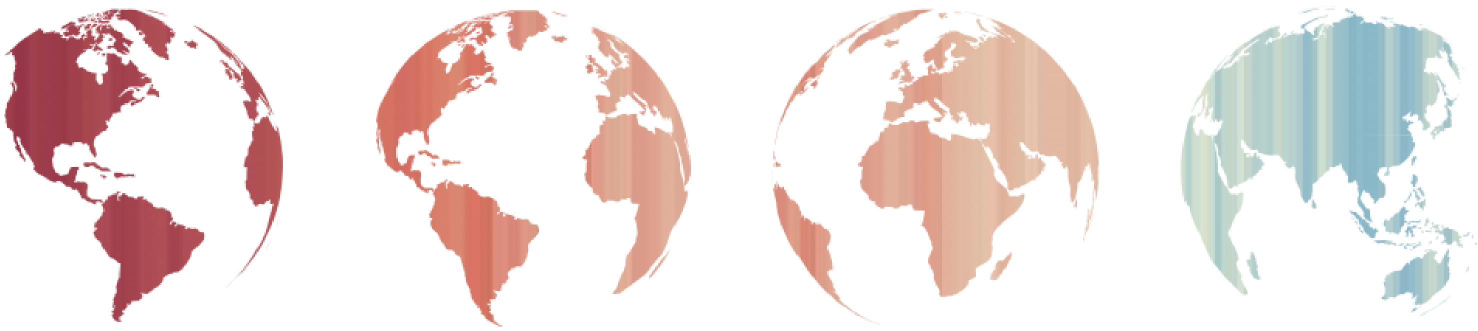
NEUES
WIRTSCHAFTS
WUNDER

The time for Sustainable Finance is NOW!



Policy Paper on
German EU Council Presidency 2020

July 9th, 2020

About „Neues Wirtschaftswunder“ (New Economic Miracle)

The German civil society alliance "New Economic Miracle" was created on the occasion of the hackathon #WeVsVirus proclaimed by the German Federal Government in March 2020.

The initiative is an association of representatives from civil society, business and associations working on the question of how a socio-ecological transformation of our economic system can succeed.

The core demand of the initiative is the alignment of future government aid to the model of a social-ecological transformation, which it first published in April 2020 in the form of an open letter to the German Federal Government, followed by a petition to the German Federal Parliament (Bundestag), a catalog of measures for future government aid and numerous statements and analyzes to the public.

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Sustainable Finance
on the EU transformation agenda NOW!

On 22 June 2020 the German federal government published "**Guiding Principles**" for the German EU Council Presidency. The Coalition restricted itself to a **parsimonious** 13 lines of text without any concrete reference. Beyond uncontroversial platitudes ("for a more innovative, fairer, sustainable Europe") there is radio silence. Chancellor Angela Merkel's speech to the European Parliament on 8 July 2020 was much more extensive, but hardly more concrete.

The **Initiative Neues Wirtschaftswunder** ("New Economic Miracle") is convinced that this important and rare opportunity for Germany must not be wasted. The next Council Presidency is not until the early 2030s! The Federal Government must now use the "**pole position**" to point out and set in motion a socially and economically sustainable path for the whole of Europe. For this reason, we are presenting a **catalogue of proposals, or rather demands, which in its entirety would allow for a turn towards a sustainable European financial system**.

Background

Germany holds the rotating **EU Council Presidency** in the second half of 2020. As the largest economy on the continent and one of the most influential governments in the European concert of opinions, Germany has always played a special role. This goes hand in hand with a correspondingly **great responsibility**. The German Presidency will probably be dominated by the management of the deep social and economic distortions of the Corona crisis. This would be the case in particular if the Heads of State and Government at their summit in mid-July failed to agree on the Commission's proposed €750 billion "Next Generation EU" economic recovery and investment plan. In this case, the German Presidency would have to invest considerable political capital in order to reach an agreement. Political capital that will then be lacking elsewhere.

At the same time, the **longer-term structural challenges** posed by the pandemic have not diminished. The corona crisis must not therefore overshadow all other political efforts. The German Council Presidency must also be characterised by using the crisis to press ahead with long-term **solutions for Europe**. The momentum shown by the new European Commission must be used constructively and purposefully. **The Green Deal**, in particular, represents a level of ambition unprecedented for Europe to get the **escalating climate and environmental crisis** under control after all. The Federal Government must use its political leverage to push this dynamic forward.

At the same time, we call on the Federal Government to add essential elements to the **European transformation agenda**. Some elements have been neglected so far. In particular, European policymakers need to focus more strongly on a **sustainable financial sector**. The European credit and capital markets represent a long lever that must be used in the socio-ecological transformation. The recommendations presented by the EU Technical Expert Group are welcome. But more needs to be done.

