THE 3fP-TRACKER

Handbook
1. ABOUT THE FINANCE FIT FOR PARIS (3fP)-TRACKER

Green finance has been gaining a growing attention across different actors inside and outside financial markets, including civil society, regulators and in particular governments across the EU. Public awareness on the relevance of aligning finance with overall climate protection ambitions was initiated and supported by international policy agreements. First and foremost, the UNFCCC Paris Agreement calls for “Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.” (Art. 2.1.c), but also the sustainable development goals (SDGs) are relevant policy frameworks in this regard. Most relevant are the currently intensifying European discussion and related processes on aligning the financial regulatory framework with the long-term sustainability policy goals (e.g. HLEG, Action Plan on financing sustainable growth, TEG).

However, the increase in number and intensity of activities addressing green finance is not automatically based on a robust and well justified or agreed understanding of direction, sequence, or ambition. There still is a substantial gap in linking proposed and discussed activities under green(ing) finance agenda(s) to formulating targets and pathways toward actual financial market regulation and policies that would be required to support delivering the low carbon transition through and by the financial markets.

Against this background, Worldwide Fund for Nature Germany (WWF) and Frankfurt School – UNEP Collaborating Centre for Climate & Sustainable Energy Finance (FS-UNEP Centre) have been developing a financial regulation performance tracker as an information and communication tool. The methodology underlying the “finance fit for Paris – tracker tool (3fP) aims at assessing the adequacy of financial regulations and policies in a given jurisdiction to support the low carbon transition and greening of financial markets. The 3fP is a web-based platform to engage relevant players in civil society, finance and politics.

3fP seeks to inform perspectives across a wider range of target audiences related to a subject that is often perceived to be technical and inaccessible to non-experts. Analyses and findings from 3fP aim primarily at enabling communication between regulators and civil society, as well as among civil society stakeholders. 3fP provides a comprehensive and structured perspective on main aspects relevant to greening financial market regulation. It provides an in-depth regulatory analysis to inspire civil society’s, regulators’ and market participants’ discussions, and pathways and concrete actions for greening the financial system. With 3fP, FS-UNEP Centre and WWF try to address a crucial information gap in assessing the degree and quality of progress in developing financial market regulation related to its sustainability / climate impacts, with a sound methodology and a coherent approach. Different regulatory pathways may be effective to deliver on the Paris Agreement’s goal, hence 3fP does not present any given combination as the best possible solution for any given jurisdiction or circumstances.

2. ABOUT US

3fP is a joint project developed and implemented by Frankfurt School – UNEP Collaborating Centre for Climate & Sustainable Energy Finance (FS-UNEP Centre) and WWF Germany, supported by the European Climate Foundation:

ABOUT THE FRANKFURT SCHOOL-UNEP CENTRE
The FS-UNEP Centre is a strategic cooperation between Frankfurt School of Finance & Management and UN Environment. The Centre is committed to facilitate private sector capital flow towards investments in sustainable energy and climate change mitigation and adaptation. A primary objective is to bridge the public-private sector gap through think-tank activities combining research, education and project implementation. A key part of this process is to enable the public sector to put in place policies, regulations and initiatives that overcome existing or perceived investment risks and other barriers. Since 2017, Frankfurt School hosts the Green and Sustainable Finance Cluster Germany (GSFCG), an initiative that brings together all relevant players in the financial market to foster the development of sustainable and green finance across Germany. For more details see www.fs-unep.org

ABOUT FRANKFURT SCHOOL OF FINANCE AND MANAGEMENT
Frankfurt School of Finance & Management is a not-for-profit research-led business school accredited by EQUIS and AACSB International. Frankfurt School offers educational programmes covering financial, economic and management subjects, including Bachelor and Master degrees, various MBAs and a doctoral programme, executive education, certified courses of study, open seminars and training courses for professionals, as well as seminars and workshops for those in vocational training. In their research, the members of Frankfurt School’s faculty explore topical aspects of business, management, banking and finance. Frankfurt School experts also manage advisory and training projects on financial matters in emerging markets and developing countries, especially on topics related to microfinance and renewable energy finance. For more details see www.frankfurt-school.de.

