



Sustainable finance: it's action time

From Sustainable Growth to Managing ESG Risks

Part two of our Sustainable finance series.

kpmg.lu

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A. Financing sustainable growth

01. FINDING YOUR WAY through the terminologies

Financing sustainable growth can be achieved in many different ways:

by integrating ESG factors into investment decisions, applying sustainable investing strategies, or investing in “sustainable assets”.

1.1 INTEGRATING ESG FACTORS INTO INVESTMENT PROCESSES

Decades ago, when the financial sector first started to consider ESG issues in making certain investment decisions, the approach was mainly based on the inclusion (or exclusion) of ESG factors to measure the positive or negative outcome created by a business within its operating environment. While progress has been made, e.g., more formalized ESG investment decision-making processes, sector-specific approaches and a better understanding of the concept of materiality for ESG data, there remains, however, no commonly accepted definitions of “**ESG factors**”.



Environmental issues such as:

- climate change
- carbon emissions
- air and water pollution
- deforestation
- water management
- water scarcity



Social issues such as:

- human rights
- labor standards
- social inclusion
- data protection and privacy
- gender and diversity



Governance-related issues such as:

- executive remuneration
- risk management
- boards and committee composition
- whistleblower policy lobbying

1.2 APPLYING SUSTAINABLE INVESTING STRATEGIES

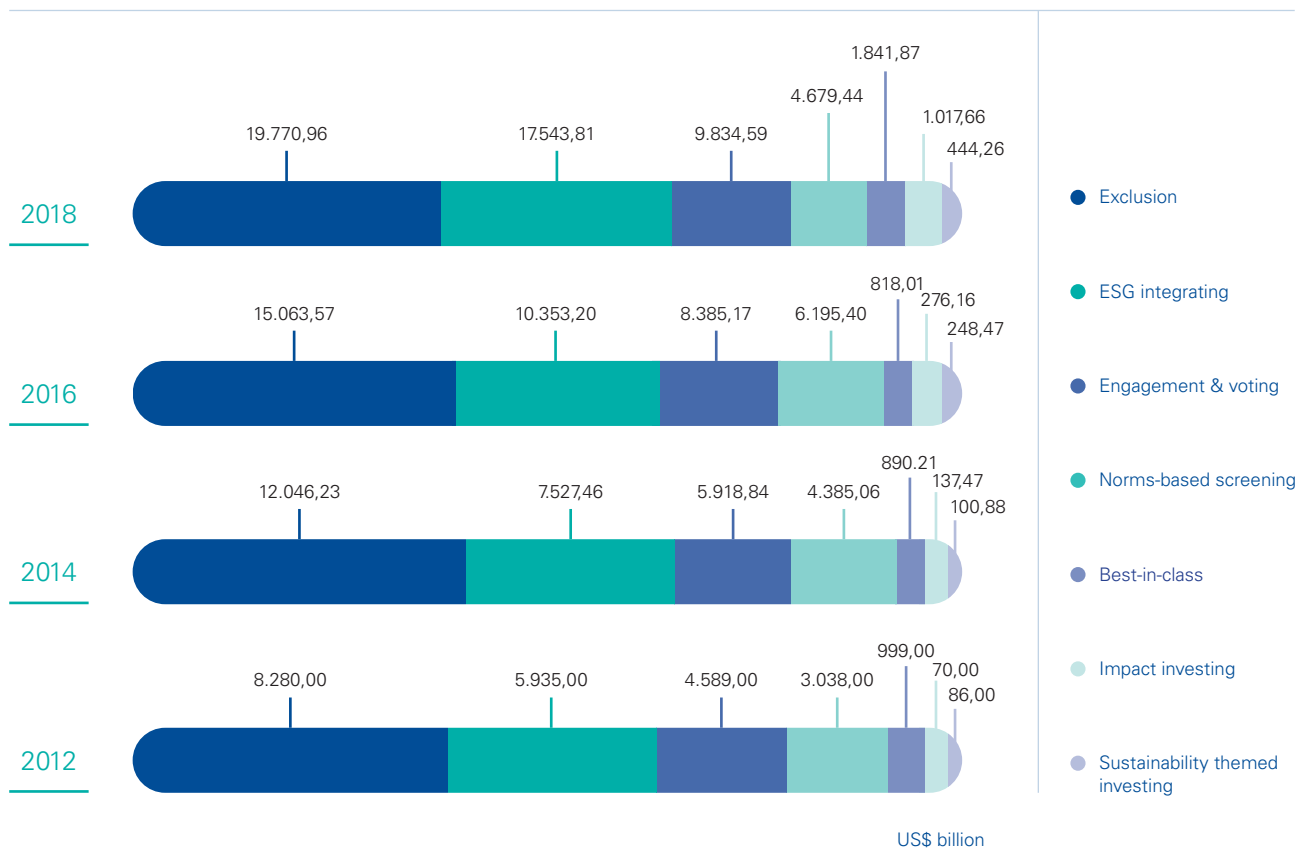
As the concept of “ESG” matured, the integration of ESG factors in investment processes led to more specific sustainability investment strategies. These started with simple exclusions, then evolved over time into more sophisticated strategies such as best-in-class, impact investing or engagement and voting, and are now increasingly being combined.

