European Association of Public Banks
European Association of Public Banks and Funding Agencies AISBL

EAPB POSITION PAPER

The Role of Promotional Banks in the Transition towards a Sustainable Economy

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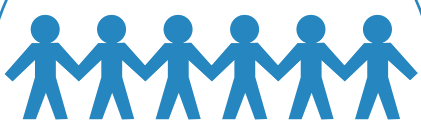
The EAPB and its members – an introduction to promotional banks

The European Association of Public Banks (EAPB) represents national and regional promotional and public banks, including municipality funding agencies and public commercial banks. Promotional banks are principal agents of the transition towards an economy that is more in line with the needs of nature and the people living in it. They are mission-driven institutions which use financial instruments to execute a public mandate on behalf of their governments and public sector shareholders, promoting economic development, environmental sustainability, and social equity.

Promotional banks are neither profit-maximizing nor required to pay dividends to private stakeholders, allowing them to fund activities with long-term benefits for the community and the environment, at advantageous rates and in a financially sound way. Activities range, amongst others, from the funding of public sector entities and companies, and the promotion of a sustainable economy to the financing of social housing, health care, education, and public infrastructure at national, regional, and local level. Unlike commercial banks, which may focus on areas with high returns in the short-term, promotional banks make long-term investments in projects that promote the continuous, sustainable growth of the economy.

From 2020 to 2023, EAPB members issued



Over €40 billion in social bonds

More than €80 billion in green bonds

Opportunities and the role of European public banks

The specific characteristics and the different roles promotional banks fulfil in each member state make promotional banks the ideal partners for achieving the European Union's sustainability goals. This section covers a number of ways in which European public banks can play a key role in financing the transition to a sustainable economy.

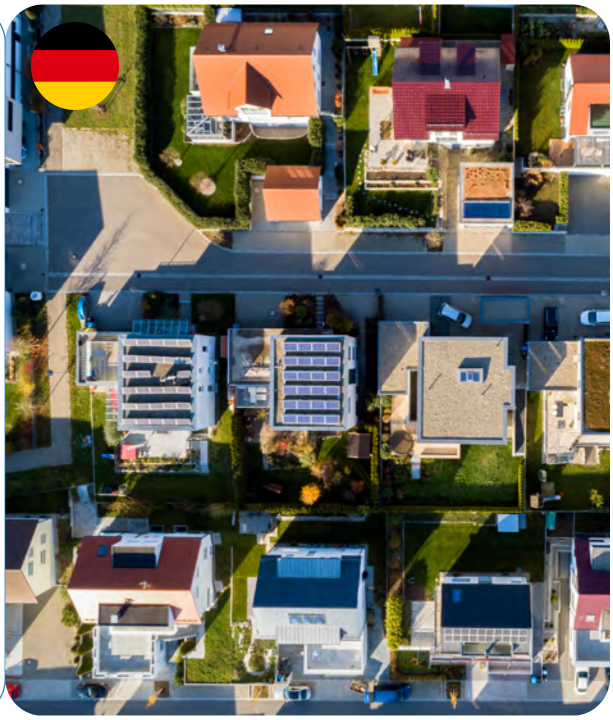
Impact Finance: Supporting Long-Term Sustainability

Building a sustainable economy requires resilience to developments and external shocks, including environmental disasters, economic downturns, social disruptions, and climate change. The transition to a sustainable economy often requires significant upfront investments in infrastructure, technology and innovation. Promotional banks differ from normal banks in their targeted investments and their focus on social and ecological sustainability and economic development goals rather than purely financial profit maximisation: we call this impact finance. For example, patient capital provided by promotional banks allows projects with longer-term horizons to secure funding, even if they may not generate immediate or high financial returns. This enables the development and implementation of sustainable solutions that may take time to mature and demonstrate their fulll impact, making promotional banks the backbone of the transition.

Promotional banks offer patient capital for long-term, sustainable projects, crucial for supporting the transition.

One example of impact finance is the NWB Bank, a Dutch public bank. NWB Bank finances the Dutch water authorities, regional governments responsible for many aspects of climate adaptation and mitigation, such as dikes and flood defence systems, that protect the Netherlands against flooding and droughts, and many different projects aimed at protecting biodiversity and increasing water quality. The financing of the Dutch water authorities' investments not only counts as impact financing but also plays an important role in mitigation of ESG risk.