Recent **scandals** in the financial market (keyword: Wirecard) also make it clear that further reforms are necessary to safeguard financial market stability and **investor confidence**. The prevailing structures have displayed significant gaps. There is an urgent need to **make improvements** here. After all, if there are doubts about corporate financial reporting and the underlying control systems, how can trust be placed in sustainability reporting, for example?

But even such measures that make the financial sector an "enabler" of climate sustainability can no longer be put off. The enormous upcoming financing requirements for private and public actors require a stable financing basis. A financial sector geared towards sustainability will help Europe to facilitate the upcoming **transformation of its economy**.

However, such a transformation of the financial sector will not happen on its own. The global market for sustainable financing is susceptible to setbacks: in the first half of 2020, for example, the number of green financing emissions fell again, while Europe was still able to eke out feeble growth rates. The sustainable finance market segment must become more dynamic and resilient. This requires **conscious** and **determined** political action. The EU has taken the lead with **important reform proposals**: from **taxonomy** to the standardisation of **"green" financial products** and the disclosure of **sustainability information** on corporate accounting. The German Council Presidency must protect these initiatives from dilution. And it should work towards **complementing** them in several areas.

The following section summarises the **core elements** of our **list of demands**, which will be explained in more detail below. In the second half of the year we will critically monitor the **activities** or **omissions** of the German Presidency in this area. We hope to become **surprised positively**.

Summary of Proposals

1. **Mobilisation of private savings for the socio-ecological transformation.**
Banks in the Euro zome held deposits of €14 trillion on their balance sheets in May 2020. Not only do they not yield a return for savers, some of them are not even passed on to the real economy. These unproductive deposits must be put at the service of the transformation of the economy. We propose a Europe-wide transformation fund through which Europe's citizens can become shareholders in the transformation of the economy and society. Financial incentives and guaranteed returns allow for effective wealth creation for broad sections of the population. They make it easier to finance the necessary investments in the context of the EU Green Deal and strengthen Europe's political stability and acceptance. With good design, public finances would only be put under a minor burden, if at all.

2. **Sustainability indices for the entire bank balance sheet.**
In Europe, most financial intermediation takes place via the credit market, not the capital market. A sustainable finance strategy must therefore not be limited to the capital market. Against this background, ESG ratings should also become mandatory for EU banks across the entire business model: these must reflect activities across the entire bank balance sheet.

3. **Sustainability rankings for asset managers.**
In addition to an ESG rating for individual investment instruments, we call for a mandatory ESG rating for individual asset managers. This institutional ESG rating is calculated across all financial and operational activities of the manager, whether "green" or "brown". Only in this way can investors be sure that the specified sustainability orientation is not just a green fig leaf. Such a rating should not only look at the structure of the assets under management, but also refer to internal governance structures and voting behaviour at general meetings of public limited companies.

4. **Promoting green bonds in the Global South**.
The trend towards an expanded range of environmentally friendly financial instruments is welcome. But green bonds should not be restricted to certain regions. Such bonds can also often have a significant positive impact in emerging and developing countries. Only targeted technical cooperation in design, documentation and standardisation will enable the globalisation of this market segment. Financial incentives can also play a constructive role in here.

5. **Sustainability Performance Targets.**
In order to ensure that corporate goals are more closely aligned with sustainability aspects, there should be an obligation to publicly set concrete corporate sustainability targets. Companies will be encouraged to disclose their sustainability targets and outline strategies for achieving them. A positive track record in formulating and adhering to sustainability goals can increase corporate credibility and attractiveness for investors.

6. **Sustainable financial strategies in the public sector.**
Public procurement accounts for around 17% of the EU's gross domestic product. Its design therefore has a considerable leverage effect. In order to sharpen the incentives for companies, comparable standards should be set throughout Europe on how sustainability aspects are to be anchored in socially and environmentally responsible procurement. All financial

investments by government or state-owned institutions must be subject to binding investment principles, in which sustainability is a key objective alongside investment security.

7. **Financial literacy for Everyone!**
   A sustainable financial sector also includes inclusion and equal opportunities in access to and use of financial services. Basic financial knowledge is as unequally distributed in society as the assets themselves. However, a financial sector that acts in the interests of society also requires a population with sufficient financial education to correctly assess opportunities and risks. On average, women are less informed than men. Poorer households less than rich ones. Existing income and wealth inequalities are thus reinforced.

8. **Fundamental reform of corporate governance standards.**
   The Wirecard scandal must not remain without consequences. Without trust and ethical behaviour patterns, the economy cannot function sustainably. Trust in the integrity of the financial sector has been damaged. It must be restored urgently and credibly. This requires a courageous and all-encompassing reform package that will make the shortcomings and conflicts of interest of the traditional practice of corporate governance, auditing and supervision a thing of the past once and for all. In order for the EU-wide common market to function smoothly and without distortions of competition, the Federal Government must press for Europe-wide regulations.