While the way of applying these strategies can differ and is subject to interpretation, it seems that the EU, in its taxonomy exercise (see next page), did not plan

to define them. The EU has concentrated its approach on defining “sustainable assets” or “thematic investments”, despite the fact that these represent a fairly small proportion of sustainable investments, as illustrated below.

Indeed, according to the Global sustainable investment review 2018, GSIA, exclusion remained the most used investment strategy in 2018, but had lost ground to other strategies such as engagement & voting since 2016.

EVOLUTION OF EUROPEAN SUSTAINABLE INVESTMENTS BY INVESTMENT STRATEGY, 2012-2018



Source: Global sustainable investment review 2018, GSIA, using Eurosif and GSIA-aligned terminology

1.3 FINANCING “SUSTAINABLE ASSETS”

As mentioned previously, one of the major obstacles to sustainable finance remains the lack of a common definition of ESG, and also the fact that there are currently no harmonized global definitions of assets that can be considered “sustainable.”

As part of its EU Action Plan on financing sustainable growth, the European Commission has worked on a proposal regulation to develop a classification system for economic activities that are considered environmentally sustainable for investment purposes, which is generally known as the “EU taxonomy.”

However, it is neither a mandatory list to invest in, nor a standard, nor a list of exclusions.

Despite strong debate on its role, usability and level of pragmatism, the EU taxonomy is intended to play a crucial role in harmonizing sustainability definitions across Europe. By considering the latest available policy and technical developments, the taxonomy helps avoid subjectivity. Overall, it should reduce the potential for greenwashing, foster money flow towards the financing of sustainable assets and encourage the transition to a low-carbon economy.

CONCLUSION

In conclusion, sustainable investments can be achieved in many different ways. However, there is an immense amount of confusion around ESG factors, strategies and sustainable assets in the head of investors.

In a world where investment decisions tend to be taken quickly, retail investors don’t have the time, and may not even be willing, to make the effort to understand the full breadth and depth of sustainable finance. Therefore, it is crucial for financial market players and finance advisers to start talking the language of the customer.



PETER ANDERSON

**European Investment Bank,
Senior Climate Change Specialist
Member of the European
Commission’s Technical Expert Group**

[Click to watch Peter Anderson explain the purpose of the EU taxonomy](#)

THE EU TAXONOMY IN A NUTSHELL

	WHAT?	<p>A list of economic activities that are considered environmentally sustainable for investment purposes.</p> <p>However, it is neither a mandatory list, nor a standard, nor a list of exclusions.</p>
	WHY?	<p>This enables informed decision-making:</p> <ul style="list-style-type: none"> ▪ by investors, financial institutions, companies and issuers ▪ by providing clarity and transparency on environmental sustainability
	HOW?	<p>Activities must:</p> <ul style="list-style-type: none"> ▪ contribute substantially to at least one of the six environmental objectives defined in the regulation ▪ do no significant harm to any of the other environmental objectives ▪ comply with minimum social safeguards ▪ comply with technical screening criteria
	MAIN FEATURES	<ul style="list-style-type: none"> ▪ reflects technological and policy developments ▪ builds on market practices ▪ not green vs. brown ▪ transitioning polluting sectors ▪ technology neutrality ▪ usability of the taxonomy

Source: European Commission



02.

MEASURING THE IMPACT of your investments

Although integrating ESG factors in investment decisions is a first step, measuring the actual impact of investments is essential in demonstrating that a positive ESG impact is made.

The term, however, is already overused. Even in best-case scenarios, it is **“outcome”** rather than **“impact”** that is generally being measured, and, even then, only partially.

Every effort should be made to ensure that the underlying data is reliable and sufficiently comparable, in order to avoid impact washing.

2.1. WHAT DOES “MAKING AN IMPACT” REALLY MEAN?

The notion of “impact” is increasingly being used by asset managers. Originally, impact investing was defined by the Global Impact Investing Network (GIIN) as “investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return”. They can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on investors’ strategic goals. Historically, impact investing was almost exclusively applied to thematic investments in the private equity space.

According to the GIIN’s 2019 Annual Impact Investor Survey, impact investors (including fund managers, foundations, banks, development finance institutions, family offices, pension funds and others) collectively manage US\$239 billion of funds.

2.2. HOW CAN THE “IMPACT” OF FINANCED ASSETS BE MEASURED?

Over the last few years, the notion of impact has percolated into listed equity investments. As a result, asset managers can now measure the impact of their portfolios by using a range of Key Performance Indicators (KPIs) such as the portfolios’ carbon footprint. While this is a welcomed development, in some cases the term “impact” is being misused or overused when what is really meant is “outcome”. Refer to the concept of the “logic chain” shown on the next page.

In order to demonstrate trustworthiness and credibility, it is becoming urgent that the impact of investments can be proved through measurement and KPIs. Methodologies which aim to ensure that investment strategies are aligned with the impact commitments made by companies, for example, alignment with the United Nations Sustainable Development Goals (UN SDGs), are being underway. We are now seeing asset managers begin to publish impact reports for their investment funds in order to strengthen trust.