ABOUT WWF
WWF is one of the largest independent environmental NGOs internationally, active in more than 100 countries. WWF Germany is part of the international WWF network of independent national organisations. One of WWF’s focus areas of work is the financial system as a lever and enabling mechanism to ensure environmental externalities are comprehensively priced and, hence, becoming subject in investment and financing decision making. As such, regulation of the financial system is one of the key themes WWF is working on. For more details see www.wwf.de.
3. Core Definitions and Glossary

Financial Market Regulation and Policies
Financial market regulation is understood as the legislative measures and regulatory frameworks governing financial institutions and markets, covering all aspects of financial supervision and financial stability arrangements, and all actor groups of the financial sector. Policies in the sense of 3fP are concrete legislative or de facto legislative rules and regulations related to processes. Examples for de facto legislative rules would be interpretations of laws or sector standards that lead to a certain behaviour. Policies may be limited to the agreement of a particular group, for instance companies, public institutions, or governments.
Financial regulation today is primarily developed to ensure financial sector stability, well-functioning markets in the sense of effectiveness, market confidence, market transparency and efficiency. Besides these primary targets, there are unrelated secondary targets where governments strive to increase welfare by ensuring consumer protection, or the prevention of financial crime.

Sustainable Finance vs. Green(ing) Finance
Sustainable Finance is referring to those investments that take environmental, social and governance criteria into account in the decision making process. Usually, green finance is considered as a major component comprising the dimensions of environmental and climate finance. In more precise terms, green finance within 3fP is defined as financial services and products that consider climate protection objectives and that take into account climate change related risks throughout the entire decision-making and risk management process. Within 3fP, the perspective related to green finance is rather a perspective of "greening finance" as the analysis and assessments are conducted with a view as to the financial system as a whole rather than niche segments thereof.
The focus on greening finance does not represent a prioritisation of climate related aspects over the broader sustainability categories. Nor have the institutions behind and related to 3fP such view. In fact, the focus results from limited resources. This focus does by no means imply any assessment of social and governance criteria to be less important.

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Sustainable finance comprises all dimensions of sustainability, i.e. economic, environmental (including climate), governance and social issues, as related to financial decision-making and financial flows.
Climate change related risks

The following table provides an overview on the standard categories of climate change related risks as they are understood and referred to regarding a comprehensive perspective on climate change related risks in 3fP:

| TRANSITION RISK | Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations. |
| POLICY RISK | Financial impact of unpredictable policy changes that have not been taken into account. (e.g. carbon pricing, tariffs). |
| LITIGATION RISK | In recent years an increase of climate related litigation claims has been observed. |
| TECHNOLOGY RISK | Improvements and innovations of technologies e.g. regarding renewable energy and energy efficiency can have a big impact on competitiveness, production costs and demand for special products. |
| MARKET RISK | Change in supply and demand of certain commodities, products and services as climate-related risks and opportunities are increasingly taken into account. |
| REPUTATION RISK | Customer and community perceptions of how much organisations contribute to the transition to a lower-carbon economy. |

| PHYSICAL RISK | Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Organisations' financial performance may also be affected by changes in water availability, sourcing, and quality; food security; and extreme temperature changes affecting organisations' premises, operations, supply chain, transport needs, and employee safety. |
| ACUTE RISK | These risks refer to weather events caused by climate change. E.g. hurricanes, floods, droughts. |
| CHRONIC RISK | In contrast to acute risks, chronic risks are more predictable and less dependent to events. The changes are stable and over the long term. E.g. sea level rise; higher temperatures; chronic heat waves. |

| LIABILITY RISK | Liability risks could arise from parties who have suffered loss and damage from the physical or transition risks from climate change seeking to recover losses from others who they believe may have been responsible. |

4. ECONOMIC RATIONALE
FOR THEORETICAL CONSTRUCT

The design of the tracker construct was derived from the main economic objectives of financial market regulations which are stability and transparency. A third dimension reflects the relevance of public policy in creating an enabling environment. This structure has been discussed, refined and validated through conducting expert interviews and group discussions with regulators, financial market actors, civil society and scientific experts using the think aloud method.

