Triodos Bank

Sustainability Classification at Triodos Bank

Position paper in regard to the EU's sustainable finance taxonomy debate

Sustainability as a sine-qua-non: people, planet, profit

For Triodos Bank, Brundtland's principles of sustainable development are fundamental to each and every finance decision:

"Sustainable development meets the needs of today Without harming the ability of future generations to meet their needs."

The Brundtland principles translate in the triple bottom line: people, planet, profit. The triple bottom line implies that decisions will be beneficial for both people and planet and the financial soundness of households, where neither of the three compromises the other two. This need for balance informs Triodos Bank's basic position in the taxonomy debate concerning the classification of activities and assets into "sustainable" and "non-sustainable".

Positive impact as the decisive factor

The starting point for finance decisions by Triodos Bank is ideological:
Investment entities and banks should be aware of the impact their investment and finance decisions have on society, both positive and negative impact. There is no such thing as a neutral financial exposure. Allocating capital (investing or financing) to any economic activity has an impact on staying within or beyond our planetary boundaries and reducing or increasing social inequality and poverty.

Within Triodos, we believe that if we want to promote human dignity, environmental conservation and a focus on people's quality of life in general, a genuinely responsible approach to business is key, including transparency and using money more consciously. Sustainable banking and investment management must be put into practice. First and foremost, this means offering products and services that directly promote sustainability. Money plays a leading role in this because using money consciously means financing and investing in a sustainable economy. This in turn helps to create a society that enjoys a better quality of life.

Manage what matters most for sustainability

To manage what matters most means recognising where the major impact of a financial institution's loan or investment portfolios is felt. Whilst greater transparency and disclosure is a very necessary step in helping financial institutions and stakeholders recognise the issues that need to be addressed, it will not be sufficient until the focus is clearly placed upon the areas of the business which make the most difference. Fundamentally, for banks and investors this is about the direction and allocation of their credit and investment – and the degree to which it contributes, positively or negatively, to key sustainability goals.

For Europe to address the major challenges of today's world including the Paris Climate Agreement and the UN Sustainable Development Goals, we need clarity and focus. We must be clear about the meaning and implications of terms within our taxonomy – to separate what is sustainable from what is unsustainable. But when seeking solutions to challenges where new approaches are required, we need to calibrate our understanding of sustainable beyond a simple classification of 'green' or 'brown', 'social' or 'anti-social'; we have to recognise that there are activities which are:

- non-compliant to our goals, i.e. harmful
- compliant (do no harm),
- adaptive, i.e. which make progress towards a positive goal (e.g. addressing an existing problem albeit with tried and tested means), or
- transformative, pioneering, and accelerating progress towards a positive goal, restoring and regenerating.

This calibration is essential in being able to make rational allocations of positive impact and balance them against choices of risk appetite. No one in the financial sector would make the binary classification of 'risky' or 'not-risky', so we need to develop more sophisticated language around the calibration of our impact.

Likewise, in approaching the potential funding gap to meet the objectives for the SDGs or Paris Climate Agreement, we should recognise that the gaps are not all alike. Some SDG investment gaps have proven solutions that just need to be deployed at scale, such as renewable energy, whereas other approaches require more development and co-creation within a diverse financial ecosystem.

The most important factors to financial sector stakeholders relate to the core principles of sustainability – and these are the areas where there are the biggest gaps on performance. For Triodos, those gaps relate to both planet and people.

Planet: The Paris Climate Agreement

When it comes to climate, timing is everything. We know that we have two years to safeguard our climate and our ability to create a prosperous world. Should greenhouse gas emissions continue to rise beyond 2020, or even remain level, the temperature goals outlined in the Paris Agreement become almost unattainable. The UN Sustainable Development Goals that were agreed in 2015 would also be at grave risk. To be prudent, we need a decarbonisation that avoids stranding major assets.

The transition to a carbon-free economy represents a most exciting opportunity for the finance industry, if the transition is jump-started in a timely manner. The role of leadership within the finance sector cannot be overstated. We need financial sector institutions and leaders – in Europe and across the world – to be partners in the global collaboration to co-create a new sustainable economy.