THE LOGIC CHAIN FOR MEASURING IMPACT INVESTMENT

	INPUT	OUTPUT	OUTCOME	IMPACT	CONTRIBUTION TO SDGs
DEFINITION	Resources (human capital, financial capital, operating capital invested in the activity)	Tangible products from the activity	Changes resulting from the activity	Broader change occurring in communities or systems resulting from the activity	SDG 4: quality education
CONCRETE EXAMPLE	Investment in microfinance institutions	Number of microentrepreneurs reached, number of microbusinesses created	Number of microentrepreneurs who were able to send their children to school	Increased literacy rates	% of contribution to SDG 4

Source: Harvard Business School

In addition to the work being done by the GIIN, the United Nations Principles for Responsible Investments (UNPRI) published its Impact Investing Market Map in 2018. This report brought more clarity to the process of identifying mainstream impact investing companies, specifically the medium and large impact investing companies (privately-owned or listed equity firms).

In its report, UNPRI :

- gives a definition of key impact investing themes;
- lists business types that can be included under these themes;
- provides thematic and financial conditions; and
- suggests KPIs to assess if a company operates in accordance with these themes.

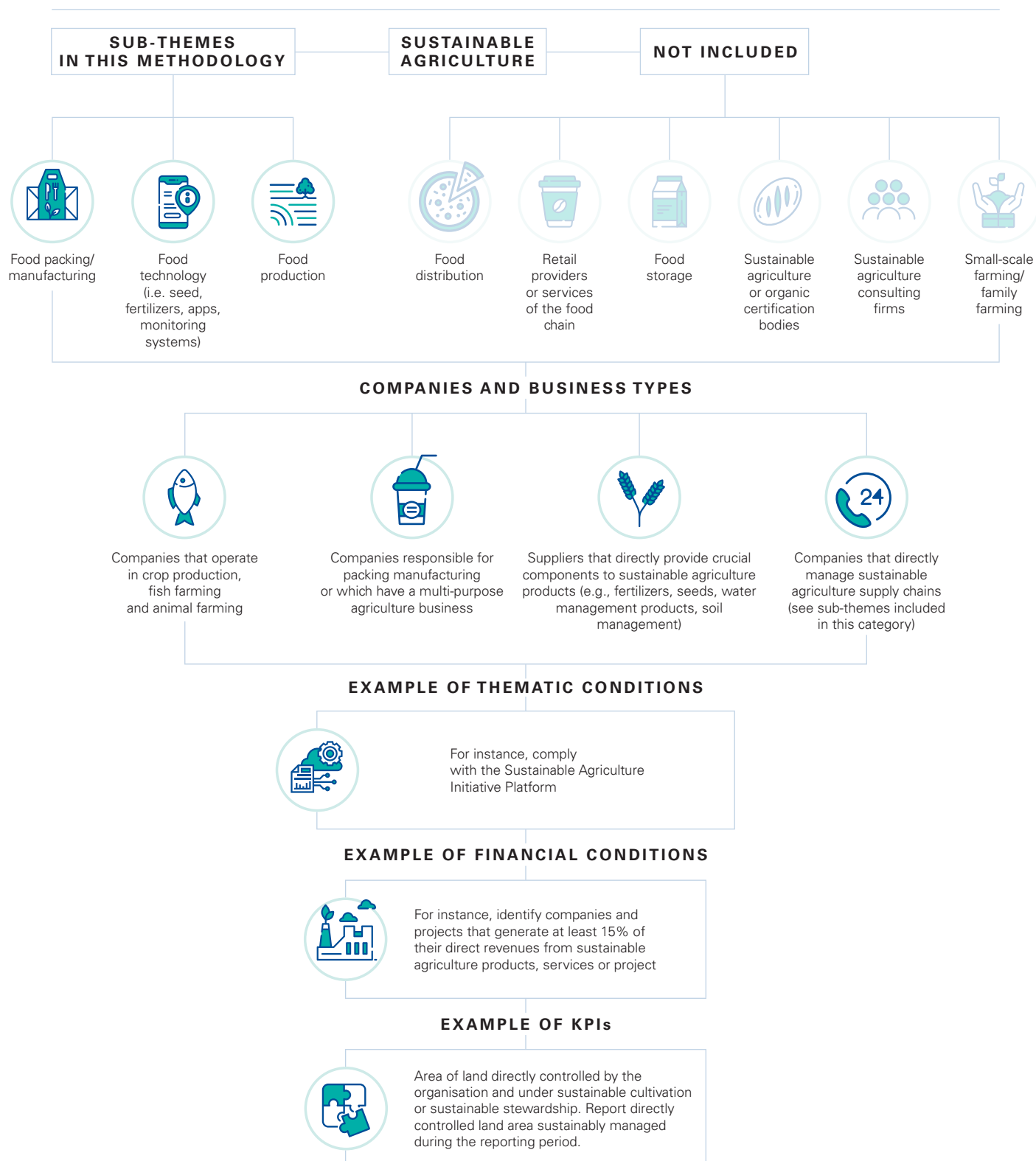
The example on the next page provides a clear illustration of business types which can, for example, contribute to a sustainable agriculture.

Every effort should be made to ensure that the underlying data to measure impact is reliable and sufficiently comparable in order to avoid “impact washing”.



DEFINITION USED BY THE PRI AND ITS PROJECT PARTNERS FOR SUSTAINABLE AGRICULTURE

EXAMPLE



Source: Impact Investing Market Map, PRI, 2018

The above graph represents the UNPRI methodology leading to the identification of types of business which can be considered as sustainable. By adding thematic conditions, financial conditions and KPIs results it becomes possible to measure impact.

