POLICY PAPER

MUCH MORE THAN A TRANSITION

THE SUSTAINABILITY SHORTCOMINGS OF THE CAPITAL MARKETS UNION

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FÉDÉRATION EUROPÉENNE DES FINANCES ET BANQUES ÉTHIQUES ET ALTERNATIVES

Index

Executive Summary

Due to a struggling **Single Market**, many EU leaders are pleading for an integration of its Member States' capital markets. Enrico Letta's report "Much more than a Market" [1] proposes a version of such a **Capital Markets Union** (CMU), claiming it to be crucial in **enhancing the EU's competitiveness and closing its green funding gap**. With Commission President Ursula von der Leyen specifically endorsing Letta's CMU in her plans for the 2024-2029 mandate [2], his proposal has become the CMU's unofficial blueprint. However, despite claiming green finance to be its main priority, Letta's framework fails to offer a concrete approach to realise this.

First of all, Letta's proposal **lacks sufficient allocation mechanisms to direct CMU-unlocked capital into green and social activities**, which would be necessary to close the green and social funding gaps and attain the EU's net zero goals. Green and social investments are necessary in mitigating climate change, but also in driving EU competitiveness, for example by avoiding a **climate-induced EU GDP loss of €2.4 trillion and ensuring an adequately skilled and sustainable workforce.** Secondly, the CMU's green and social impact will be heavily influenced by the **EU Sustainable Finance Framework**, which falls short in making any green and social allocation mechanism function optimally. It lacks an adequate social component and its green requirements are based more on political than scientific grounds.

As a federation of banks and financiers with decades of experience in sustainable and social finance, **FEBEA proposes two lists of recommendations to solve the shortcomings of Letta's CMU**. The first package consists of **five potential allocation mechanisms** meant to direct the EU's increased capital flow towards green and social targets. Among these mechanisms are an increase of capital requirements for dirty investments, and the introduction of ESG requirements for initial public offerings (IPOs) on the two EU stock markets proposed by Letta. The second package contains **four proposals to improve the EU Taxonomy**, as the centre of EU's Sustainable Finance Framework, facilitating the optimal functioning of any green and social allocation mechanism. Among other things, it suggests introducing a definition of transition finance in the Taxonomy, as well as a social component that goes beyond DNSH principles.

Overall, FEBEA's proposals are meant to **curtail the short-termism culture** that dominates the financial sector. Mainstream finance and its tunnel vision for profit has boosted climate change and neglected its social impact during the past decades, resulting in trillions of euros of damages worldwide. Without governments incentivising and creating disincentives for large institutional investors to move away from this habit, the CMU will only reinforce the same mechanism that created the necessity for sustainable policies in the first place, rather than solving this situation, as is claimed in "Much more than a Market".

[1] *Enrico Letta. (2024). Much more than a Market.*
[2] *Ursula von der Leyen. (2024). Europe's Choice: Political Guidelines for the Next European Commission 2024-2029.*

1. Key messages

Lack of Allocation Mechanisms: Letta's proposal lacks mechanisms to direct capital towards green and social investments needed for the EU's net-zero goals.

Flawed Regulatory Framework: The EU Sustainable Finance Framework is inadequate, needing significant improvements to support green and social objectives.

Short-Term Profit Focus: The financial sector's short-termism has contributed to climate change and neglected social impacts, needing a shift to long-term sustainable practices.

Recommendations for Improvement: FEBEA suggests new allocation mechanisms and enhancements to the EU Taxonomy to address the proposal's shortcomings.

Holistic Competitiveness: The paper advocates for a shift towards a concept of competitiveness that prioritises ecological and social well-being over short-term profits.

2. Introduction

The idea of a **European Capital Markets Union** (CMU) has been revived. Facing a stagnating Single Market, strong global competition, and funding gaps for key EU policies, both the European Commission (EC) [3-4], and the European Council (EUCO) [5] have made the integration of Member States' capital markets **a top policy priority for the coming political mandate**.

A proposal of what this CMU should look like was made by former Italian Prime Minister Enrico Letta in his prominent report released in April 2024. The report, titled **"Much more than a Market"**, states that a deepening of the Single Market by finalising the CMU would result in an **increase of private capital available in the EU**, and that this capital should mainly serve to **close the funding gap of the EU's social, climate and digital ambitions**. With Commission President Ursula von der Leyen stating her plans to implement Letta's version of the CMU, it is clear that this will be a legacy project during the coming European political term, and that **"Much more than a Market" will be its blueprint**.