4.1 TRANSPARENCY AND DISCLOSURE

Current mandatory disclosure frameworks lack explicitness on the scope and detail of disclosed information. Market transparency is a requirement for the functioning of a market. The relevance of information and trust for the functioning of a market was initially presented by Akerlof’s “lemons market” (1970). Without the disclosure of any/relevant information, risk neutral investors would always opt for the cheapest option in the market. As a consequence, options with higher quality withdraw from the market and a market collapse ensues. This example may be transferred to climate change related disclosure. Investors need climate-related information to be able to incorporate them into the decision making process. However, until today, the awareness that the consequences of climate change may also have severe financial implications tends to be low as the standard investment horizon is usually shorter than the time it takes until the financial risk stemming from climate change materialises (Minsky moment). If investors were already aware of this risk they were likely to assume a negative impact from non-disclosed climate change related information. A negative reaction from investors can be expected under the hypothesis that material risks related to the consequences of climate change have not been considered by companies or financial institutions. In turn, investors will perceive higher risk which could result in higher financing cost or reduced access to capital. In other words, if investors would consider climate-related information value relevant, further regulation would not be necessary as market participants would voluntarily disclose related information in order to reduce information asymmetry to gain financial advantages like mentioned before.

Increased climate change related disclosure of relevant and useful information leads to increased transparency, which is supposed to induce a better understanding and possibly behavioural change. As the likely consequences of climate change are insufficiently internalized in the absence of a meaningful price of carbon dioxide, creating transparency can signify a first step to induce better understanding about potential exposure to climate-related risks. Also, in case of climate change related disclosure duties, economic actors may get increasingly under public scrutiny. Potential losses in intangible assets such as brand value, corporate image, or reputation may support driving behavioural change. Furthermore, even if the carbon dioxide price would reflect the true cost of emissions, contextual information regarding technologies, transition strategies etc. would be required.

A precondition that information can be disclosed is data availability which we do not discuss in this section as we consider it rather as a technicality than an economic constraint. In case certain information is mandatory, we assume that economic actors develop means to make relevant data available.
Investors in the sense of “end customers” are not able to obtain sufficient information to take qualified investment decisions. In addition, they do not dispose over adequate power to influence the strategic orientation of their assets. Again, insufficient transparency in a market creates inefficiencies such as insufficient information and an inappropriate time horizon to take qualified decisions. The financial system itself and the majority of products offered are highly complex and difficult to understand for non-professional investors. Therefore, regulation may be required to address information asymmetries, create transparency and to support clarity so that end customers are enabled to make informed investment decisions. Probably the most important aspect of disclosure is the information indicating whether long term risk are adequately priced.

4.2 SUPERVISION, RISK MANAGEMENT AND SYSTEM STABILITY

All relevant climate change related risks should be considered in risk management (risk identification). A market failure is assumed if a blind eye is turned to the potential impacts of climate change related risks, often due to their tail risk character and lacking research on exact scope and impact. This refers to both physical risks and risks resulting from the ongoing transition to a net zero carbon economy. There is thus an economic normative rationale for regulation to assure that the financial sector is aware of the full scope of risks in order to address relevant factors in time, thus supporting to avoid disruptive scenarios. Thus, climate change related risks material for the stability of the financial system may be systematically ignored or underestimated. Solid research for scoping and potential impacts of climate change related risks should be encouraged by policy / regulation and supervisory authorities.