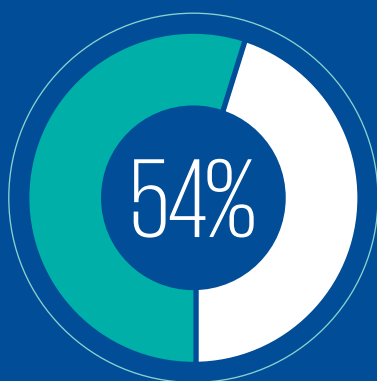
03. TRANSLATING ESG FACTORS into monetary terms

3.1. ESG FACTORS CAN AFFECT COMPANY VALUATION

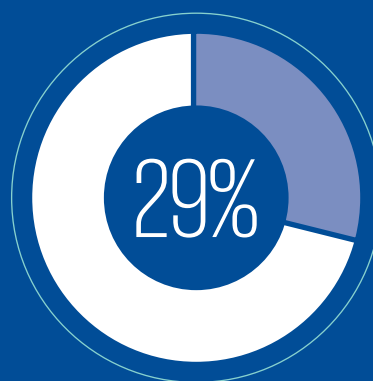
As outlined previously, impact measurement is taking hold, but the translation of these impacts into financial terms is even more important, specifically when it comes to valuating a company.

The market now recognizes a need to move away from assessing the value of an asset by its balance sheet, and towards monetizing its ESG impacts and externalities in order to derive «true value».

Models such as KPMG's proprietary True Value tool are under development to assist in this process.

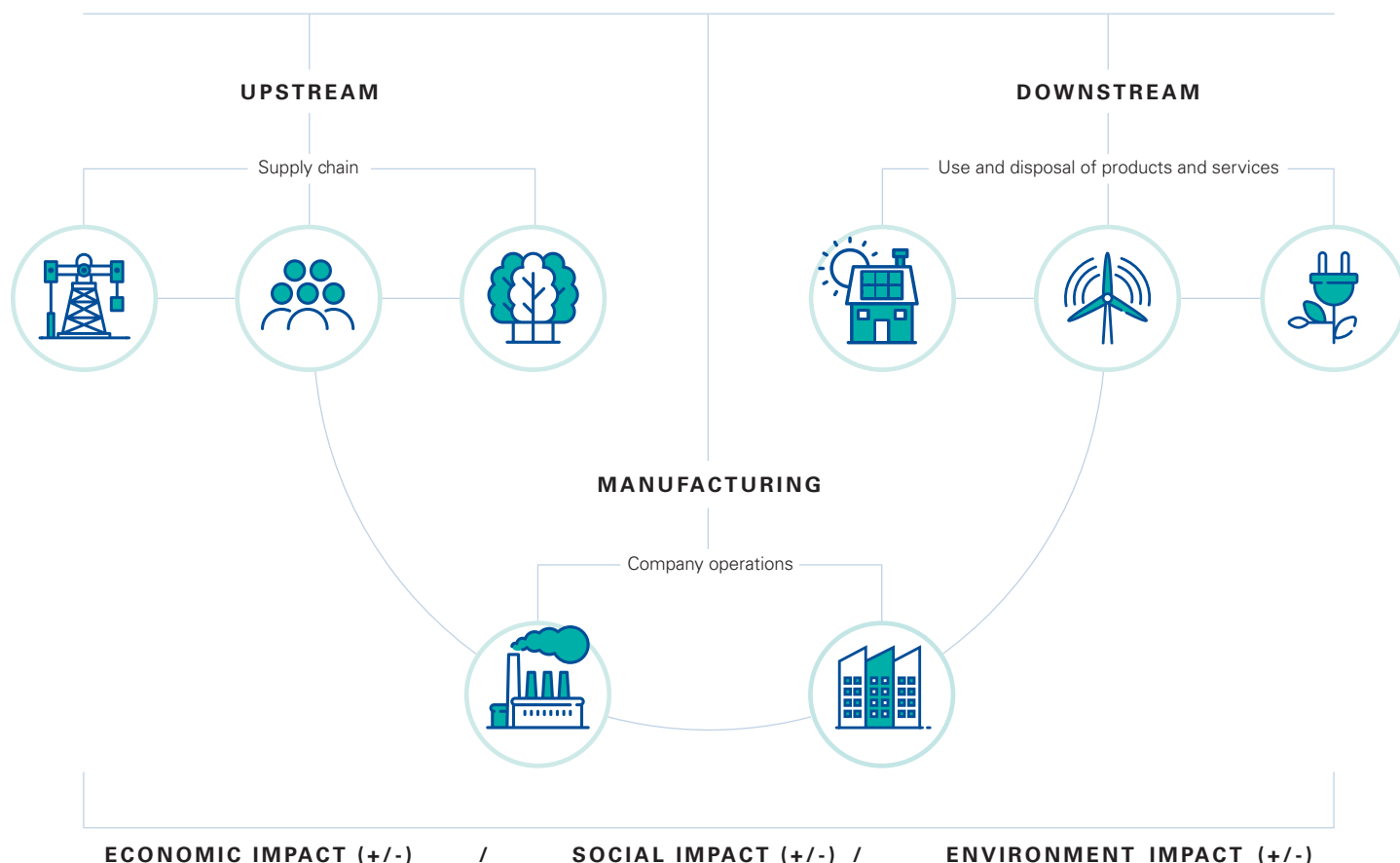


Over half (**54%**) of general partners (GPs) of private equity funds have reduced the price of an acquisition bid based on ESG due diligence findings, according to a 2017 study