9. **Investor protection through reliable bank research.**
   The Wirecard case has once again demonstrated the unsatisfactory quality of bank analysts' equity research. The price targets issued were completely unmoored from reality. They probably also contributed to the fact that many small investors who believed the "experts" were seduced to invest in the stock, which ultimately led to massive losses. Wirecard may be an extreme case, but it is not an isolated case. Obvious misplaced incentives in favour of uncritical analyses must be remedied. A regulatory reform linking the remuneration of analysts to the objectively measured quality of their forecasts should be high on the agenda.

The Measures in Detail

1. **Mobilisation of private savings for the socio-ecological transformation.**

Banks in the EURO zone held deposits of **€14 trillion** on their balance sheets in May 2020. This amount exceeds the annual GDP of the euro area and corresponds to €35,000 per capita. And the trend is upwards. Banks are finding it difficult to turn this **flood of deposits** into profit. Often they see no other option than to deposit customer deposits with the Eurosystem. The **negative interest rates** on bank deposits at the ECB amounting to over €1.8 trillion in May 2020 speak for themselves. German banks alone account for one third of this amount.
In other words: **Huge bank deposits are economically idle**. Not only do they not earn a return for the savers, some of them are not even passed on to the real economy. These unproductive deposits must be put at **the service of the transformation** of the economy. By way of comparison, the EU estimates that **€180 billion** would have to be invested annually by 2030 to achieve the Paris climate targets. The necessary financial resources for this lie dormant in bank balance sheets, without any return or benefit. These funds must be raised.

Creative solutions are needed. For example, a Europe-wide **transformation citizens' fund** could be set up, which would invest exclusively on the basis of sustainability principles. The operational basis will be enabled by the comprehensive introduction of the **EU taxonomy**. A state capital guarantee of up to €100,000 can be given to each citizen, analogous to the practice in the European deposit guarantee schemes. This means that citizens will not lose a single cent up to this limit, even if the underlying projects turn out to be loss-making. If, on the other hand, profits are made, they should be distributed tax-free, comparable to the Muni bond market in the US. Furthermore, investments that invest exclusively in financial instruments meeting the highest sustainability requirements should also benefit from a reduction in capital gains tax.

In order to provide citizens with an incentive to deduct their savings from unproductive savings deposits and allocate them to a transformative EU citizens' fund, member states can offer a **guaranteed minimum interest rate** up to the €100,000 limit. A detailed proposal to this effect has already been presented by the German Working Group for Environmentally Conscious Management (B.A.U.M. e.V.). Its exemplary calculations illustrate that such a state/EU-guaranteed interest rate could be made possible without significant sacrifices for the public sector. Depending on the design, the additional tax revenues in the course of the transformative investment offensive may lead to incremental tax revenues which would cover the interest guarantee.

Through Riester pensions and the like, the German state has tried to promote the **accumulation of wealth** by the population. And it has made serious money available for this purpose. However, such initiatives have so far failed to meet the expectations placed in them. The Riester pension alone costs the federal government just under €4 billion per year. With an interest rate guarantee of 2%, almost €200 billion could be invested by the Transformation Citizens' Fund.

Our proposal would not only have the advantage that the funds would be explicitly mobilised for the core of European policy (Green Deal). Citizens would also be direct "stakeholders" of the socio-ecological transformation. This would help to bring about the necessary "mindshift". It would be even better if the proposal were set up at the **EU level**. This is explicitly proposed in the Future and Climate Plan of B.A.U.M. e.V. This would clarify the link to the pan-European transformation challenge. It would also strengthen the bond between the population and the EU. A stronger **bond between the EU and its citizens**, even if only due to the investment returns associated with Brussels, would help to take the wind out of the sails of anti-European and populist movements, which all too often question the necessity of a socio-ecological transformation all together.

Preferential treatment can be applied to both bonds and shares. A tax-privileged "**green DAX**" of the most environmentally innovative companies would channel financial resources into those companies that are particularly committed to sustainability. Not all **ESG indices** today have the quality to effectively separate the wheat from the chaff. Many ESG indices remain on a simplistic and mechanistic level. However, there are already scientific approaches to constructing better indices, for example on the basis of **emission intensities of companies** relative to comparable companies in their sector (see for example the innovative approach of Right.Based on Science).

At the same time, such tax-privileged mechanisms can help to promote the **underdeveloped investment and shareholder culture** that is currently found at best among the most affluent sections of the population. Not only since the ground breaking study by **Thomas Piketty** has it been obvious that the higher returns on capital compared to sight and time deposits are a powerful driver of growing wealth inequality. Distributive justice and environmental and climate protection could be **brought into harmony** here. In Germany in particular, wealth inequalities are particularly pronounced in international comparison. The need for action is obvious. What is missing is the will to implement it.