Current risk management frameworks lack an appropriate long-term perspective / are biased toward short-term risk management (“tragedy of the horizon”). A second market failure is assumed in the prevalent bias toward a short-term perspective on relevant risks. This is deeply rooted in how financial markets are regulated and supervised. For climate change related risks in particular, relevance may substantially increase in the coming decades. Thus it is critical that regulation today includes incentives to integrate longer-term perspectives into standard financial risk management.

Climate change related risks have yet to be aligned with standard risk metrics and risk management approaches in the financial system (flexible and “fit for purpose” risk management). Financial stability should be a goal that is safeguarded in various market environments and during changing market environments. It is therefore critical to integrate climate change related risks into the standard risk management metrics and methods, to make the existing system of financial regulation and supervisory practice robust and fit for purpose in a world where climate change related risks grow in relevance, and increasingly need to become part of the mainstream risk management systems.
4.3 ENABLING ENVIRONMENT

Governments can address different market imperfections through dedicated actions and own engagement, in most cases of temporary nature. This includes supporting the creation of a green(ed) financial market by acting as a role model, ensuring access to green finance knowledge and education. By creating an enabling environment, governments can address several market imperfections. Firstly, by acting as role model (e.g. through own green investments) governments create demand, thus trigger market creation and behavioural change by raising awareness of market participants. Secondly, generating a knowledge-base and providing targeted information to civil society provides a public good as the topic can anchor in public knowledge and raise awareness for the link between finance and the fight against climate change. In an ideal case, this would trigger increased demand for green financial products and enable individuals to make conscious decisions. Thirdly, governments can address positive externalities of innovation in green financial products by stimulating market growth through targeted and temporarily limited incentives like tax reductions, subsidies, or guarantees to green financial products (e.g. to bridge the incremental cost of climate friendly financial products that have a relatively higher perceived risk profile compared to conventional solutions). These actions will create confidence in the sector and market participants are able to reduce their risk perception.

A taxonomy for green financial products can signify a formalized basis to that all actors can reference to as their least common denominator. A taxonomy can provide the formal framework for an enabling environment as it provides market participants with clear definitions and a reference body. Additionally, it signifies a tool for the government to demonstrate the importance of the topic which will help to position green finance as a mainstream topic.
5. ANALYTICAL CONCEPT AND SCORING METHODOLOGY

5.1 THE OVERALL 3fP STRUCTURE

The design of the 3fP is unique as it conducts the regulatory analysis along the main dimensions of a stable financial system: Transparency and stability. Furthermore, it looks into public actions creating an enabling environment for green financial markets. As such, it does not at all attempt building up green financial sector regulation but rather provide an assessment of the current regulatory framework against one that is fit for purpose. In order to enable actors to discuss the way forward.

The 3fP-Tracker is based on three dimensions reflecting the two main objectives of financial sector regulation and the public policy aim of greening finance:

1) Transparency & Disclosure;
2) Supervision, Risk management & System Stability
3) Enabling Environment.

Each dimension consists of sub-dimensions that in turn are compiled by a number of indicators:

**TRANSPARENCY & DISCLOSURE**
- Common disclosure framework

**SUPERVISION, RISK MANAGEMENT & SYSTEM STABILITY**
- Supervisory authority positioning
- Supervision of banks
- Supervision of insurance companies
- Supervision of pension funds
- Supervision asset management and investment funds
- Supervision rating agencies

**ENABLING ENVIRONMENT**
- Supporting green finance with public incentives
- 2-degree consistency of public sector acting
- Public capacity building and awareness raising on green finance
- Established and maintained common taxonomy
- Green public-private initiatives of financial centres
5.2 WEIGHTING OF DIMENSIONS AND SUB-DIMENSIONS

Every country receives a score for each dimension. The score for each dimension is an aggregation of the scoring achieved in the sub-dimensions. All sub-dimensions per dimension are assigned equal weighting, e.g. if there are four sub-dimensions, all of them are assigned a weighting of 25%. However, all dimensions have a different number of sub-dimensions:

- **TRANSPARENCY AND DISCLOSURE**
  3 sub-dimensions, all weighted equally

- **SUPERVISION, RISK MANAGEMENT AND SYSTEM STABILITY**
  5 sub-dimensions, all weighted equally (country)
  6 sub-dimensions, all weighted equally (Europe)

- **ENABLING ENVIRONMENT**
  5 sub-dimensions, all weighted equally

An analogue approach was chosen for the aggregation of indicators within one sub-dimension. Depending on the total number of indicators, all indicators are counted with the same weight within one sub-dimension, resulting in the overall score of the sub-dimension.

This equal weighing approach was selected for three major reasons; firstly, it is easy to understand and maximum transparent. Secondly, the rating is objective and without any personal judgement which would already reflect an opinion about the importance of individual aspects. Thirdly, by not only providing the aggregate score but rather showing explicit scores for each sub-dimension the tracker provides maximum visibility of all the qualitative information that is included in analysing and scoring each indicator. This prevents information to become “less visible” by focusing too much on the top-level aggregate score.

5.3 SCORING BASED ON SCALES

The 3fP-Tracker is based on qualitative expert evaluations which are translated into numerical scores. Indicator scores range from zero (the lowest value) to ten (highest value). Scales are structured by four levels of score-based categories, all of which can be found for all 3fP indicators in the technical annex tables. The four categories characterize different regulatory states. They are derived based on so-called cause-effect chains which can also be found in the technical annex for all 3fP indicators. These cause-effect chains create the link to the economic rationale behind each indicator and its corresponding scoring scale.

The highest category “10” corresponds to the stylised target state “ideal state” which tries to formulate a reference to best practice according to current knowledge to achieve a respective goal. Formulating “ideal states” is a first approximation which does take into account that there is neither perfect knowledge on how financial regulation should be “greened” nor is there one perfect pathway that is to be chosen. The ideal states rather try to reflect an understanding of

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6 Europe has one sub-dimension more because rating agencies are exclusively regulated on EU-level.
comprehensiveness, coherence and transparency. As the “ideal state” is changing over time, the expert team will regularly assess and adjust the “ideal state” and underlying scoring system. The lowest category “0” reflects the least favourable state of no existing relevant regulation. In this way, countries are evaluated on the basis of whether and to what extent they comply with the specified scoring levels and fulfill the 3fP criteria. This scoring is intended to be updated every six months. Within each level, the score can be determined within a range of 3 points as follows:

- Ideal state       8 - 10
- Some shortcomings  5 - 7
- Major shortcomings 2 - 4
- Not existing      0 - 1

The ideal state is designed in such a way that there is not only one ideal state but many ways to achieve. This means that the description of the ideal state which would allow providing full score is rather focusing on conditions to be effectively implemented. The style and used vehicle (e.g. hard or soft law) remains unspecified. As such, a country could receive full score for an indicator for disclosure regardless if implementation of a change in accounting treatment was done in the commercial code or just in its implementation guide as long as it is effective.

Information used for scoring and explanation of scores:
The experts translate the assessment based on existing financial market regulation and policies, into a numerical rating. Official recommendations or self-commitment statements are considered in analysis but result in lower scores than existing regulation. Standardising the analytical process in this way makes targeted comparisons of reform acts possible. This method presents significant advantages as it allows, for example, a distinction to be made between rights granted de jure, their de facto implementation, and reflecting on intended processes.