However, while Letta's proposal explains in detail how the CMU would attract private capital, it largely **fails to explain how this will close the green and social funding gaps**. Therefore the increase in capital, combined with the pre-existent shortcomings in the EU's Sustainable Finance Framework [6], **will likely only work towards increasing mainstream financial sector profits**. Aside from lacking mechanisms to allocate liquidity towards green objectives in a socially just manner, a report by Finance Watch [7] calculates that **private capital would be able to finance only a third of the necessary investments to close the green funding gap**, noting that the typical climate change mitigation project does not provide the profit margins demanded by private investors. It calls on the EU to take measures in preventing significant underinvestment in climate projects as a result of the CMU.

[3] Ursula von der Leyen. (2024). Europe's Choice: Political Guidelines for the Next European Commission 2024-2029.
[4] DG FISMA. (2024). Management Plan 2024.
[5] European Council. (2024). Strategic Agenda 2024-2029.
[6] FEBEA. (2024). Progress and Pitfalls: FEBEA's view on the EU's Sustainable Finance Framework.
[7] Finance Watch. (2024). Europe's coming investment crisis.

The CMU thus seems to primarily favour the expansion of profit margins of large investors and mainstream financial market participants (FMPs). **These FMPs are generally the ones with the relatively least investments in activities contributing to the green transition**, as was shown in the 2023 Ethical Finance Report by Banca Etica Group and FEBEA [8]. It therefore neglects the advantage of **"biodiversity" in the banking sector**, and emphasises a prioritisation of short-term financial gains over a dedication to a just green transition, which would ideally involve supporting financial actors whose DNA is built on such commitments [9].

Based on the aforementioned shortcomings of Letta's CMU and the current Sustainable Finance Framework in financing a just green transition, FEBEA recommends the Commission to alter and include several policies and instruments in its future proposals for capital market integration. First of all, we recommend the **implementation of specific allocation mechanisms,** absent from Letta's CMU design, to steer the surplus of capital towards green and social objectives. From increasing capital requirements for dirty investments to leveraging ethical finance through green and social guarantees, existing and new private capital in the EU needs to be persuaded into a more constructive direction. Secondly, such mechanisms should be facilitated and propped up by **improvements to the EU Taxonomy,** including an adequate social component, an improvement of its green definition, and a definition of fossil-based economic activity .

[8] Fondazione Finanza Etica, Fundación Finanzas Éticas, and FEBEA. (2023). Ethical and Value-Based Finance in Europe (Sixth edition).

[9] FEBEA members and other banks and financiers within the ethical finance community can be used as examples on how to reform mainstream institutions through the CMU, with the purpose to contribute to a just green transition. The principles they hold to, namely transparency, integrity, participation and responsible funding allocation, are therefore the same principles that should be applied to the sustainable finance framework to guide the CMU influx of capital.

3. Capital Markets Union explained

The Capital Markets Union (CMU) consists in an **integration of capital and financial markets** across EU Member States. While this sector was initially excluded from the Single Market due to political and technical reasons, in 2014 the Commission set out to integrate them under President Jean-Claude Juncker. By harmonising regulations and removing barriers, **the CMU is meant to enhance cross-border capital flows, grant easier access to non-debt funding for companies, promote economic growth, and strengthen EU financial stability**. It also aims at reducing reliance on bank loans by promoting more varied funding sources, such as equity and debt securities.

But despite the Commission's efforts, the CMU has been an arduous project throughout the past decade. Member States are hesitant to give up competences on supervision and control over their financial markets, and integration is an extremely complex operation on a regulatory and technical level. However, the faltering Single Market competitiveness, geopolitical and geo-economic challenges, and the **funding gap for a just dual transition**, provide new momentum for a revival. Financial market integration would attract extra private capital to deal with these issues, amongst other things by partially **mobilising €10 trillion of estimated EU household savings** to stimulate growth and close core funding gaps.