2. Sustainability indices for the entire bank balance sheet.

In Germany, as in the EU as a whole, most financial intermediation takes place via the **credit market**, not the **capital market**. A sustainable finance strategy must therefore not be limited to the capital market. Against this background, **ESG ratings** should also become mandatory for EU banks **across the entire business model**: these must reflect activities across the entire bank balance sheet.

The first approaches are already in place: in the Fossil Fuel Finance Report 2020, various NGOs have compiled extensive data on the fossil finance activities of 35 globally active banks. So far, however, these innovative evaluations are still piecemeal and do not involve the banks themselves, the objects of the analysis.

At the **initiative of Triodos Bank**, 16 leading German banks with over 46 million customer relationships entered into a voluntary commitment in July 2020 to align their loan and investment portfolios with the goals of the Paris Climate Agreement. The commitment includes the measurement, publication and target setting of greenhouse gas emissions reductions associated with the credit and investment portfolio. This initiative shows that awareness of sustainability is also on the rise among banks. What is still missing is comparability and a regulatory framework.

To avoid **rating inflation** over time, ESG overall bank ratings should be implemented as a relative concept, similar to some fund ratings. For example, 20% of banks would always be in the top fifth and 20% in the bottom fifth. By definition, this cannot lead to a situation where it appears that all institutions are above average ESG-oriented. The orientation is dynamically always anchored at the "**best of class**" and is not based on fixed absolute characteristics. Such a conceptualisation makes a continuous "ESG competition" between banks more likely for reputational reasons.

Banks whose ESG rating is in the lowest category should expressly comment on this in the **annual report** and explain whether and, if so, how the bank intends to improve its positioning. The **transformation of the banks' business models** is thus potentially accelerated. The reporting of the overall bank's ESG rating should be just as prominent and mandatory as, for example, energy efficiency labels for refrigerators, cars or apartments.

A competent European regulator, such as the **European Banking Authority** (EBA), should monitor the quality and comparability of ESG certifiers. To this end, **clear rules** must be drawn up on which providers are to be admitted to offer ESG assessment for banks. This procedure corresponds to the licensing process already established in the EU, for example for credit rating agencies. Currently, ESG ratings are suffering from a wide variation of ratings between different providers. This makes it difficult to compare ESG-ratings and invites "ratings shopping": clients only hire the agency that has produced the most favourable assessment.

We welcome regulatory incentives that make banks' business models more sustainable. However, this should not be achieved through a reduced "green" equity **risk weight** of bank loans, as the European banking lobby has rather self-servingly proposed. After all, if the capital to be deposited for bank lending no longer reflects the credit default risk, the danger of banks getting into balance sheet imbalances increases. This would increase the probability of **banking crises**. Financial and environmental sustainability must not be played off against each other!

The same applies to **credit ratings** by the relevant agencies: they must measure the default risk of bonds and contribute to investor protection. Agencies must call the credit risk as they see it. As soon as non-credit related factors dilute the credit rating, transparency on the capital market decreases, to the detriment of **stability** and **investor protection**. However, care must be taken to ensure that credit risks, which are in fact related to climate change and other ESG risks, are comprehensively and transparently taken into account in the assessment.

3. Sustainability rankings for asset managers.

The market for **sustainable investments** is becoming increasingly popular in the asset management industry. This is encouraging.

According to the German Investment Funds Association (BVI), the share of mutual funds that pursue an **explicit ESG investment policy** has increased eightfold since 2017 to 40%. According to information from the annual sustainability study by Union Investment, the asset manager of the German cooperative banking sector, **80% of institutional investors** are already investing sustainably by 2020.

However, this overstates the actual **structural change**. Pictet Wealth Management reports that in 2019, sustainable ESG funds quadrupled their inflows to over $20 billion. That sounds like a lot. However, given the $74 trillion of financial assets under management worldwide (2018), it is clear that the industry is still in its infancy in terms of sustainability. The very existence of ESG funds says little in itself about the orientation of asset managers (AM). Institutional and private investors are still unable to reliably assess the sustainability of AM operations.

In addition to an ESG rating for individual investment instruments, a **mandatory ESG rating** for individual AM is necessary. This institution-ESG rating is calculated across all financial and operational activities of the manager, whether "green" or "brown". Only in this way can investors have the certainty that the prescribed sustainability orientation is not just a **green fig leaf**. Such a rating should not only look at the structure of the assets under management, but also refer to internal **governance structures** and voting behaviour at general meetings of public limited companies.

For example, the letter to shareholders by Larry Fink, CEO of **BlackRock**, the world's largest mutual with over $6 trillion under management, caused quite a stir in early 2020. In his letter, he placed as strong a focus on sustainability as never before. However, there is still a big gap between **claim and reality**: In ShareAction's 2020 sustainability ranking, BlackRock received only a **poor "D" ranking**, well below the average of its competitors (Share Action Asset owners disclosure project, March 2020). **Green window-dressing** is detrimental to efforts to credibly put sustainable finance in the spotlight. It must be called out.