5.4 SCORING AND VALIDATION PROCESS

In order to ensure the validity, reliability and comparability of the assessment, each individual score undergoes a multistep review process:

1. Expert from the core project team assesses one country.
2. Second review by another expert within the core project team.
3. Review and discussion with country experts
4. Refining of assessment based on consultations with external experts from various fields (legal, regulation, civil society etc.).
5. Final decision on assessment within the 3fP steering committee.
6. DEFINITIONS AND CONCEPTS OF THE 3fP-TRACKER DIMENSIONS

3fP is a snapshot of where the national financial regulation stand today against the imperative of the <2-degree target, and a guide to where the evolution of the regulatory framework may go in the future. The 3fP-Tracker brings together the dimensions of transparency, stability of the financial system and the enabling environment. These dimensions are used based on the following definitions:

6.1 TRANSPARENCY & DISCLOSURE

Market transparency is a requirement for the functioning of a market. In perfect markets any information would be available at any time. Information as such has major influence on risk perception and thereby on the pricing of an asset. Since a long time disclosure of financial information is mandatory, further regulation on non-financial aspects which have significant impact on business activities such as strategy, governance, risk management etc. followed. However, until the EU directive Directive 2014/95/EU enacted on national level in 2017, non-financial disclosure in the context of climate and the environment was unregulated. Even though transparency is largely driven by disclosure requirements, it also is created through governance mechanism and fiduciary duties. As such, this dimensions measures how well transparency on climate-related aspects is enforced.

TRANSPARENCY AND DISCLOSURE - IDEAL STATE

In a perfect world, financial system regulation would provide a mandatory framework for climate change related disclosure that is coming close to full market transparency in order to avoid inefficiencies in the market. Such regulation would be necessary as long as there is a mismatch between the investment horizon and the materialization of climate change consequences, or until other regulation will enable the internalization of climate change abatement cost across the entire product value chain. Furthermore, individual (end) investors should be enabled to take investment decisions based on climate-relevant information.

TRANSPARENCY AND DISCLOSURE - SUBDIMENSIONS AND INDICATORS

COMMON DISCLOSURE FRAMEWORK

- Disclosure on governance
- Disclosure on strategy
- Disclosure on risk management
- Disclosure on metrics and targets
- Adapt accounting standards
- Accounting for stranded asset risk
INVESTOR’S FIDUCIARY DUTIES

- Investment evaluation transparency
- Shareholder responsibility for governance and strategy
- Asset manager responsibility
- Executive remuneration policy
- Climate change related risk management
- Customer/beneficiary centricity

CONSUMER TRANSPARENCY

- Packaged Retail and Insurance-based Investment Products (PRIIPs)
- Investment advisor duties
- Retail fund transparency
- Green labels/standard
6.2 SUPERVISION, RISK MANAGEMENT AND SYSTEM STABILITY

Financial stability is a state whereby the build-up of systemic risk is prevented. As stated by the European Central Bank "Systemic risk can best be described as the risk that the provision of necessary financial products and services by the financial system will be impaired to a point where economic growth and welfare may be materially affected". Macroprudential policies aim to:

- prevent the excessive build-up of risk, resulting from external factors and market failures, to smoothen the financial cycle (time dimension),

- make the financial sector more resilient and limit contagion effects (cross-section dimension),

- encourage a system-wide perspective in financial regulation to create the right set of incentives for market participants (structural dimension)."  

Financial stability is a core economic category of financial system regulation and supervision, and financial system stability is in itself a financial policy goal. The dimension “Supervision, Risk Management and System Stability” of the 3fP looks into the underlying regulation guiding supervision and risk management requirements for ensuring financial system stability. It analyses the regulation in reference to a financial system target state that fully reflects all climate change related risks based on current climate science, and fully integrates these risks into all dimensions of risk analysis and risk management.

SUPERVISION, RISK MANAGEMENT AND SYSTEM STABILITY - IDEAL STATE

Based on the three above aspects, an ideal system for supervision, risk management and system stability reflects the full range of climate change related risk, based on solid research and impact assessment, it does so by taking into account an appropriate long-term perspective as relevant to climate change related impacts (often decades, going beyond policy/regulatory cycles or even asset lifetimes). Thus integrating climate change related risks into mainstream risk management and supervision processes complements the existing system from an economic perspective and in general makes the supervisory system and risk management more flexible and fit for purpose in view of transformational trends.