The Commission therefore called on Enrico Letta to propose the outline for a comprehensive and politically feasible CMU. His much-anticipated report compiles old and new ideas on forming the CMU and how to maximise its market capitalisation. He counters the lack of political will by framing financial market integration as crucial in tackling the EU's aforementioned challenges, **arguing in favour of the EU's need for an influx of capital to invest in defence, the reduction of strategic dependencies, the championing of EU tech companies, and, most prominently, to finance the green transition.**

Letta's instruments

To achieve the necessary capital influx, Letta's report proposes several concrete instruments, focused on **unlocking capital, creating investment incentives, and streamlining EU regulation**. The most important instruments are discussed in the boxes below.

European Long-Term Savings Product

The European Long-Term Savings Product is meant to mobilise savings by providing an auto-enrolment form of additional pension for participants, adding to the investment capital of pension funds and separating pension systems from political decisions.

European Long-Term Investment Fund (ELTIF)

The ELTIF already exists, but Letta pleads for its expansion. By being managed by pension funds, it gives retail investors the opportunity to invest in alternative and non-public funds, such as SMEs and other non-listed companies. In turn, these companies would profit from the availability of extra capital.

Single-access EU stock exchanges

Letta suggests making public non-debt funding more accessible to start-ups and SMEs by introducing two single-access EU-wide stock exchanges: one for deep-tech startups and one for mid-cap SMEs. Whereas European startups now often move to US or Asian markets for crucial investments to scale up their operations, IPOs accessible on an EU-wide stock exchange would facilitate both demand for and supply of capital within Europe. It would additionally attract private investors, as IPOs would derisk investments in startups by increasing potential returns, attracting venture capital and private equity firms to invest in European companies.

European Green Guarantees (EGGs)

Some of Letta's instruments are meant to specifically finance green objectives. For one, the introduction of EGGs should leverage private loans to and investments in sustainable initiatives, as currently happens on a smaller scale with InvestEU.

Increase of public-private partnerships (PPPs)

Letta advises member states to switch from "in-house models" of providing public services (such as government-ran operations and state-owned companies) to a PPP model, where governments contract private companies to provide the relevant services. This privatisation is supposed to stimulate competitiveness throughout the EU.

Securitisation of green assets

Another green instrument is the securitisation of green assets. According to Letta, a green securities market would free up space on the balance sheet of institutional FMPs, and provide another market for FMPs to invest in.

