sustainable business to make a breakthrough:

Throughout the business world, experiments involving digital solutions are being conducted. This raises a host of questions concerning infrastructure, data protection and data sovereignty. In addition to this, however, one question has systemic significance for linking the real economy with the company appraisals used for financial products.

Advancing digitalisation means that the transaction costs for recording external effects have fallen for companies. These comprise environmental, social and economic impacts. Some firms already calculate virtual balance sheets that include environmental and social costs and benefits.[4] They use these for internal innovation management and decision-making regarding risks and opportunities. There is a parallel here with the Industrial Data Space model developed by the initiative *Plattform Industrie 4.0*.[5] If digital solutions for sustainable business have system-relevant penetration, they require a definition of duties of care and generally recognised standards for the evaluation of environmental and social issues. The state needs to act here because it alone can create a level playing field which can set out for all companies what type of data (and what data depth) is meant or which factors should be used for a financial valuation of water or land use, biology or emissions, for example. At present, the state is not doing this. This deficit must be addressed. *Plattform Industrie 4.0* has succeeded in achieving this, but a solution is yet to be found with regard to full-cost accounting. So far, companies have had to use their own approaches, which differ by their very nature.

The trend towards full-cost accounting holds immediate importance for sustainable finance. Conventional financial data only express firms' market value to a certain extent, while a proportion of this value (in some cases a significant amount) in fact lies in their supply chains, corporate culture, staff skills and – importantly – their use of the environment, social infrastructure and the company's context.

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[3] Cf. p. 28 in: Vermögensrechnung des Bundes (only in German), Federal Ministry of Finance, Berlin 2019.
[4] Cf. Value Balancing Alliance e. V., Frankfurt; https://www.value-balancing.com
[5] https://www.plattform-i40.de/PI40/Navigation/EN/Home/home.html

The German Council for Sustainable Development (RNE) advises the Federal Government to become actively involved in full-cost accounting. With the Sustainability Code, the RNE offers a public data space for transparency and social dialogue regarding sustainable business at regional, national and European level.

The RNE will work with the fintech Arabesque to promote and support a sustainable economy public data space. This could help to take a major step towards establishing real prices, which have been called for from an environmental perspective in countless contributions to the debate over several decades.

5. Introduce and establish sustainability as a fiduciary duty:

Liquidity, security and returns remain the primary parameters for decision-making regarding investments. Sustainability must be given more concrete form in the existing regulations for investable assets, e.g. in Article 80 (1) of the German Social Security Code (SGB) IV. This legal text has served as the defining reference to date. It must be amended to integrate environmental, social and governance (ESG) aspects into the fiduciary duties. Sustainability aspects must also be incorporated into the principles of corporate governance for financial market players.

ESG considerations should already be broadly embedded in the internal fiduciary principles set out in voluntary rules of conduct, as promoted by the German Investment Funds Association (BVI) since 2003. This includes substantial requirements pertaining to integrated sustainability management, incorporating ESG factors in investment guidelines, and qualitatively effective experience reports.

6. Consistently align development finance with sustainability criteria:

Financing for development should be geared towards impacts which contribute to achieving the Sustainable Development Goals (SDGs) – not just in a programmatic sense, but also operationally to a much greater degree.

The International Monetary Fund (IMF) estimates that spending of 2.6 trillion US dollars will be needed to finance the SDGs in 121 emerging and developing countries by 2030.[6] Although estimates of this kind are disputed and certainly do not include environmental and social balance sheet costs, the IMF's message is accurate in that the SDGs are not a small matter to be treated as a secondary consideration while development otherwise continues to run its conventional course.

The German Council for Sustainable Development (RNE) recommends that the Federal Government make greater use of its co-decision rights in international organisations such as the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB) and the Green Climate Fund for the purpose of SDG implementation. It should explicitly support the issuing of SDG bonds, whose transparency, prevention of corruption, and environmental and social standards set benchmarks and promote the SDG rating of ODA funding (official development assistance).

[6] International Monetary Fund (2019): Fiscal Policy and Development: Human, Social, and Physical Investments for the SDGs, Washington, D.C., p. 5.

7. Integrate sustainability incentives into instruments which promote foreign trade:

Germany needs to work internationally and multilaterally to lend strong support to an improved, sustainable financial system with suitable financial instruments. The Pact for Africa signed between the African Union and the EU in 2017 established an alliance which was designed to boost investments in Africa, strengthen trade, create jobs, and promote education and skills for sustainable development. However, it still has not taken shape. Together, Germany, economic cooperation partner countries and trade partners face the task of implementing concepts to fund globally sustainable development – for instance by safeguarding exports of sustainable products, goods and services, and by offering corresponding incentives and export credit guarantees which are linked to compliance with sustainability criteria and transparency requirements, such as the Sustainability Code, as a minimum standard.

8. Highlight the advantages of the German banking system:

Germany's savings banks and cooperative banks – and, in some cases, its private banks – represent a particularly stable, SME-oriented part of the financial system in terms of their remit, business model and size. These features play an important role in the discussion surrounding sustainable finance in Germany. They could be cited as a good example of structural stability and sustainability in the international debate.

Publicly owned and cooperative banks enjoy a special status because the notion of supporting the common good and providing for the future is embedded in their sense of identity. This should be underpinned substantively on a regular basis.