The dimension has the following six sub-dimensions that derive from the general logic of financial market regulation according to different actor groups. This provides the most practicable approach when referring to explicit laws and regulation as relevant for instance for banks or pension funds.

SUPERVISION, RISK MANAGEMENT AND SYSTEM STABILITY
- SUBDIMENSIONS AND INDICATORS

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SUPERVISORY AUTHORITY POSITIONING

- Regulatory body’s/bodies’ awareness to climate risk integration
- Climate change and system relevance

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REGULATION/SUPERVISION OF BANKS

- Supervision of bank governance/strategy reflecting climate change related risk
- Minimum requirements for bank risk management (in the context of the supervisory review process) include ESG/climate risks and a long-term perspective
- Scope of supervisory reports of the regulator (risk profile for banks) during the annual supervisory review process covers ESG/climate risks and a long-term perspective
- Banking stress tests consider climate risks and a long-term perspective
- Capital requirements reflect ESG/climate risks and a long-term perspective

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REGULATION/SUPERVISION OF INSURANCE COMPANIES

- Supervision of insurance governance reflecting climate change related risk
- Minimum requirements for insurance risk management include ESG/climate risks and a long-term perspective
- Scope of supervisory review of the insurance company covers ESG/climate risks and a long-term perspective
- Insurance stress tests consider ESG/climate risks and a long-term perspective
- Capital requirements reflect ESG/climate risks and a long-term perspective

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REGULATION/SUPERVISION OF PENSION FUNDS

- Supervision of pension fund governance reflecting climate change related risk
- Minimum requirements for pension fund risk management include climate risks and a long-term perspective
- Scope of supervisory review and/or stress tests of the pension funds covers ESG/climate risks and a long-term perspective
- Capital requirements for pension funds reflect ESG/climate risks and a long-term perspective

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REGULATION/SUPERVISION OF ASSET MANAGERS AND INVESTMENT FUNDS

- Requirements for organisation, capital requirements and risk management include ESG/climate risks and a long-term perspective

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REGULATION/SUPERVISION OF RATING AGENCIES

- Requirements for organisation and risk management include ESG/climate risks and a long-term perspective
6.3 ENABLING ENVIRONMENT

Enabling Environment refers to actions of governments towards the shift of private sector money to climate related projects and investments. There is the need for a financial system, in which government plays an exemplary role.

Next to the regulatory framework, the transition to a low-carbon economy can be improved by governmental action creating an environment in which market participants have incentives to invest in green projects and change their business conduct. Often an enabling environment can be created by changes in the sphere that is directly manageable by public sector actors and related policies. As such, an enabling environment is often easier to achieve because less barriers compared to hard law regulations are standing in its way. The dimension Enabling Environment has been included in the tracker design as to reach the Paris Agreements and NDCs, governments will need to accelerate this process by setting an advantageous scene for change. Therefore, governments need besides financial market regulation to take action by introducing temporary support instruments that speed this transition.

We are aware that brown incentives could have been assessed as well at this point, but in this first phase we deliberately decided to focus on public green finance incentives only. For future evaluations the team will come up with an approach that also takes brown incentives into consideration.

**ENABLING ENVIRONMENT - IDEAL STATE**

The enabling environment should be designed in such a way that it addresses as many market imperfections as possible without distorting markets by e.g. over-subsidizing. Ultimately, through the enabling environment, general awareness should be raised, a knowledge-basis should be made available to civil society, and a market for green financing should be created with private actors being crowded in. Additionally, the enabling environment should be consistent and following a clearly outlined strategy. This means that Governments should have ended or should abstain from incentives for counterproductive actions like any tax reliefs for brown investments. As a central cornerstone of an enabling environment, a green taxonomy should be designed in a clear and comprehensive manner that provides a neutral and broadly accepted framework across policy, finance and civil society.