So far, investors have little opportunity to make informed decisions. Only with the introduction of a binding and European regulated AM ranking can clients select AMs that make **a positive overall contribution to sustainability**. Isolated ESG ratings for individual instruments do not allow this view. Rather, they often serve as an irresistible invitation to greenwash. The financial and reputational incentives for insurance companies to adopt sustainable behaviour would be strengthened by greater transparency.

Such an initiative would **open doors** for many market participants: At the COP25 climate summit in December 2019, **631 institutional investors**, who together manage more than $37 trillion in assets, clearly urged governments to take more effective action to **mitigate climate change**. Politicians are lagging behind the capital markets on this issue. This cannot continue!

Initial calculations of this kind show that **European AMs are leading** the way in terms of responsible investments. This leading position must be extended. It can be assumed that sustainable investment will continue to gain ground globally. A transparent overall ESG rating of AM is therefore **no disadvantage** for the European investment industry as a whole. **On the contrary**: it positively highlights its relative leadership - albeit one that still has a lot of room for improvement - in the rapidly expanding field of sustainable investment. In the medium term, this should provide a **competitive advantage** for European AMs and strengthen the European financial industry as a whole. For various reasons, Europe should therefore have an incentive to finally initiate this overdue reform in favour of sustainability and transparency.

The **European Securities and Markets Authority** (ESMA) would be the appropriate European regulator to oversee the quality and comparability of ESG ratings for mutual funds. ESMA has already gained considerable experience in licensing and effective supervision of credit rating agencies and therefore has the necessary credibility among the relevant market participants.

In order to ensure that the ESG ratings for AMs do not lead to an unintentional crowding out of European investment companies by non-EU providers without an obligation to conduct comparable sustainability assessments, a **border adjustment regulation**, comparable to tariffs in international trade, is needed to prevent "sustainability leakage".

If regulations in non-EU countries do not provide for an equivalent taxonomic classification of AM, the foreign AMs EU **are automatically classified at the lowest ESG level**. This principle of equivalence corresponds to the established model in other areas of the financial market, such as credit ratings. (In the latter case, the regulation is even stricter in this respect than the one proposed here: ratings issued abroad under non-equivalent rules may not be used at all in the EU to count against regulatory requirements).

Thus, the more robust EU regulation potentially has an **extraterritorial** effect. After all, Europe accounts for a quarter of global assets and is therefore an attractive market for AMs worldwide. AMs wishing to be active in the EU will have an incentive to promote the **introduction of EU-equivalent classification standards** in their home market. An EU regulation could thus have an impact far beyond its own borders. This aspect is of particular interest against the background of the dominant financial centre London, which now operates outside the EU.

4. Promoting Green Bonds in the Global South.

Green bonds are on the rise. The International Capital Markets Association (ICMA) has catalogued a total of 450 green issues between 2016 and 2020.

Here, too, **Europe takes a leading position** in an international comparison. The EU's Sustainable Finance Initiative rightly aims at standardisation to give the segment additional momentum. The **proliferation** of different standards must be contained. This is the only way to ensure comprehensible transparency. The trend towards an expanded range of environmentally friendly financial instruments is to be welcomed.

But green bonds should not be restricted to certain regions. In **emerging and developing countries**, such bonds can often have an even broader positive impact. Not only because most of the world's natural resources are located there, but also because there is often a particular need to catch up in terms of environmental and climate protection investments.

Europe should make a **decisive contribution** to the development of such a market. Targeted technical **cooperation** in design, documentation and standardisation can support the globalisation of this market segment. But financial incentives can also play a constructive role. Europe could make bonds safer and thus financially more attractive for investors by **guaranteeing** part of the debt service of poorer countries. There have been examples of similar financial designs going as far back as the so-called Brady Bonds, which enabled the breakthrough in solving the Latin American debt crisis of the 1980s.

Such **North-South cooperation** can help to reduce the risks of impending over-indebtedness of many emerging and developing countries by reducing their debt service burden. In the area of transparent governance, many developing and emerging countries still face considerable challenges. The **reporting obligations on the use of funds in sustainable projects** that go hand in hand with green bonds counteract the danger that the funds raised are diverted into obscure channels and thus fail to have any effect on national development. The latter was, regrettably, all too often the case, most tragically during the government bonds boom in African over the past decade.

So-called social bonds are experiencing an unprecedented ascent in 2020, triggered by the needs of the corona crisis: in April 2020 their issue volume exceeded that of green bonds for the first time ever. However, most of these bonds will still be issued in the rich economies. The design and further development of **innovative SDG bonds** for poorer countries should be promoted. The use of funds would be closely aligned with the **UN Development Goals** (SDGs) and thus also benefit disadvantaged population groups, the poorest of the poor, to a greater extent. Since 2018, for example, the **World Bank** has issued experimental SDG bonds, which could be used as a blueprint.