Around one third (**29%**) of the GPs surveyed said that the ESG performance of a portfolio company had affected its exit valuation, whether positively or negatively

HOW TO MEASURE THE TRUE VALUE OF A COMPANY



Source: KPMG International




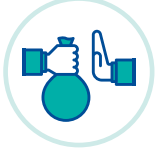



CORNELIA GOMEZ

**PAI Partners,
ESG Director**

[Click to watch Cornelia Gomez talk about
how to integrate ESG into due diligence](#)

3.2. FINANCIAL CONSEQUENCES OF ESG ISSUES: REAL-WORLD EXAMPLES

	CONTAMINATED LAND AND POLLUTION	<ul style="list-style-type: none"> British Petroleum has paid US\$65 billion in compensation for the Deepwater Horizon oil spill in the Gulf of Mexico. The company processed 369,000 claims for compensation after the disaster.
	AIR POLLUTION	<ul style="list-style-type: none"> Volkswagen has paid over US\$25 billion in restitutions and fines (so far) for altering diesel cars to cheat emissions tests. Forty employees are under investigation, eight have been charged and one has been sentenced to 7 years in prison.
	HEALTH AND SAFETY	<ul style="list-style-type: none"> In 2018, logistics company DHL was fined GBP£2 million over the death of a worker at one of its depots. DHL Supply Chain admitted two breaches of the Health and Safety at Work Act.
	ANTI-BRIBERY AND CORRUPTION	<ul style="list-style-type: none"> A Seoul court jailed Lotte Group chairman Shin Dong-bin for bribery. He was accused of giving US\$6.5 billion to a confidence of former president Park Geun-hye, allegedly in exchange.
	GOVERNANCE AND STRUCTURE	<ul style="list-style-type: none"> In 2015, HSBC was ordered to pay GBP£28 million by the Geneva authorities for organizational deficiencies which allowed money laundering to take place in the Swiss subsidiary of the bank.

04.

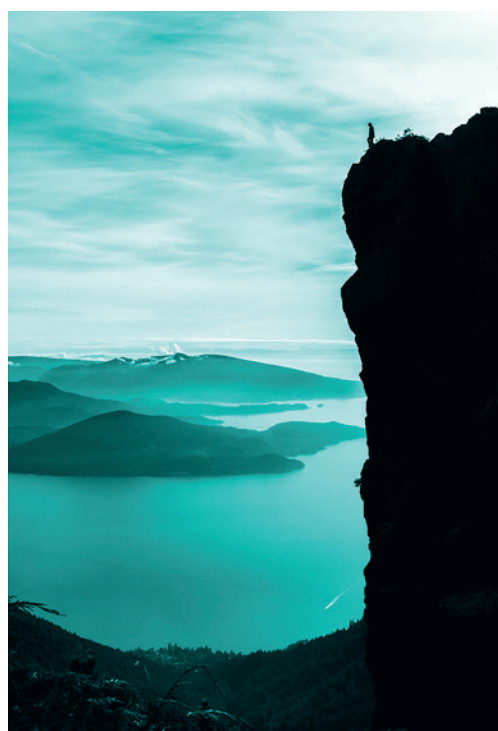
MAKING THE MOST of your investment product

4.1. ESG WILL IMPACT THE WAY FINANCIAL PRODUCTS ARE DESIGNED

For those asset managers that already offer a range of funds tagged as “sustainable”, the upcoming legislative package from the EU will certainly have an impact on the value chain of the investment products themselves.

While the EU taxonomy will help asset managers identify “sustainable assets”, the EU Ecolabel may help in selling so-called sustainable funds to investors who have expressed related sustainability preferences, in accordance with the expected amendments to MiFID II and IDD.

On the disclosure side, Undertakings for Collective Investment in Transferable Securities (UCITS) management companies and Alternative Investment Fund (AIF) Managers whose financial products target “sustainable investments” will have to disclose information about these in pre-contractual disclosures, as well as on their websites and in periodical reports.