NRW.BANK, the public bank in North Rhine-Westphalia, focuses on financing social housing projects for private and public investors as well as for private households. Instruments used include loans with long durations, advantageous fixed and low interest rates and repayment discounts. Loans are bound to social criteria, e.g. an upper limit for rental prices depending on the housing market situation in the sub-region. Additional promotional incentives are provided e.g. for higher energy efficiency and housing that addresses the needs of the elderly. New construction as well as the renewal of stock is funded. In addition, measures to improve housing stock and neighborhoods in terms of climate adaptation or accessibility are financed.



KommuneKredit, a Danish special-purpose credit institution, has a business model in which all municipalities and regions in Denmark are jointly and severally liable for the associations liabilities. KommuneKredit provides financing for public purpose infrastructure investments in municipalities, regions and affiliated companies. KommuneKredit issued its first loan in 1899 and the list of investments include general municipal and regional financing purposes such as investments in energy-efficient district heating, climate proofing and coastal protection, energy-saving initiatives and climate-friendly transport to social purposes such as housing for marginalised people, senior housing, schools, city museums and sports centres. The investment purposes that KommuneKredit is allowed to finance are regulated by law.

SFIL, a French public development bank that (i) extends loans to French local authorities and public hospitals and (ii) supports the international activity of large French companies through export credit refinancing. SFIL has developed green loans to support its borrowers' transition to a greener and low carbon economy, as well as social loans to support their investments in social infrastructure (education, health, culture, sports...) and urban renewal. These green and social loans are backed by green, social and sustainable bond emissions. In this way, SFIL creates a bridge between the French local public sector and international players of sustainable finance. Green and social loans represented 43% of SFIL's commitments in the local public sector in 2023 compared to 37% in 2022 and 27% in 2021.

Fostering Sustainable Innovation and Experimentation

Many sustainable initiatives and technologies are still in the early stages of development and may face uncertainty and risk. Patient capital allows innovators, entrepreneurs, and researchers to explore new ideas, experiment with different approaches, and iterate on solutions without the pressure of short-term profitability. This fosters a culture of innovation and entrepreneurship critical for driving the transition to a sustainable economy. Therefore, promotional banks often act as catalysts for market transformation by supporting early-stage projects, with private investors crowding in afterwards.

Another way that promotional banks do this is through engagement. A key sector of investment of promotional banks is in public sector entities and SMEs. Public banks not only provide them with cost-efficient funding, but also help them implement sustainable practices, through client and sector engagement. In dialoguing with clients, public banks provide their clients with advisory and educatory services and help them implement sustainability in their business practices and risk management.

Public banks aid public sector entities and SMEs in their transition efforts by offering advisory services and guidance on integrating ESG risk considerations into their business practices and risk management.

For example, the KfW (Kreditanstalt fur Wiederaufbau) has launched a “Climate Protection Campaign for Companies” (Klimaschutzoffensive fur Unternehmen). This is a promotional programme that supports companies of all sizes in investing in selected climate-friendly economic activities that are categorised as environmentally sustainable according to the EU taxonomy. The aim is to promote projects by companies that contribute to achieving climate neutrality and moving away from fossil fuels in Germany and Europe. The funding, provided in the form of low-interest loans, is subject to conditions of the climate protection campaign that are based on the part of the technical criteria of the EU taxonomy that defines the significant contribution to climate protection. The European Commission also specifies further criteria for full compatibility with the EU taxonomy, but these are not part of the funding conditions for this programme. The promotional programme complies with the Paris-compatible sector guidelines of KfW Bankengruppe, which define specific requirements for the climate compatibility of respective investments.

The Polish Development Bank (BGK) prepares and provides free online training for its financed SMEs regarding sustainability and ESG reporting requirements.

The KfW also funds Crop Trust, a vault that helps to save valuable seeds from all over the world in Svalbard, Norway. The seeds are stored in an underground chamber at a temperature of minus 18 degrees, which makes Crop Trust a vital project for securing biodiversity and feeding humanity in times of advancing climate change.

Addressing Market Failures and Externalities

In many cases, market forces alone may not adequately account for the intangible social and environmental benefits of sustainable projects, leading to underinvestment or misallocation of resources. Promotional banks help bridge the investment gap by actively aiming for these often non-monetary benefits for society, ensuring that investments reflect broader societal goals beyond immediate financial returns.

