MEMO
N°03

HOW TO SUCCESSFULLY FINANCE THE ENERGY TRANSITION

FÉDÉRATION BANCAIRE FRANÇAISE

- The challenges of the Paris agreement

- How to accelerate financing of the energy transition

- What is the Green Supporting Factor ?

01

THE CHALLENGES OF THE PARIS AGREEMENT

A historic agreement

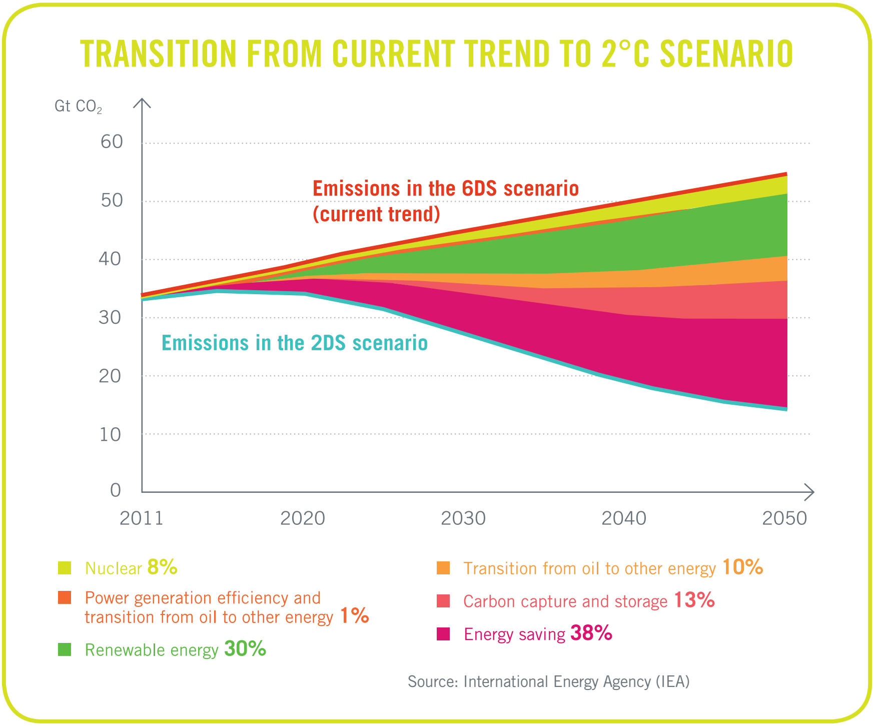
At the **Paris Climate Conference (COP21)**, on 12 December 2015, 195 countries signed up to the **first ever universal agreement on climate change.**

The Paris agreement seeks to strengthen the world's response to the threat of climate change, in a context of sustainable development and combating poverty. Its main aims are:

- **to keep the average increase in global temperature** well below 2°C compared to pre-industrial levels and to pursue efforts to limit the increase even further, to 1.5°C above pre-industrial levels, which would clearly reduce the risks and impacts of climate change;
- **to strengthen countries' ability to deal with** the effects of climate change and promote resilience to such change and low greenhouse gas (GHG) emission development, in ways that do not threaten food production;
- **to make financial flows compatible with progress toward low GHG emission development** and resilient to climate change.

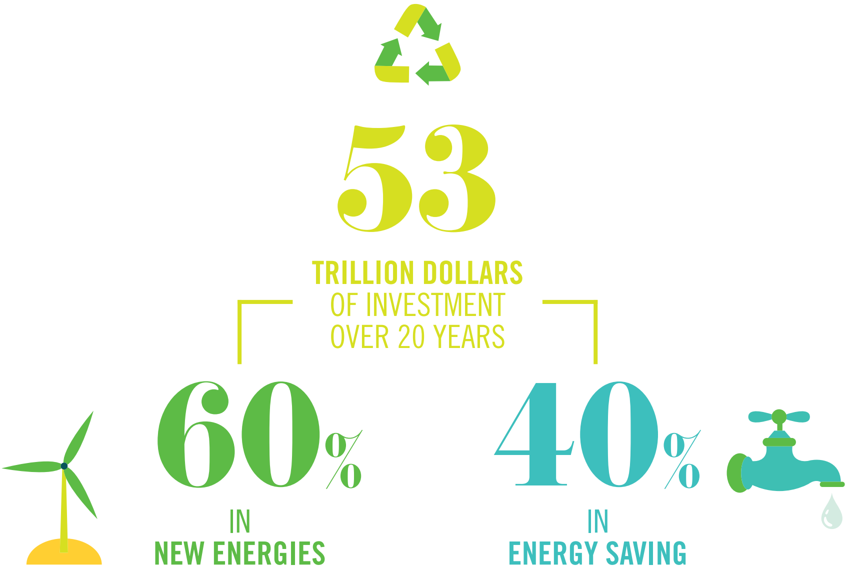
How can these aims be achieved?

According the International Energy Agency (IEA) report Energy Technology Perspectives 2015[1], the aims of the agreement can only be achieved if certain measures are put in place, including measures to reduce emissions of CO2 and other greenhouse gases. The IEA has identified these measures in its 2°C scenario (2DS)[2] which sets out the path that emissions need to follow if the 2°C target is to be met.



Compliance with all these measures to reduce GHG emissions will demand major investment.

The IEA estimates that to meet the 2°C target would require **US$ 53,000 billion in investment by 2035**.



(1) The report seeks to better understand the scale and nature of the challenges posed by energy transition over the next forty years: how best to improve energy security, energy efficiency and the reduction of greenhouse gas emissions, and how to guide innovation and R&D toward the most promising areas.