The **debt crisis** of the world's poorest countries, which is now smouldering again, is also due to the non-transparent and sometimes unfair use of funds. Bonds issued by developing and emerging countries, which provide for **close monitoring** of the use of funds, thus not only promote the achievement of development goals. They also help to overcome harmful **boom-bust financial cycles** in the global South. The EU should play a key role in supporting this process.

5. Sustainability Performance Targets.

In order to ensure that **corporate goals** are more closely aligned with sustainability aspects, there should be an **obligation to publicly set** concrete corporate sustainability targets. Companies should be encouraged to disclose their sustainability targets and outline strategies on how they intend to achieve them. Binding **periodic progress reporting** on the basis **of transparent key performance indicators** (KPIs) ensures that corporate sustainability strategies can be publicly tracked and monitored. This allows investors and other interested third parties to get an idea of the **level of ambition** of the corporate sustainability strategy. Over time, a track record of the achievement of self-imposed goals can also be derived.

Companies are free to publish unambitious or no sustainability targets at all. However, this must also be explicitly and prominently disclosed. This allows activist investors to more pointedly ask management and supervisory bodies about these issues and, if necessary, to refrain from investing. **Entrepreneurial freedom** is not restricted. The more transparent information on sustainability plans does have an impact on the reputation in the area of **corporate social responsibility** (CSR). Ambitious companies can thus gain a **competitive advantage** with customers and investors for whom sustainability considerations are part of the decision-making process.

The **International Capital Markets Association** (ICMA) goes one step further. In its Sustainability-Linked Bond Principles (June 2020), the association of capital market players proposes so-called **sustainability-linked bonds**. These are bonds whose interest rates fall when a company achieves defined KPI performance indicators. Interest rate increases in the event of failures are also conceivable. Such financial instruments could create a financial incentive for companies to anchor sustainability aspects more firmly in their corporate planning.

6. Sustainable Financial Strategies in the Public Sector.

The expectation that private actors will commit to a more sustainable way of doing business must be preceded by **exemplary positioning** by the public sector.

The public sector must lead and look at all facets of its financial affairs through the prism of sustainability. This includes **public procurement**. Public procurement accounts for around 17% of the EU's gross domestic product. Its design therefore has considerable leverage.

Companies with an ambitious sustainability approach should also be able to derive competitive advantages from it with regard to public procurement. In order to sharpen the incentives for companies and strengthen the single market, comparable standards should be set throughout Europe on how sustainability aspects are to be anchored in **socially and environmentally responsible procurement**.

Competition between Member States must be avoided so as not to create perceptions of ambiguity in the private sector. **Transparency** is of elementary importance in this context, to keep abuse and corruption away from sustainability issues in any case. The **EU procurement directives** should be tightened up promptly with a view to make them dovetail more closely with the ambitions of the EU Green Deal.

Regarding the management of **public financial assets**, the German Council Presidency should insist that the public sector impose **strict conditions** on itself throughout Europe. All financial investments by state or state-owned institutions must be subject **to binding investment principles**, in which sustainability (expressed in terms of ESG ratings, for example) is a key objective alongside investment security. In addition to hard exclusion criteria, the **best-in-class approach** should be pursued: preference should be given to financial instruments of those companies or countries that play a **pioneering role** in terms of sustainability aspects.

Some public administrations have already committed themselves to the principle. The government of the German state of **Schleswig-Holstein**, for example, recently presented a draft law to this effect. The impact of this type of initiative would be greatly enhanced if all member states were to adopt a common approach.

7. Financial Literacy for Everyone!

A sustainable financial sector also includes inclusion and equal opportunities in access to and use of financial services. However, a financial sector that acts in the **interests of society** also requires a population with sufficient **financial education** to assess opportunities and risks correctly.

Attempts to measure financial education indicate that the level achieved in Germany is relatively high. According to a relevant survey, two-thirds of German citizens are considered to have a satisfactory elementary financial education. For the EU as a whole, the situation looks less positive: in a global comparison with other developed economies, EU citizens lag behind in financial education.

Basic financial education is as **unequally distributed in society as wealth itself**. On average, women are less informed than men. Poorer households less than rich ones. Existing income and wealth inequalities are thus reinforced. Wealthy people make better financial decisions overall due to their better financial education, which in turn helps to increase their prosperity. The gap between households with large and small assets is widening. This creates divisions in society.

The problem of lack of financial education becomes particularly obvious in times of **zero interest rates**. People who leave their savings on the bank account lose a little bit of purchasing power every day due to inflation. On the other hand, those who invest their assets on the **capital market** can still expect an **adequate return** over the long-term.