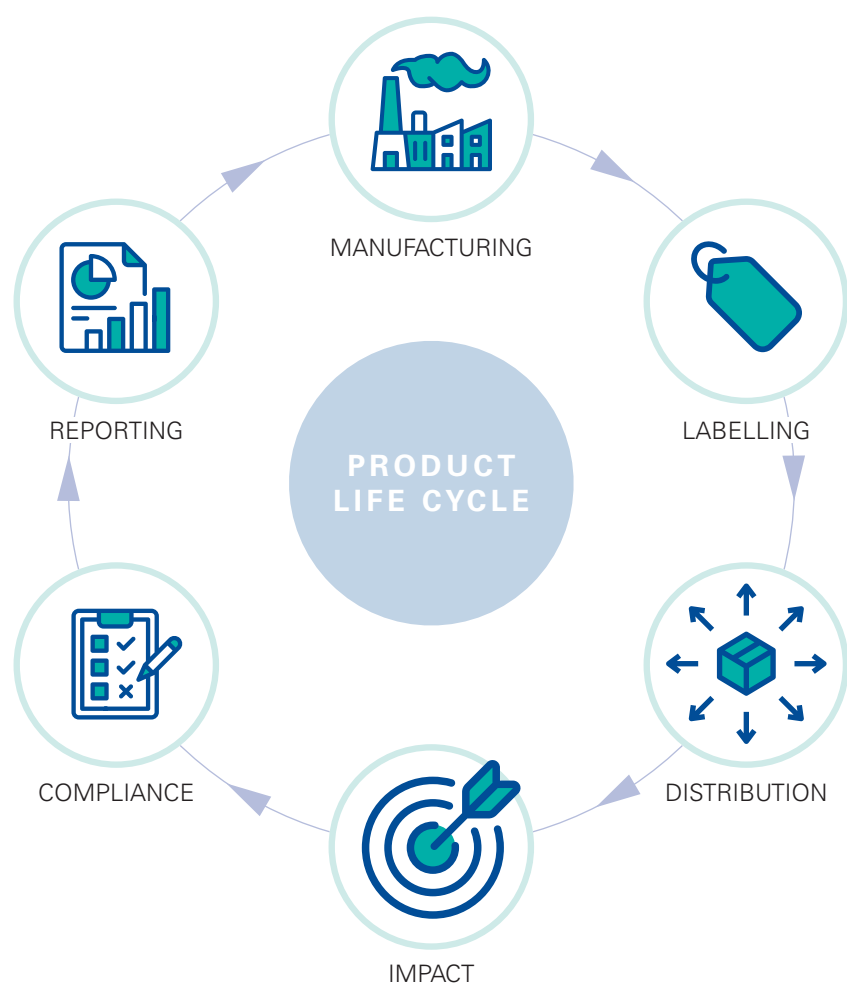


ALICE MARTINOU

**BNP Paribas Wealth
Management Luxembourg,
Head of Positive Impact**

Click to watch Alice Martinou talk about
an innovative digital tool used to define
the sustainability profile of investors

ILLUSTRATION OF HOW INTEGRATING ESG WILL IMPACT THE INVESTMENT PRODUCT LIFE CYCLE



MANUFACTURING

- DESIGN products in line with the upcoming EU taxonomy and specific ESG criteria.

LABELLING

- ALIGN products with upcoming EU Standards and labels (i.e., Green Bonds Standards and Ecolabel for financial products).

DISTRIBUTION

- IDENTIFY the sustainability preferences of clients and match them with relevant investment products.

IMPACT

- DEMONSTRATE the impact of portfolios specifically in terms of carbon emissions and impact towards the UN SDGs.

COMPLIANCE

- PERFORM compliance checks of ESG strategy in the prospectus with the actual portfolio of the fund.

REPORTING

- DISCLOSE in factsheet/reports on carbon intensity of funds and/or alignment to the 2°C scenario, or other types of indicators.


In view of both these regulatory changes and the increasingly high investor demand, ESG will eventually need to be integrated into each step of the life cycle of an investment product, from design to disclosure.

4.2. ESG WILL CHANGE THE WAY FINANCIAL PRODUCTS ARE SOLD

New ESG requirements, especially those regarding the sustainability preferences of clients, as set out in the draft delegated acts to MiFID II and IDD, are likely to have an impact on the entire distribution chain. In the front line, investment advisers will not only have to assess the sustainability preferences of their clients, but also match these with relevant products that fulfill those criteria. For financial institutions operating open architecture

business models, this will be even more challenging. Training and competency building will be crucial in order for advisers to be able to explain the products and their specificities to clients in a clear and simple manner.

Product manufacturers, for their part, will need to design products that are most likely to meet investors' preferences and are easy for investment advisers to sell.

	INVESTOR	SUSTAINABILITY PREFERENCE <ul style="list-style-type: none"> Will have sustainability and impact-related expectations Will require more transparency
	INVESTMENT ADVISER	SUSTAINABILITY PROFILE <ul style="list-style-type: none"> Will define the sustainability/ESG profile of the investors
	PRODUCT MANUFACTURER	SUSTAINABLE PRODUCTS <ul style="list-style-type: none"> Will design products in line with most common ESG preferences of clients
	PORTFOLIO MANAGER	ESG INVESTMENT DECISIONS <ul style="list-style-type: none"> Will include ESG factors and risks in day portfolio management



DIANA MACKAY

**Broadridge Analytical Solutions Ltd.
Managing Director**

[Click to watch Diana Mackay talk about the impact of ESG on fund distribution](#)



B. Managing ESG risks

01. UNDERSTANDING climate-related financial risks

Mainstreaming sustainability in Risk Management is actually one of the objectives of the EU Action Plan on financing sustainable growth. However, a number of financial players don't yet make the distinction between ESG factors and ESG risks. **Below we attempt to clarify ESG and more specifically climate-related financial risks.**