(2) A scenario that provides at least a 50% probability of limiting temperature rises to less than 2°C, through a near 60% reduction in global GHG emissions by 2050 compared to 2013; this still allows for a total of 1,000 billion tonnes of CO_2 to be emitted between 2013 and 2050.

02

HOW TO ACCELERATE FINANCING OF THE ENERGY TRANSITION

Engagement of French banks

Global warming poses an immediate challenge but also represents a real opportunity for French banks, which have been at the industry's cutting edge for years.

The French banks are well ahead on financing the energy transition and heavily engaged as companies. They are already making a success of the energy transition in their day-to-day work.

Possible actions

The key challenge is to reduce the relative cost of investing in the energy transition, by cutting either equipment costs or financing costs.

Industrialisation and rising volumes have had highly positive effects on the cost of equipment.

Despite the low-interest rate environment and growing awareness of the low-risk nature of the assets promoting energy transition, **the cost of financing the energy transition remains a major challenge.**

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BILLION EUROS OF **NEW CORPORATE LOANS** OVER THE YEAR (DECEMBER 2016 TO DECEMBER 2017).

This equates to 7 wind turbines an hour

To support and accelerate the financing of these assets in an economy where 70% of finance comes from banks, **it is essential to recognise** their benefits for the energy transition.

The universal banking model of French banks means they can support the energy transition while supporting investors, retail customers and businesses, by offering solutions that promote a lower-carbon economy.

GREEN BONDS, AN AREA OF FRENCH EXPERTISE

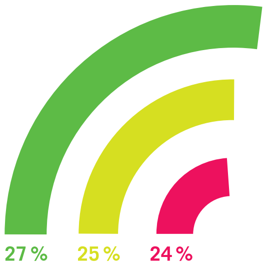
Green bonds, issued by companies, local or regional authorities or international agencies, are specifically designed to fund projects or activities that generate direct environmental benefits. French banks are internationally recognised for their expertise in this area Production volumes, capacity for innovation and their pioneering role in supporting these bonds from inception 10 years ago make them key global players.

France issued a €7 billion green bond in January 2017 and is European leader and No 1 issuer of sustainable debt (global No 2, just behind China and ahead of the USA).

In green bond emission volumes, **Paris is top-ranked, with US$ 33.7 billion issued since 2009** by French companies, ahead of New York (US$15.3 bn) and Frankfurt (US$ 13.6 bn). (source: PwC report, March 2018)

GLOBAL GREEN BONDS MARKET IN 2017 (source: CA-CIB)

Green bonds bought by French investors
Issues arranged by French banks
French issuers



03

THE GREEN SUPPORTING FACTOR

The banking profession is positioning itself as **an accelerator of the energy transition,** and has produced a new innovative tool: the **Green Supporting Factor.**

Prudential incentives

The FBF wants to propose an "appropriate prudential approach" to financing and investment in the energy transition, by incentivising the de-carbonisation of banks' balance sheets and encouraging them to cut the climate risk on their books.

From a regulatory point of view, this should mean a lower capital requirement for financing and investing assets that favour energy transition, in a context where new prudential standards penalize long-term financing and those in infrastructure.

The Green Supporting Factor would work in the same way as the already proven SME Supporting Factor, which provides a 0.7619 factor for capital requirements on credit risks from SME exposures.

Clearly defined eligible assets

To identify which assets are eligible, the FBF proposes using rules laid down by widely recognized certifying bodies such as the French **"Transition énergique et écologique pour le climat" (TEEC)** certificate or the terminology used by the **Climate Bond Initiative.**

Assets benefiting from the Green supporting factor could include:

- financing or investment granted **to counterparties whose business relates to energy transition**[1]. The bank in question would rely on an external certification body to confirm the counterparty's eligibility,
- other financing or investment whose **purpose relates to energy transition**[1].

All participants in the economy would be eligible

To ensure the successful financing of the energy transition, the counterparties eligible for the «Green supporting factor»

should include **any and all participants in the economy, whether financed through retail banking networks or corporate and investment banking:** : individuals, SMEs, companies, banks and sovereign bodies.

For instance, eligibility for the Green supporting factor would cover:

- **individuals** buying an electric car or paying for energy efficiency improvements,
- **SME** constructing a green building,
- **companies** that build or operate solar, wind or energy storage infrastructure,
- **Government bodies** issuing sovereign bonds to finance the energy transition.

Promote European green labels

The promotion of European green labels is also a major issue of international competition: the Green Supporting Factor favours this dynamic.

(1) For instance, as described in Appendix I of the TEEC label

European policy process has started well

The French Banking Federation welcomes the decision by European Parliament rapporteur Peter Simon to include the **Green Supporting Factor (GSF)** in his report on proposed amendments to banks' capital requirements and the comments on this issue by Valdis Dombrovskis, Vice-President of the European Commission.

Published in March 2018, **the Commission action plan for a greener and cleaner economy** also addresses the question of an appropriate prudential treatment: "Banks and insurance companies are an important source of external finance for the European economy. The Commission will explore the feasibility of recalibrating capital requirements for banks (the so-called green supporting factor) for sustainable investments, when it is justified from a risk perspective, while ensuring that financial stability is safeguarded" (source: European Commission press release, 8 March 2018).

The Commission confirms that the first step toward implementing the GSF will be the creation, starting in Q3 2019, of the professions demands for **a European taxonomy** focussing on climate change, and activities related to environment and social issues. The Commission also picked up the banking industry's argument for **the creation of standards and certifications for green financial products and assets**. Early work by the Commission will focus on standards for green bond issues. Regarding **sustainability disclosure** , the Commission's thinking is notably based on French legislation (article 173 of the energy transition law).

The French banking federation also won the backing of the Italian Bank Association in January 2018. The European Banking Federation has also said it supports the **Green Supporting Factor.**

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