**ENABLING ENVIRONMENT - SUBDIMENSIONS AND INDICATORS**

- **ESTABLISHED AND MAINTAINED COMMON TAXONOMY**
  - Established and maintained common taxonomy

- **SUPPORTING GREEN FINANCE WITH PUBLIC INCENTIVES**
  - Government provides financing instruments for green investments
  - There are subsidies for sustainable investments/fiscal policy/taxation of products that reflect ESG criteria
2-DEGREE CONSISTENCY OF PUBLIC SECTOR ACTING

- Government reflects climate change related risks in its investment strategy
- Government agencies issue Green Bonds
- Green public institution that provides financial services
- Central bank disclosure on climate-related risks

PUBLIC CAPACITY BUILDING AND AWARENESS RAISING ON GREEN FINANCE

- Providing free green label certifications
- Consumer education on green finance is integrated in curricula (schools, universities, general public education)

GREEN PUBLIC–PRIVATE INITIATIVES OF FINANCIAL CENTRES

- Green public–private initiatives of financial centres
FAQ1  Are we tracking existing regulation only or also regulatory plans and announcements?
The assessment covers not only existing regulatory texts but also announcement and plans articulated by governments or their agents. Additionally, the analysis comprises not only hard law but also soft law and policies and takes also voluntary standards or recommendations into account. Especially, these documents do not necessarily have to be issued by officials but by sector associations, NGOs etc. All these documents are assessed because the 3fP-Tracker focusses on how effective the individual indicators within the framework are managed within one country. For example, if voluntary standards are followed hard law regulations may not be required as an effective regulatory framework is already in place.

FAQ2  How ideal is the ideal state?
The description of the ideal state has to be considered as relative for two reasons. First, as outlined FAQ1 the 3fP always assesses how effective the regulatory framework for one indicator is. This implies that there are multiple regulation designs that can achieve full score. There is not one silver bullet as effectiveness is always closely connected to country context and its legal history. Second, the description of the ideal state might be subject to change. In each assessment cycle (every 6 months), we aim to update the ideal states for each indicator according to our latest knowledge. Even though the ideal states are always designed based on best practice examples and/or economic recommendations, there might be additional solutions we and our review expert community may have not thought of.

FAQ3  How about voluntary private sector practice?
Individual practices of the private sector are not taken into account as long as they are in- or explicitly triggered by regulatory actions or voluntary sector standards. This means that of course, we take into account if the whole financial sector has, for instance, implemented ESG criteria in their mainstream investment decisions but we do not analyse the behavior of individual players which might be frontrunners is the field and try to achieve a competitive advantage.

FAQ4  How to benchmark regulatory quality and impact?
Measuring regulatory quality and impact is difficult as it is often not possible to link a regulation to any quantitative performance indicator as it would be possible in other fields e.g. the success of a company measured by its financial performance. Therefore, we assess quality and impact based on expert recommendations such as the High Level Expert Group (HLEG), the Task Force on Climate related Financial Disclosure (TCFD) and on our assessment team’s and peer reviewer’s expertise. At the same time, we are conducting interviews with other field experts in all countries covered and on EU-level to gather their view and recommendation. Like this, we define for each indicator a clear set of criteria that reflect the level of quality of a measure.

FAQ5  How does 3fP relate to HLEG recommendations and the Commission’s action plan on financing sustainable growth?
Of course, the 3fP-Tracker assessment takes the HLEG and the EC’s action plan on financing sustainable growth into account. For the EU-level assessment, the latter even indicates a core document that is highly relevant for the evaluation. Furthermore, all financial market regulation HLEG action areas are fully reflected in our dimensions and sub-dimensions. However, we do distinguish between expert group’s recommendation (either HLEG or any other) and regulatory preparatory processes and actual regulation/legislation. As described in FAQ4, these documents provide us with key information also in regard to the ideal state of an indicator. Nevertheless, we evaluate assumptions taken by others, conduct cross checks and reserve ourselves the right to provide adjusted or different recommendations.