Alteration of capital requirements for institutional FMPs

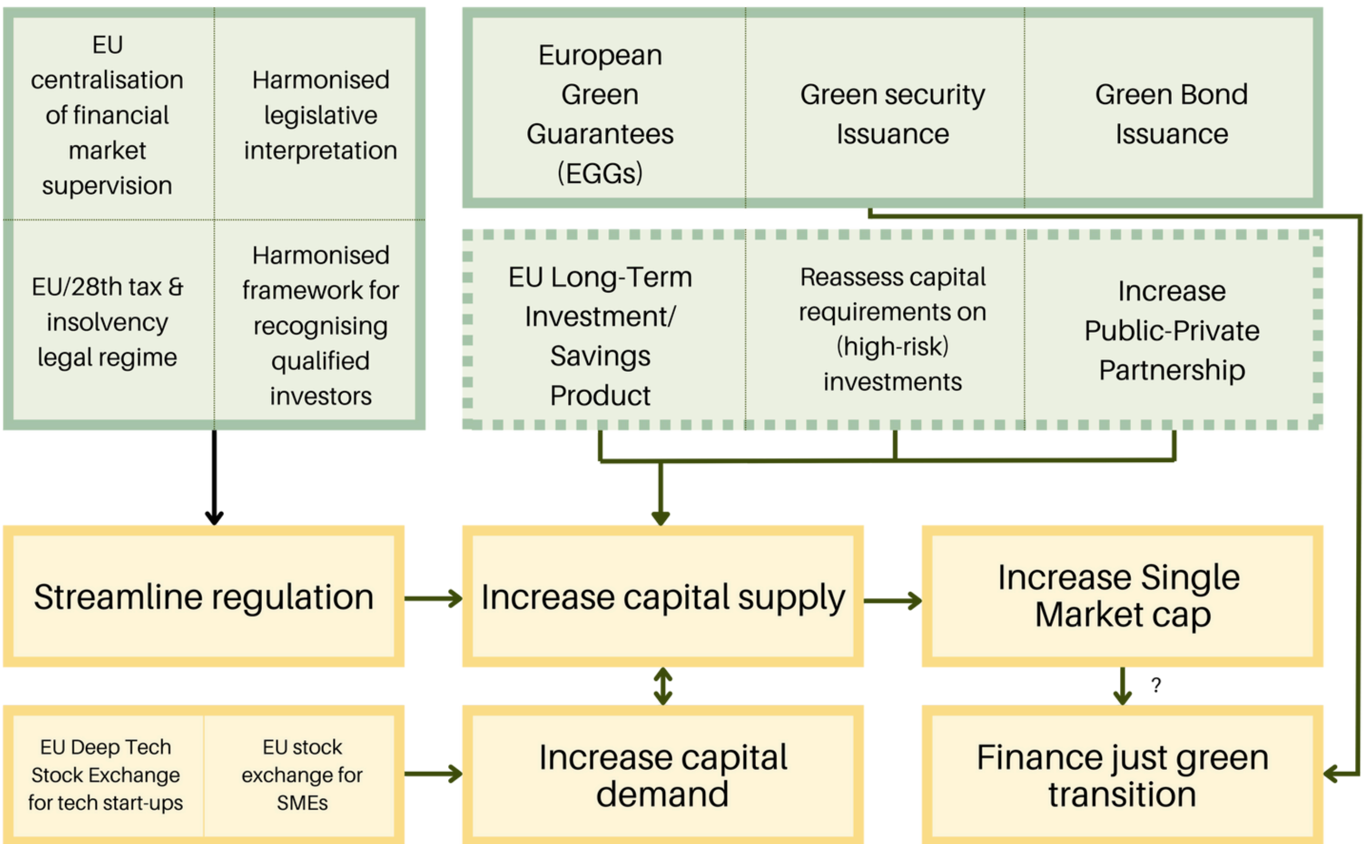
Letta proposes to review Basel standards – which govern the amount of capital that institutions are meant to keep in reserve per invested/lended euro to mitigate insolvency risk – on both the regulatory as well as the institutional level. For one, the report offers to decrease the capital requirements for high risk investments, to stimulate banks to invest in company equity. It also proposes to assess capital requirements per insurance undertaking instead of on the insurance group level.

EU Green Bonds

The last instrument directly linked to sustainability is the additional issuance of common Green Bonds by the EU. Although common debt is highly controversial, it has already been used with the NextGeneration EU package, and its proceedings would be directly channelled into the green transition.

28th insolvency regime

Lastly, Letta proposes a large package of regulatory reforms to facilitate the aforementioned instruments and stimulate cross-border investments. First and most prominent is the introduction of a 28th insolvency regime, which entrepreneurs can opt for instead of the relevant Member State's insolvency laws, simplifying and incentivising cross-border investments for foreign investors. Letta additionally suggests a centralisation of financial market supervision, an EU-wide framework for recognising qualified investors, and efforts to harmonise the interpretation of EU financial legislation.



4. The main issue

Letta's version of the CMU can effectively increase the amount of capital in the EU's economy, but **the report lacks explicit mechanisms to credibly channel this additional capital into the green just transition.** Letta justifies the finalisation of the CMU with the need to unlock capital to fund the just green transition. However, it appears that the ultimate outcome of this integration would be to scale up the EU mainstream financial sector and inflate the size of European industry to compete on a global level. Accordingly, **Letta's proposals are limited to the enhancement of EU industrial competitiveness, failing to approach the issue from a holistic perspective.** In order to fulfil the EU's strategic priorities, competitiveness should be viewed as the means to secure the necessary resources for an ecologically and socially just future, not as an end in itself. As stated in the 2023 Ethical Finance Report [10], this is the core difference between mainstream and ethical finance: the former has short-term profit as its centre, while the latter views **finance as a tool to serve society and the planet.** Accordingly, the notion of industrial competitiveness should leave space to the more inclusive concept of overall economic competitiveness, that puts the well-being of the economy and its people at the centre of this measure.

Although, some of the proposals brought forward in the report are effective in driving money towards green objectives, such as **Green Bond issuance by the EU**, which shows great potential to unlock capital for the green transition. EGGs could also be an effective tool to stimulate green bank lending by **derisking credit contributing to the green transition**, and viable given the already established architecture for guarantee provision through InvestEU.