For instance, BGK has launched an Accessibility Fund, which is aimed at increasing the accessibility of buildings for persons with special needs. Eligible accessibility projects include, for example, elevators in multi-storey buildings, elimination of unnecessary stairs and installations of mechanisms for opening doors. These adaptations make life easier for all those who have difficulties in mobility or with poor sight.

Because their investments are mostly long-lived and with a very slow (or non-existent) return on investment, local authorities and hospitals seek long-term financing for their investments. French SFIL can grant local governments and hospitals long loans for up to 40 years, with an average maturity of 20 years in 2023. This range of maturity is hardly available on private financial markets. It is made possible by the peculiarities of a public development bank’s ALM strategy, which relies exclusively on long-term financing (bonds) and low maturity transformation.

Promoting Resilience and Adaptation

Building a sustainable economy requires resilience to external shocks, including environmental disasters, economic downturns, and social disruptions. The countercyclical function of promotional banks allows investments to withstand short-term fluctuations and uncertainties, enabling projects to adapt and respond to changing conditions while staying committed to long-term sustainability objectives.

Veneto Sviluppo, the financial arm of Italy's Veneto Region was among the sponsors and investors of the Viveracqua Hydrobond project, providing a solution for financing water infrastructure in need of ongoing maintenance or replacement to minimize leakage and water waste. Eight water utilities formed a consortium and issued minibonds totalling €300 million. These minibonds were then bundled into an Asset-Backed Security (ABS) to attract broader investment. Veneto Sviluppo, provided a 6 million EUR first-loss piece (in addition to the 24 million second-loss pieces provided by the eight water utilities), the EIB, invested 145.8 million in the transaction. The ABSs were subscribed to by two banks and a regional Pension Fund (Solidarietà Veneto). The participation of Veneto Sviluppo was a key risk-sharing element of the transaction and a risk mitigation factor.

Challenges faced by European public banks

When designing regulatory frameworks, the specific business model of promotional banks is often not sufficiently taken into account by the EU institutions and authorities. Therefore, promotional banks regularly face challenges when implementing and responding to EU rules, especially from the sustainable finance regulatory landscape.

The isolated view on ESG risk

The current regulatory and supervisory perspective on sustainability and ESG risk is microprudential, that is to say it considers ESG risks as they impact individual financial institutions and their portfolios, in an isolated manner. This is in contrast to considering the broader systemic implications as contemplated by a more holistic perspective that also includes ESG opportunities and the positive impact these can have. For promotional banks, double materiality, including the impact of their activities and the ESG risk mitigating effects thereof, as illustrated in the roles and examples provided above, is of fundamental and strategic importance to their mandate and right of existence as well as their public sector shareholders and governments. After all, promotional banks were founded by their shareholders to have societal impact. An isolated view on ESG risk, which does not take into account the impact of financing and the ways this can mitigate ESG risks, then, does not seem to do the systemic character of ESG risks any justice.

Some promotional banks are also regulated in terms of the entities they are obliged to provide financing for by their governments or public shareholders. The manoeuvrability of these institutions is limited, then, in terms of the clients and exposures that they can or even should remove from their portfolios based on ESG risk considerations and in the context of managing or decreasing the ESG risks the institution is exposed to. A more holistic view of ESG risk would serve to recognize these clients as part of the broader system of acting entities that are impacted by and have an impact on ESG factors. Regulators and supervisors state that institutions should assess sustainability risks in their own banking book, but simultaneously are starting to recognize that ESG risks are much more systemic rather than idiosyncratic. Sustainability factors affect the system, the overall economy, not just individual institutions. We welcome this development, and simultaneously urge regulators and supervisors to consider the principle of double materiality in their definitions and requirements for the management of ESG risks.

Promotional banks are of the fundamental opinion that ESG impact and ESG risk cannot and should not be seen in isolation from one another.