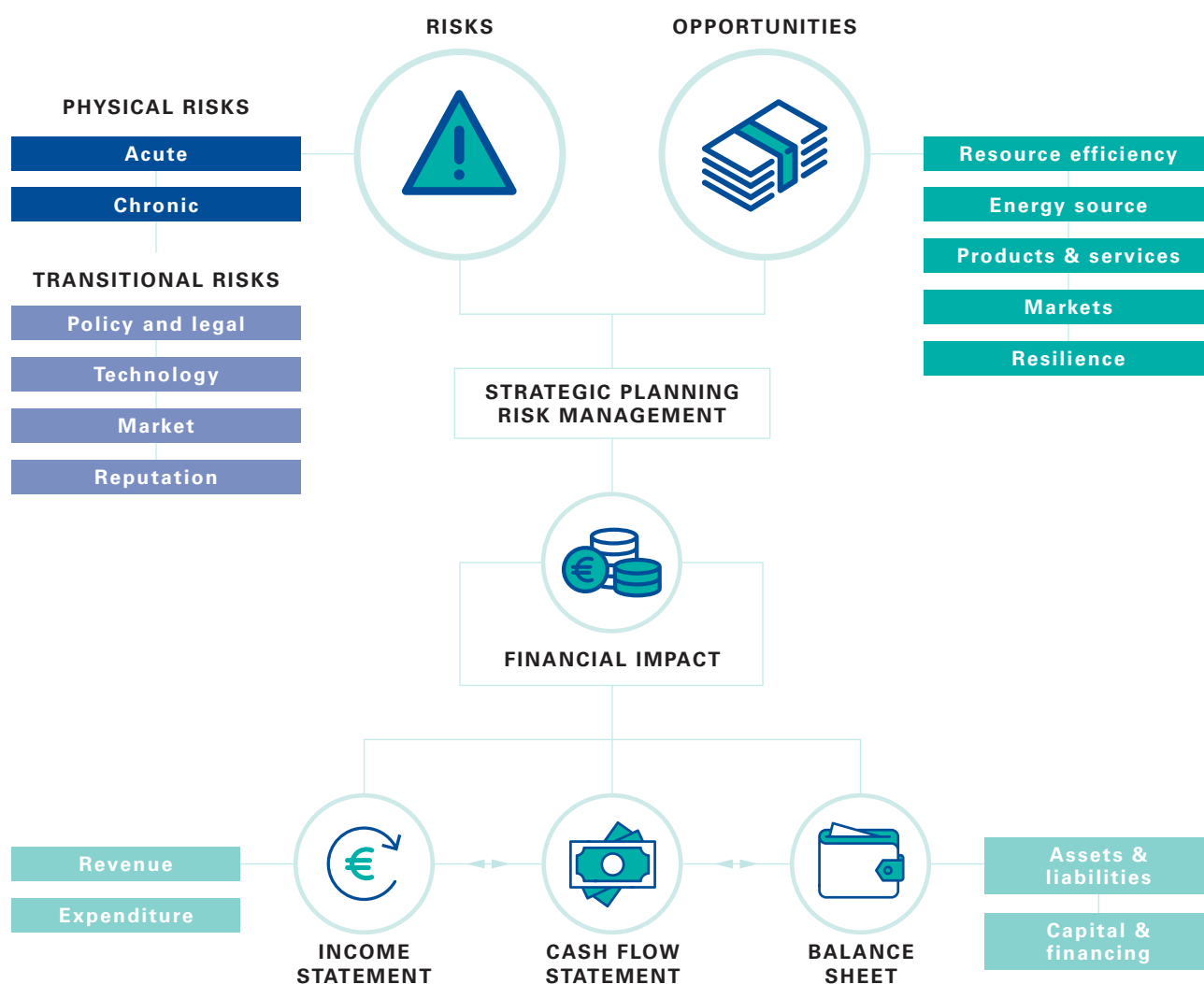
1.1. WHY CLIMATE-RELATED FINANCIAL RISKS TAKE CENTER STAGE

According to the Task Force on Climate-related Financial Disclosures (TCFD): *"One of the most significant, and perhaps most misunderstood, risks that organizations face today relates to climate change (...) The large-scale and long-term nature of the problem makes it uniquely challenging, especially in the context of economic decision making. Accordingly, many organizations incorrectly perceive the implications of climate change to be long-term and, therefore, not necessarily relevant to decisions made today."*

The TCFD divided climate-related risks into two major categories: (1) risks related to the transition to a lower-carbon economy and (2) risks related to the physical impacts of climate change. In any case, the concept of climate-related financial risks is gaining ground, aided by advice in the form of UNEP FI's comprehensive guide to scenario-based methods for climate risk assessment, published in May 2019. A group of 16 international banks had also published two sets of related documents during the course of 2018, one report detailing a jointly developed methodology for scenario-based assessment of transition-related risks and opportunities, and the second report covering physical risk assessment methodologies.



CLIMATE-RELATED FINANCIAL RISKS



Source: TCFD and KPMG

Climate risk is not currently ignored by banks; institutions already perform ad hoc analyses to probe particular climate vulnerabilities. There is no single off-the-shelf comprehensive approach to evaluating transition risk at portfolio or institutional level that describes the risk in terms of financial losses.