[10] Fondazione Finanza Etica, Fundación Finanzas Éticas, and FEBEA. Ethical and Value-Based Finance in Europe (Sixth edition).

EU sovereign Green Bonds from NextGenerationEU furthermore proved successful in financing green economic activity. However, there are two issues with this: on the one hand, these instruments are regulated by **inadequate legislation, the European Green Bond Standard** [11]**,** which rules that underlying assets only need to be 85% aligned with the Taxonomy. This is not sufficient nor credible for the fulfilment of EU strategic priorities, which is why civil society organisations have called for a review of these standards to impose a **100% alignment with the Taxonomy** to earn the Green Bond label [12]. Conversely, with the current EU budgetary rules restricting the amounts the EU can borrow, an EU Green Bond would probably **not gain enough popularity among investors** to become the EU's safe asset, as intended by Letta [13]. With some Member States' much larger bond issuance capacity, the solution would be to change the treaties to increase the Commission's bond issuance, also following Finance Watch's estimation showing that a full **integration of the CMU to only cover one-third of the EU climate funding gap.** But this is a notorious, politically challenging topic, as several Member States are against guaranteeing each other's outstanding debt.

Also, among Letta's proposals, **FEBEA discourages green securitisation the most**, as it is known to increase banks' risk exposure. Securities markets motivate banks to package their safest asset class to market these securities, which can have dangerous repercussions on their financial stability and on that of the whole market. In addition, such derivatives uphold the short-termism culture inherent to the financial markets' excessive focus on profit, rather than shifting the narrative towards a private contribution to solving societal problems such as climate change. The **ethical finance ecosystem,** whose values are intrinsically compliant with the EU Sustainable Finance Framework, promotes a functioning alternative to short-termism and **is already equipped to stream these resources towards the people and the planet**, representing the best practice in financing the just green transition.

[11] European Union. (2024). European Green Bond Standard Regulation.
[12] E3G, ShareAction, and WWF. (2024). Investing in Europe's prosperity. A vision for financing the transition to sustainability 2024-2030.
[13] Centre for European Reform. (2024). Enrico Letta's report: Much more than a market, but less than an agenda.

In addition to structural improvements that can be made to Letta's green allocation mechanisms, their effectiveness will furthermore depend on the legislative context in which they are introduced. To what extent EGGs and Green Bonds are green, will ultimately be determined by **the definition of green in the EU Taxonomy, which FEBEA deems inadequate and insufficiently based on scientific standards** because of a disproportionate industry lobby. Moreover, the Taxonomy Regulation [14] **lacks an adequate definition of social investment and social impact,** despite including a few do-no-significant-harm (DNSH) criteria, which only serve as minimum safeguards. A more explicit inclusion of social considerations in the Taxonomy would not only demonstrate a credible commitment to a comprehensive transition, but also significantly enhance EU competitiveness, as confirmed by the EUCO guidelines [15]. This recommendation is also supported by the European Supervisory Authorities (ESAs) [16-17], more specifically through the recent call from the European Securities and Markets Authority (ESMA) for the formulation of a social taxonomy [18] in a recent opinion on the Sustainable Finance Framework.

Incorporating social investment criteria could thus position the EU to leverage its true competitive advantage: its people. Social investment can translate into a highly educated and skilled workforce, into appropriate housing to accommodate people moving freely within the EU, as well as into healthy and resilient citizens. These factors contribute to the development of **European industrial champions** suited to compete on the global scale. A significant step forward in this direction has been recently taken with the **2024 La Hulpe Declaration** [19], launched by the Council Belgian presidency and supported by the Commission and Parliament. This has in turn led re-elected Commission President von der Leyen to commit to an **Action Plan for the European Pillar of Social Rights** in her political guidelines. Additionally, the Council has issued Conclusions [20] urging the Commission to establish a **knowledge hub** to evaluate the impact of social policies at the Member State level. This very welcome initiative signals a stronger focus on social policy in the current parliamentary mandate, but it remains to be seen whether it will effectively translate into social caveats for sustainable finance too.