The demographic change requires all citizens to act **prudently financially**. To secure **income in old age**, private savings will in many cases have to supplement the state pension in order to have an adequate income in retirement. The lack of basic financial literacy still observed among many social groups, including younger people, thus not only increases the risk of more pronounced relative inequality in society. It also brings with it the risk of **poverty in old age** and **financial dependence**, especially for women.

Financial education must be included as a **compulsory subject** in the curricula of all secondary schools. Special attention should be given to the importance and opportunities of sustainable investment. Only in this way can at least the **next generation** make more self-determined and better-informed decisions. Education should also be offered to **adults**. Care must be taken to ensure that such offers are designed and implemented by **independent bodies**. "Educational offers" by financial service providers themselves should be kept out of the public domain. Such offers are characterised by inherent conflicts of interest. They are therefore unsuitable for an unbiased and neutral transfer of knowledge.

Traditional fears of contact with financial topics must be overcome in the interest of each and every individual. **Opportunities** must be communicated in the same way as **risks**. For example, the widespread reluctance to get involved in the stock market, especially in Germany, must not turn into **unrestrained gambling**.

As the Wirecard case in particular has impressively demonstrated, risky investment strategies can quickly wipe out even large asset positions. A **change in values** towards higher-yielding forms of investment requires **trust**. This trust is repeatedly damaged by financial scandals. Better financial education must therefore go hand in hand with more **robust institutions** that are better able to protect investors' interests. We make concrete and comprehensive proposals in this respect in proposals number 8 and 9.

The initiative of a transformational citizens' fund proposed above (point 1) could be combined with a large-scale **financial education offensive**. For many citizens, this could be the first time they invest in something other than bank deposits or savings contracts.

8. Fundamental Reform of Corporate Governance Standards.

The latest financial scandal surrounding the insolvent DAX company Wirecard highlights in all its severity the **deficits** in the prevailing structure of the systems that are intended to ensure **sustainable and trust-building corporate governance**. The shortcoming here is not only in the way in which the **auditing company** has fulfilled its task. Unpleasant questions also arise about the role of **state supervision** and the corporate bodies themselves.

No economy can function for long without **trust** and **ethical behaviour**. Trust in the integrity of the financial sector has been damaged. It must be restored urgently and credibly. This requires a courageous and **all-encompassing reform package** that makes the shortcomings and conflicts of interest of traditional practice a thing of the past once and for all. For the EU-wide common market to function smoothly and without distortions of competition, the Federal Government must press for Europe-wide regulations.

We must not stop at the lapidary, mantra-like political assertion that something like this should "**never happen again**". It must finally be ensured that the financial market serves society and not the other way round! A **clear break** is needed. There must be a pre-Wirecard era and a post-Wirecard era.

The first thing that seems urgent is a reform of the **practice of auditing**. While the facts in the Wirecard case still have to be legally established, the mere suspicion that the auditor has not fully complied with his duty damages the **integrity of financial markets**. To prevent such situations from arising in the future, the auditing system must be fundamentally changed.

It is no secret that many auditing companies make profits primarily from **consulting**, and less from certifying accounts. This situation creates an almost **insoluble conflict of interest**. This conflict must be resolved. The ideal solution here is to expressly prohibit companies that certify the financial statements of companies from engaging in any kind of consulting business. The **consulting part** must be transferred to a unit that is legally and personally independent of the auditor and above which there is no longer a group structure. **Auditing and consulting must henceforth go their separate ways**. That is the whole point. This strict practice has long been common practice in the credit rating industry for good reason. What is right there cannot be wrong here.

Furthermore, it even the appearance **of chumminess** between **management** and **auditors** must be prevented. Stricter **rules of auditor rotation** can contribute to this. For listed companies, a more frequent change of auditor should be made mandatory (e.g. every 5 years). Even stricter rotation rules are already being enforced in Europe in a legally binding manner, for example for rating analysts responsible for credit ratings of capital market issuers: And with good reason: new brooms sweep best.

For particularly large companies above a yet to be defined market capitalisation, consideration should continue to be given to recruiting **two independent auditing companies**. One of the companies would be involved in a plausibility check, which would examine the certification of the main auditing company on a random and holistic basis. This dual control principle would considerably reduce the risk of the auditor's lazily or deliberately turning a blind eye. In France, the joint audit has been mandatory for listed companies for decades, whereas in Germany it is voluntary. This measure leads to additional costs for companies. However, in view of the **confidence-destroying alternative** that is currently manifesting itself, these costs are justifiable, appropriate, and socially necessary. To ensure adequate competition in an increasingly concentrated market, one of them must not belong to the so-called "Big 4".