Taxonomy alignment

The Green Asset Ratio (GAR), while a valuable metric, excludes significant segments of the economy such as SMEs, making it an incomplete key performance indicator (KPI) for guiding banks strategies and representing the sustainability of their portfolio. The Banking Book Taxonomy Alignment Ratio (BTAR), which includes exposures towards counterparties not subject to disclosure obligations under the Corporate Sustainability Reporting Directive (CSRD), does not preclude a review of the GAR as we believe the GAR will still be seen by investors as the key metric. **Moreover, the role of promotional banks should extend beyond merely aligning its portfolio with the green taxonomy; it should prioritize maximizing the impact of its finance.**

From an environmental perspective, directing attention to the most polluting sectors and endeavoring to mitigate their impact on our planet seems most prudent. Ideally, this transformation would lead these sectors toward taxonomy-alignment of their activities, thanks to funding provided by promotional banks. However, Taxonomy-alignment still presents a considerable challenge to many undertakings, due to factors such as technological limitations, cost constraints, market demand, regulatory constraints or merely due to the nature of the business model. This makes transition finance beyond the green taxonomy crucial.

Transition finance emerges as pivotal in fostering substantial environmental progress by facilitating the evolution of polluting activities into sustainable ones. While financing activities already in alignment with the taxonomy holds value, supporting investments that facilitate the transition of the most polluting activities towards sustainability can yield more significant emissions reductions. Transition finance recognizes the challenges in steering industries toward sustainability and acknowledges that immediate alignment with the taxonomy may not always be feasible. By investing in such projects, promotional banks actively contribute to reducing overall emissions, promoting the adoption of cleaner technologies, processes, and practices in sectors with substantial environmental footprints. This proactive stance not only expedites progress toward sustainability goals but also nurtures innovation and resilience across sectors, ultimately fostering a more sustainable and inclusive economy in the long term.

Promotional banks are instrumental in transition finance, aiding sectors with substantial environmental footprints where emission reductions can be most impactful.

This is why we believe that the focus on Taxonomy and the GAR in the sustainable finance framework might be misleading for investors. **To prevent misallocation of funds, the sustainable finance framework should be complemented by a framework facilitating transition finance and social investments.** For further substance, please refer to our position paper on taxonomy alignment.

Alignment of disclosure regulations and access to data

With a wide array of regulations related to reporting and disclosures, ESG data is of the utmost importance for most banks. Public banks are making a lot of progress in collecting data, in order to better capture ESG risks as well as set quantitative targets for their client portfolios. However, ESG data remains a concern as well, namely due to the following reasons.

Firstly, there is a lack of standardization, which constitutes a risk that data requirements are interpreted differently from bank to bank. Secondly, banks and credit institutions encounter limitations with regard to ESG data availability and consistency. There is a misalignment, then, between disclosure regulations and access to data required in order to comply with said regulations.

Public banks are making strides in data collection to manage ESG risks, but face challenges in complying with ESG disclosure regulations due to inconsistent standards and data availability issues.

For example, municipal and regional public authorities are not subject to reporting requirements under the CSRD nor the taxonomy regulation, which precludes data acquisition for the financing institutions. Moreover, some promotional financial entities are legally obliged to also provide general lending (lending where use of proceeds is unknown) to local authorities, for which ESG data is not available. Also, the development of sector specific European Sustainability Reporting Standards has been postponed by two years, which could be problematic in terms of banks meeting their own reporting obligations. Thirdly, additional costs are involved in collecting ESG data.

Authorities appear to take the view that these costs can be charged to the customer. Whereas this might be the case in the private sector, promotional institutions are supposed to provide funding at preferential conditions (i.e. without profit maximization) as part of their public mandate. The leeway to avoid costly data or the ability to charge these costs to the lending party is therefore highly limited. Finally, some EAPB members are not subject to the ESG disclosure requirements of the sustainable finance regulatory landscape but are however influenced by it indirectly as there is an investor-driven ESG-data demand caused by the EU regulation.

We urge legislators and regulators to push for high standards of ESG data. This could combat the lack of standardization, would allow banks to comply with data and reporting requirements and could combat the limitations that banks face with regard to ESG data availability and consistency. Moreover, we urge legislators and regulators to communicate explicitly on the role of public banks and to provide guidance on how members that are not subject to EU sustainable finance regulation should navigate in this landscape.

The aim of this position paper is to create a call for attention to the position of European promotional and public banks and the role they play in Europe's transition towards a sustainable economy, with the hope of promoting a collaborative effort between the European public banks and policymakers, regulators and supervisors.

For further details, do not hesitate to contact:
Mathilde Pradeau – Mathilde.pradeau@eapb.eu

Avenue de la Joyeuse Entrée 1-5, B-1040 Brussels
Phone: +32 / 2 / 898 30 00
E-mail: info@eapb.eu
Website: www.eapb.eu

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