[14] European Union. (2020). EU Taxonomy Regulation.
[15] European Council. (2024). Strategic Agenda 2024-2029.
[16] European Supervisory Authorities: European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), European Securities and Markets Authority (ESMA).
[17] ESAs. (2024). Joint ESAs Opinion on the assessment of the Sustainable Finance Disclosure Regulation (SFDR).
[18] ESMA. (2024). ESMA Opinion on Sustainable investments: Facilitating the investor journey.
[19] Council of the European Union. (2024). La Hulpe Declaration on the Future of the European Pillar of Social Rights.
[20] Council of the European Union. (2024). Conclusions.

As previously discussed, neither the CMU nor public funds alone are sufficient to cover the EU's annual €520 billion p.a. climate finance gap. However, with the potential to increase the supply of capital through further integration of the EU's capital markets, it is only sensible to channel these funds where demand is the highest. As Letta himself notes, **the cost of inaction towards the ecological and social transition amounts to an estimated additional EU GDP loss of €2.4 trillion,** compared to efforts to stay below the 1.5°C of the Paris Agreement.

Therefore, stronger regulatory guidelines are the starting point for this paradigm shift. The EU Taxonomy's shortcomings are still too evident, starting from the lenient definition of green, which **leaves too much room for greenwashing.** Additionally, the Taxonomy Regulation **does not draw a line on what qualifies as *not green***, which undermines the practical effectiveness of the entire Sustainable Finance Framework. This gap also threatens the credibility of any green and social allocation mechanisms that would be introduced under the CMU, as **there is no standardised definition to clearly distinguish what is genuinely green to what is fossil-based.** On this line, the new ESMA opinion on the Sustainable Finance Framework also includes a provisional proposal on how harmful activities should be classified and included in the Taxonomy, widely in line with what FEBEA and other ethical finance representatives have been pushing for.

Furthermore, the Corporate Sustainability Reporting Directive (CSRD) requires affected parties to draw **transition plans** clarifying their path towards decarbonisation. However, in the absence of guidelines regarding which economic activities classify as "driving a business's transition", it is both challenging to draw a coherent plan and dangerous as it leaves room for moral hazard. In fact, especially on capital markets, **"transition" is turning into a buzzword,** just like "green" was before it was somewhat regulated. Thus, securities labelled as such are becoming a trend on the market, enhancing their holders' image while hiding potentially harmful activities behind them. **A holistic definition of all economic activities into green, fossil-based, social and transition is therefore strongly needed** to stop "washing" harmful activities with deceiving marketing practices and set a committed and genuine trajectory for the EU's green and, most importantly, just transition.

5. Recommendations

Set 1. Introduce allocation mechanisms facilitating capital to support the just green transition

Integrating capital markets does not necessarily imply that all mobilised resources are allocated optimally in support of the EU's green and social goals. Short-termism and profit maximisation would still be at the heart of financial markets.Thus, the current plans for the **CMU should contain regulatory mechanisms that ensure the expected capital influx is directed towards supporting a just green transition**.

1A: Increase capital requirements for harmful investments

Capital requirements for investments not aligned with the EU Taxonomy should be increased to disincentivise harmful investments. This is intended to drive banks and other financial institutions to allocate money to sustainable and social targets, which in addition would contribute to closing the green funding gap, are financially less risky than dirty investments such as fossil fuels.

1B: Assess capital requirements on an entity level

Currently, many companies with alternative focuses besides profit, such as **social economy entities,** are automatically classified as high-risk. This makes financiers investing in them subject to 100% capital absorption, disincentivising them to support businesses that, as Letta says himself, are pivotal to the goals of a just green transition. **FEBEA therefore recommends improving legislation to facilitate the capital flow into the social economy, for example by entity-based capital requirement assessments or separate capital requirements for the social economy sector as a whole.** The latter would require a streamlined definition of social economy enterprises throughout the EU.

1C: Align requirements for IPOs on the single-access stock markets with the EU Taxonomy

To stimulate new EU champions and successful companies to be future-proof and refrain from harming the environment or EU citizens. FEBEA **believes these organisations should be required to align with the EU Taxonomy** to an adequate extent when selling their shares on capital markets.