The sensitive issue of the **remuneration** of auditing companies must also be fearlessly tackled. The certification of balance sheets is a task in the **public interest**. Their execution should not be influenced by commercial interests. A **standardised fees schedule** for auditors should therefore be examined, similar to the practice for **notaries**. All companies to be audited could pay a **fixed amount** in relation to their complexity and balance sheet total into a pool from which the auditors would be uniformly compensated for their services. The direct monetary connection between auditor and auditee would thus be severed. The pool could, for example, be managed by a competent **state supervisory authority**.

The functioning of **financial supervision authorities** must be put to the test, too. **Blind spots** in supervisory activities must be closed urgently and lastingly. Trust in supervisory authorities has been shaken. Strengthening the institutions and **staffing** of supervisory authorities will certainly remain an ongoing issue.

Finally, **politicians** must also ask themselves whether the way in which corporate bodies operate is still up to date. Are **supervisory boards** sufficiently fulfilling their duty to effectively control **management** and avert disaster from companies, employees and investors?

How can we prevent supervisory boards from becoming **toothless breakfast directors** who uncritically wave through board proposals?

Rules to strengthen the independence and competence of **supervisory boards** could help to rebuild lost trust. Ongoing qualification requirements and deductibles for supervisory boards in **D&O insurance policies** need to be reconsidered to create an incentive for a more robust exercise of control. A "**revolving door policy**", whereby former members of the Management Board can transfer to the Supervisory Board at relatively short notice, undermines the effectiveness of this corporate body.

9. Investor Protection through Reliable Bank Research.

Moreover, the Wirecard case has once again demonstrated the unsatisfactory quality of bank analysts' equity research. The **price targets** issued were completely decoupled from reality. They probably also contributed to the fact that many retail investors who trusted the "experts" were seduced to invest in the stock, which ultimately led to massive losses. Wirecard may be an extreme case, but it is not an isolated case.

In general, we observe **overly rose-tinted price targets** issued by analysts. Such a **distortion** exposes small shareholders to particular risks, as their resources to conduct their own research are limited. However, as the Wirecard case has shown, even some of the largest **institutional investors** have uncritically relied on the recommendations of bank analysts. They have thus shirked their own fiduciary responsibility to conduct their own risk analysis in the interest of their customers.

In the past, it has been observed that analysts of banks made particularly **positive predictions** if their bank has **significant business relations** with the company being rated. Analyses that are actually intended to provide information and protect customers may no longer be subordinated to the business interests of the bank.

The poor quality of most bank analysts' forecasts leads to risks to financial stability, promotes social cynicism and hinders the development of a shareholder culture among the general public. The latter in turn nurtures the danger of further increasing wealth inequality in society (as described above).

It is thus high time to create **incentives** for analysts to move away from the entrenched tradition of uncritical cheerleading. The EU must come up with proposals to remedy the **obviously distorted incentives** in favour of uncritical “analysis”. A **regulatory reform** that links **analysts' pay** to the objectively measured quality of their forecasts should be high on the agenda.

This would not completely eliminate the **inherent conflicts of interest**. But analysts would be confronted with a new incentive structure that would make it easier for them to emancipate themselves from their role as promoters of the companies under their purview.

To gain additional transparency about the **quality of equity analysis**, European supervisors should establish **quality "ratings" of analysts** according to a transparent and objective set of criteria and make them public in a timely manner. This transparency would also help to counteract the hitherto powerful conflicts of interest.

Outlook

Social-ecological transformation is a complex process. To be successful, all relevant social forces must pull together in the **same direction**! The financial sector has a prominent role to play in the concert of **transformative forces**. The transformation towards a more sustainable economy will be associated with high **investment efforts**. Banks and capital markets are elementary transmission belts for providing the necessary funds.

A commitment to sustainable business practices can be heard in ever broader circles within the financial sector. We observe a **gradual change of values** in finance. This rethinking is already being reflected in the **business models** of some financial service providers. This gives us hope that a deep-seated awareness of **sustainable business practices** will also take root in the banking and stock markets.

But the **clock is running relentlessly** and faster than current changes in consciousness. This is particularly true of the **task of the century**, containing climate change. Politicians must at last step into the breach, take responsibility to lead the process.

Cleverly set **incentives** and regulations can also influence the behaviour of players on the European financial market in the direction of sustainability.
In the long term, however, intrinsic behavioural changes will have to take place alongside regulatory or fiscal initiatives.

The pace of the European Commission's implementation of the **Green Deal** and the **Sustainable Finance Agenda** shows that political decision-makers are more serious than ever. The direction of the new Commission's **priorities** is encouraging. The Taxonomy Regulation that has been launched is a **milestone** and will enable the implementation of many measures in the field of sustainable finance. What is missing now, however, is more than just a detail: **great deeds** that follow big plans. That is precisely why this **EU Council Presidency** is so important. There is no time to lose.

The Time to Act is NOW!