Recent insights and research on the financial impact of climate change are already driving huge shifts within the finance industry. Carbon is increasingly recognised as a high risk asset whereas the new sustainable, clean and renewable industries are demonstrating that they hold the most promising opportunities. Following the trail of leaders on a mission within the sustainable finance movement, mainstream banks and investors are already pivoting towards a business model that recognises the imperative of supporting society and the environment.

Recommended Action 1:
Defining "Brown" as a class of assets and activities that are not compatible with the Paris Climate Agreement and which should be avoided as from today is the first and most important step in the taxonomy exercise.

Recommended Action 2:
In order to enable the monitoring of the greenhouse gas emissions impact of financed assets and activities, reporting of scope 1, 2 and 3 emissions must become mandatory for all corporates and finance providers without any delay.

Recommended Action 3:
After the class of "Brown" assets and activities is defined, a granular classification can be set up, which follows the three stages of a transition towards sustainable development: compliant (do no harm), adaptive (solving existing problems), and transformative or pioneering (building new sustainable business models).

People & Human rights: re-align finance with society

The HLEG described the purpose of sustainable finance as "to serve the economy and wider society... to underpin balanced prosperity and competitiveness, as well as to promote innovation that generates social inclusion, respects the environment, protects the climate and delivers on objectives for human rights".

Financial regulation does not focus on these goals. The legal obligations of finance usually consist of secondary, enabling, objectives such as maintaining financial stability, transparent market operations, treating customers fairly, and so on. The financial sector's primary social responsibilities – to enable resources to flow to good ideas, or to help manage the relationships between the economy, people and the environment – are taken as read, or at best left for each financial institution to consider for itself.

If we damage our environment (for example by letting climate change occur), and undermine cohesion in society or stall our economies, then we can only logically expect financial instability. What is more, such instability could not be averted using the current set of tools: a financial crisis of this nature would be on an altogether different scale to what we have witnessed to date. Until and unless we recognise the integrated and holistic purpose of finance, we cannot realistically hope to create lasting financial stability. This fundamental paradigm shift in the underlying philosophy of financial sector leadership and regulation is required if we are to create a socially useful finance sector and a resilient future.

A stated purpose of the Commission's Sustainable Finance Action Plan is to channel capital towards socially sustainable activities, as well as discourage the pursuit of one sustainability goal from negatively influencing another, while responding to consumer demands for socially sustainable products. However, the chosen sequencing of the Commission's taxonomy exercise, which prioritises climate mitigation and climate adaptation, ignores the interaction of "planet" versus "people" effects of finance. This is a crucial omission. The protection of human rights is intimately linked to resilient financial institutions, which in turn have a significant role to play in promoting or undermining the development of resilient societies.

The existence of the United Nations' Declaration on Human Rights, International Labour Organisation's declaration on Fundamental Rights and Principles at Work, the Equator principles, fair trade principles, and the like, have not had the desired impact as purported by the Brundtland Commission. There are plenty of tools and metrics available to monitor human rights compliance, but the absence of legislative confirmation seems to shift the balance towards "profit".

Values based banks have been showing that applying the triple bottom line leads to more stable financial returns. Triodos Bank thus calls upon those drafting the classification system of "sustainable" versus "non-sustainable" economic activities, to balance "people" (social) with "planet" (environmental) criteria from the start.

Recommended Action 4.
In the sustainability taxonomy, balance environmental metrics with existing metrics for human rights compliance from the start.

Pricing, valuation & accounting: Engage accounting & rating stakeholders

As rightly pointed out by the HLEG, the accounting standards and rules that are used to assess the financial position and performance of companies; and value assets and exposures, are a crucial part of the information needed to make investment decisions by external providers of capital. If only prices and values would include the true cost of production, reflecting the externalities of an asset or economic activity, people would make different choices.

Other than the obvious necessary adaptations mentioned above with respect to obligatory scope 1, 2 and 3 emissions reporting, urgent actions with respect to the valuation and industry codes used by accountants and rating agencies are thus called for. Changing the way that assets and activities are valued and accounted, including changing the codes, will require solid investigation, testing and backtesting, before a new classification can be effective and lead to a change in finance decisions.

Recommended Action 5.
Start, in parallel with the taxonomy exercise, investigating how to "split" current industry, assets and activity codes in accounting and rating methodologies into "sustainable" versus "non-sustainable" assets and activities within an industry or asset class, and as such, facilitate true cost valuation across the economy.

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