1D: Involve the ethical finance community to support best practices in a just green transition

In July 2024, Banca Popolare Etica secured a €60 million loan from the European Investment Bank (EIB), together with technical assistance provision under the Social Inclusive Finance Technical Assistance (SIFTA) programme [21]. This agreement is expected to leverage a total of over €165 million to support gender equality, refugee inclusion and development in Southern Italy. **FEBEA recommends similar blended finance initiatives supporting ethical finance providers to ensure effective funds management towards the just green transition.**

1E: Increase the amount of European Green Guarantees

EGGs should be the largest mobiliser of private capital, as InvestEU proved them to be an extremely effective instrument in de-risking and incentivising green transition financing. For this to work optimally the requirements for green guarantees should however be aligned with the improved EU Taxonomy. Aside from stimulating green and social finance, the introduction of EGGs would **decrease the shortage of debt financing by banks that many undertakings are experiencing.** It would therefore decrease the need for a capital-based financial ecosystem, and prevent risks associated with a heavy reliance on capital markets [22].

Set 2. Enhance the EU Taxonomy

We recommend the EU to **extend and improve the EU Taxonomy**, as it influences and facilitates many policies downstream and should expedite green allocation mechanisms optimally. The **EU Taxonomy should act as a finance filter**, isolating most dirty activities to enhance social and green investments, and optimising the CMU's function in closing the just green transition funding gap.

[21] EIB. (2024). EIB and Banca Etica provide over €165 million to support gender equality, refugee inclusion and development in southern Italy.
[22] Finance Watch. (2024). Europe's coming investment crisis.

2A: Add an adequate social component to the EU Taxonomy

This would induce investments into social objectives to enhance the social justice dimension of the green transition. Aside from dividing the costs and benefits of the green transition equally**, investment in inherently social sectors such as education, health and housing are necessary to prevent a bottleneck in boosting competitiveness: adequately skilled and healthy workforces are fundaments of economic growth.** This aligns with the June 2024 Joint Opinion by the ESAs, recommending to extend the EU Taxonomy by including social sustainability elements [23]. An adequate social component to the EU Taxonomy could for example be based on essential needs such as housing and health, and take a two-pronged approach focusing on products/services for basic human needs and processes to avoid human rights risks. To achieve this, we recommend building upon recent advancements in social pledges at the EU institutional level. Accordingly, FEBEA endorses the Council Conclusion on the creation of a knowledge hub as a space for Member States to develop social policy indicators. Additionally, we recommend the inclusion of private sector champions in social finance, particularly ethical finance providers, within the initiative. This could serve as a credible foundation for developing science-based social indicators for the EU Taxonomy, establishing it as the sole objective basis for the EU Sustainable Finance Framework.

2B: Scientifically enhance green criteria in the EU Taxonomy

To let the CMU's envisioned capital influx assist in the green transition, the **EU Taxonomy needs to use scientific criteria to improve its definition of sustainable investments**. An example of what this may look like in practice is the **WWF's Independent Science Based Taxonomy (ISBT)** [24]**,** which sets more rigorous requirements, among other things excluding the current provisions for gas and nuclear investments from the EU Taxonomy.

[23] ESAs. (2024). Joint ESAs Opinion on the assessment of the Sustainable Finance Disclosure Regulation (SFDR)
[24] WWF. (2023). Independent Science-Based Taxonomy launched to save EU's official list of green investments.

2C: Introduce a category for fossil-based investments to the EU Taxonomy

A category for fossil-based investments would define and identify significantly harmful activities. This would **increase transparency to investors downstream through reporting requirements in the SFDR**. It is also in line with the ESAs recommendation on a replacement of the Articles 6, 7 and 9 of the SFDR, which are now wrongfully used as labels, by a rating scale from A to E, where E could for example be considered a fossil-based or dirty investment.

2D: Include a clear definition of transition finance in the EU Taxonomy

The issuance of financial products dubbed "transition" investments – investment opportunities that are supposed to support issuers in their transition to becoming operationally green – is growing significantly, with e.g. the Japanese government planning to issue €10 billion in transition bonds in 2024 [25]. **This market remains self-regulated**, however, meaning there are no legal definitions for transition investments or supervisors to control them, and products like transition bonds are popular vehicles for greenwashing [26]. To counter this, **we recommend including a clear definition of transition finance in the EU Taxonomy,** in line with the definition offered in the July 2024 ESMA Opinion on sustainable investing [27]. In a broader perspective, the "whack-a-mole" pattern observed with new sustainable finance products, where greenwashing persists until legislation is enacted (as seen before with green bonds, now with transition bonds, and possibly in the future with blue bonds) [28] should be addressed by adopting an a priori definition of sustainable debt.