9. Actively help shape financial market regulations in the interests of sustainability:

The financial market is largely regulated by the European Commission. For Germany to play a meaningful role in this process (never mind act as a forerunner), the Federal Government needs an overall concept for its contribution to sustainable financial and economic policy. It must set out how the social market economy should be linked with sustainability and human rights policy by means of regulatory policy and which different options should be used to achieve this in relation to regulatory policy, personal responsibility, joint commitments by the state and market players, and modern, agile reference procedures.

The work currently under way on the taxonomy of green and sustainable finance is important but not sufficient. This serves to clarify the concept of sustainability for market players, which is important so as to put an end to the industry's underminingly imprecise and clichéd use of the term "sustainable". Tried and tested methods for the exclusion of certain sectors or the selection of best-in-class performers, for example, must be enhanced with regard to impacts, due care and transparency.

Oversight and auditing practices are also expected to take up the above-mentioned sustainability rating trends. It is possible to apply simple but effective criteria and processes which should increasingly be tested and/or adopted.

10. Ensure that the European Central Bank (ECB) upholds the sustainability principle:

The mass purchase of government bonds and securities by the ECB is rightly a controversial topic in terms of both economic and social policy. It is therefore doubtful whether sustainability criteria would actually help. Conversely, there is no doubt that securities which are linked to corruption, environmental destruction, human rights violations and the production of prohibited weapons are an obstacle to the necessary financial security and that their acquisition must be terminated as a matter of urgency. Furthermore, the ECB would certainly not be able to make comparatively broad-based purchases if it were to adopt the sustainability goals and publicly report on this issue.

II. Where market players need to take action

1. Improve the information basis and ratings:

There are many sustainable investment strategies: negative screening, integration, best in class, norms-based screening, engagement, divestment, the exercise of voting rights, thematic funds and impact investing. They differ significantly in their impact and with regard to the volume of capital which can be invested.

The amount of information provided to investors and communication about impacts and objectives should be extended. This is within the power of market players.

Linking sustainability and digitalisation with one another is crucial for a future-proof financial system. Better use must be made of (reporting) databases and supply chain systems for ratings in connection with sustainable investment decisions. As explained above, digital technology makes it easier to internalise external effects. The market must make broad, collaborative use of these possibilities.

Granular yet standardised information can be used to develop individual scenarios. With the recommendations of the Task Force on Climate-related Financial Disclosures, the financial industry has a good framework for focusing more strongly on climate neutrality and climate scenarios. The public wants to know the extent to which investment/credit portfolios and corporate business models are geared towards the 1.5 °C climate target and which steps are being taken towards climate neutrality.

2. Formulate expectations for corporate reporting:

Data transparency, exemplarily integrated thinking and management in the financial market sector are levers for sustainable business. This must be reflected more strongly in portfolios, financial products and lending. Financial market players must incorporate their companies' sustainability reports into corporate decision-making and use them as a means of reporting on the integration of sustainable finance. This will improve the quality of the reports' content.

Reporting on climate neutrality and the SDGs and on steps to integrate sustainability into both key business activities and the supply chain is currently insufficient. It would be relatively easy to change this. The Sustainability Code already offers concrete guidance on the materiality of business fields in relation to sustainable finance.

3. A sustainable financial industry invests in sustainable companies:

Funding for sustainable business ideas must be stepped up. This calls for a comprehensive communication and information offensive by all market players. In the ideal target scenario, investors and the funded companies should both strive for effective sustainable management collaboratively and in equal measure. This would enable them to generate mutual advantages.

Operating reserves, pension funds and foundation asset investments are only being used to a limited extent at present. This offers further potential for market players.

We recommend that the financial industry draft a profile for sustainable business in Germany containing a cross-industry list of the business practices and fields which investors expect will have the greatest impact. It should also set out issues where a substantial breakthrough is expected in the next decade and which are already relevant from a financial viewpoint (e.g. technologies like power-to-X, climate-neutral aircraft engines or social projects such as car-free neighbourhoods with equitable transport systems).

4. Sustainable finance must set standards in the property industry

Sustainable construction which embraces the circular economy, climate neutrality, fair wages and social rents should become the norm within the property industry.

Over recent years, strong interest from international investors has generated high returns – whilst simultaneously leading to a shortage of affordable housing. The public authorities should link the licence to invest with transparency requirements and give precedence to investors who can demonstrate that they pursue objectives which are positive for society and the environment. Examples from a number of municipalities show that this can be done (Münster, Vienna and elsewhere). In the interests of a sustainable financial sector, funds from money laundering and tax havens or from countries associated with human rights violations should not be able to enter the German property industry.

5. Build up social acceptance and participation in an inclusive financial sector for sustainable development:

Market players have a responsibility to society as a whole to further enhance sustainability competencies throughout the population. Everyone must have the same opportunities to recognise and utilise their own financial opportunities if they wish to do so. Resilience and self-efficacy are at the heart of sustainability.

A viable financial system also requires social acceptance. Society only grants a licence to operate if the financial system as a whole seems inclusive and the contribution towards sustainability is comprehensible.

6. Expand financial literacy and continuing professional development to include sustainability issues

Financial literacy must include a basic knowledge of the financial market. Sustainability issues should also be incorporated into continuing professional development in the financial sector. Providers of formal and informal education should cover the topic of sustainability. Policymakers and senior representatives of the banking oversight and regulatory system, commercial and development banks, the fintech sector, savings banks and cooperatives should clearly explain the connection between sustainability and individual approaches to savings and investments to both their employees and their customers.