[25] SP Global. (2024). Sustainable Bond Issuance To Approach $1 Trillion In 2024.
[26] Jacob Baylon Schumacher. (2023). Transition Finance and its Relationship to Green Finance.
[27] This recommendation also aligns with the June 2024 Joint ESAs Opinion on SFDR reform. Other work on a possible definition of transition investments has been done by the EU's International Platform on Sustainable Finance (IPSF) in its 2023 report.
[28] Man Institute. (2023). Blue Bonds: The New Kid on the Block in Sustainable Debt.

6. Conclusion

The EU funding requirements for the just green transition are immense and despite claiming so, **the CMU's current blueprint does not provide sufficient solutions for this.** It builds on and reinforces the short-termism and profit focus that has led the finance sector to consistently contribute to the climate crisis. FEBEA therefore recommends the Commission to introduce several measures that will stimulate the flow of capital towards closing the EU's social and green funding gap.

First of all, the Commission should **introduce social and green allocation mechanisms together with proposing and implementing the CMU.** FEBEA gives multiple examples of this, meant to make sustainable investments more profitable and attractive to investors. This can be done through e.g. the increase of capital requirements for dirty investments, and setting EU Taxonomy aligned requirements for companies wanting to go public on the two EU stock markets proposed by Enrico Letta.

Second of all, **the EU Taxonomy needs to be improved in order to make current and future social and green allocation mechanisms function optimally.** Its substance is currently based too largely on political and industry lobby-influenced decisions, rather than on scientific standards. FEBEA gives multiple recommendations to improve this, such as adding a social taxonomy and a category for fossil-based investments.

Global crises and internal flaws have revamped the question of the EU's competitiveness. The advance of the far-right in the EU makes affirmative action on this even more challenging than it already was. In the meantime, the effects of climate change are starting to become more and more severe, reinforcing societal challenges such as migration and poverty. The EU has constructive ideas on dealing with this, but given the limited capacity of public financing to cover green and social investment needs, **it is only reasonable to resort to private markets for a solution.** The CMU might be the last chance to make this work constructively, however, and so the **Commission has to get it right.**

For this reason, FEBEA advocates for a **holistic paradigm shift**, moving away from the mainstream notion of competitiveness to emphasising the **EU's real competitive advantage: as we said, its people.** Despite the increasing attention paid by financial markets supervisors, more credible action needs to be taken in areas such as research, dialogue and implementation of social considerations, as well as stricter green definitions, classification of fossil-based sectors and clear guidelines for transition activities. Thus, FEBEA calls for a comprehensive review of the EU Sustainable Finance Framework, particularly **to complete the EU Taxonomy.**

Therefore, the **expertise of ethical finance providers should be leveraged as best practice in financing the just green transition** and they should be given more recognition for being green and social champions in the sector. Now, more than ever, it is crucial that their voice is amplified and that **they are given a central role in the new CMU framework to guarantee movement in the right direction.** By doing so, we can ensure that the transition not only addresses ecological concerns, but that also does not leave behind social justice, fostering a truly inclusive and resilient economy for all.

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FEBEA – the European Federation of Ethical and Alternative Banks and Financiers – is a non-profit association based in Brussels. It gathers 33 financial institutions whose aim is to finance social and solidarity economy (SSE) and projects with social, environmental and cultural value in 17 European countries, serving more than 700,000 people.

Its objective is to support the exchange of experiences and promote cooperation between social economy and social finance practitioners.
Each FEBEA member is integrated in the SSE Sector in its country, focusing on mobilising savings and equity from responsible citizens and using these funds to finance sustainable development and local communities. FEBEA is member of GECES, the European Commission’s expert Group on Social Economy and Social Entrepreneurship and of Social Economy Europe, the main European network of social economy practitioners.

FEBEA members finance:

- The creation of jobs, social employment in particular;
- Social enterprises and social economy;
- The non-profit sector and participatory economics;
- New forms of social entrepreneurship
- People or groups of people who are victims of social or professional exclusion or are unbanked;
- Sustainable development: renewable sources of energy, organic farming, biodiversity, etc.;
- International solidarity and fair trade.

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