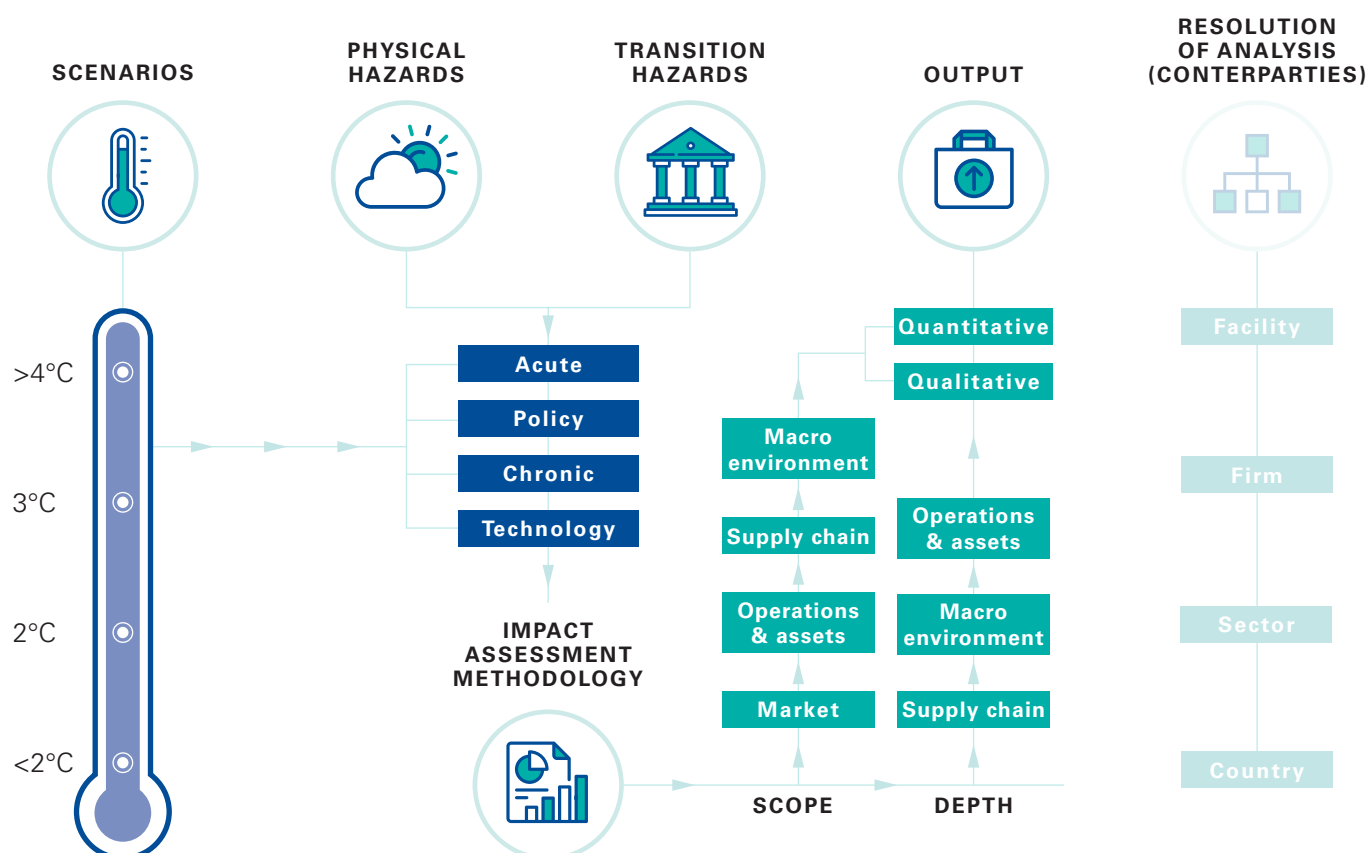
1.2. HOW TO ASSESS THESE RISKS WITH SCENARIOS AND STRESS TESTS

The use of stress-testing as a type of scenario analysis in the financial sector started to be required by regulatory authorities after the financial crisis of 2008. The Basel Committee on Banking Supervision published its latest stress-testing principles in October 2018, replacing its 2009 version. In June 2019, the Committee agreed to join the Network for Greening the Financial System (NGFS) as an observer. With increasingly visible climate-related risks affecting financial assets, it is plausible that regulatory authorities will start to consider recommending

that institutions adopt climate scenario analysis as part of their risk management functions in the near future.

While financial valuation is mostly based on shared methodologies and similar datasets, methodologies for assessing climate-related financial risks vary widely. This illustration provides a framework outlining the key components to consider when undertaking climate stress tests. Other approaches can also be considered, depending on the desired scope, depth and focus of analysis.

ANALYTICAL ELEMENTS OF SCENARIO-BASED IMPACT ASSESSMENTS



UPDATE ON THE WORK OF THE EBA

EXAMPLE OF ANALYTICAL ELEMENTS OF SCENARIO-BASED IMPACT ASSESSMENTS

The European Banking Authority (EBA) has developed its work plan to translate the European Commission's Action Plan on financing sustainable growth into specific steps and publications. The work follows a sequential approach whereby a market analysis, a review of Pillar 3 and then Pillar 2 frameworks will be considered first before potentially reviewing Pillar 1 regulation and discussing prudential treatment of green and social assets.

In 2019, the EBA prioritized its technical preparatory work on sustainable finance including monitoring market practices related to sustainability and engaging with relevant stakeholders and the industry.

In this respect, the EBA has initiated a joint survey with the ECB SSM to identify how EU banks incorporate ESG considerations into their strategy, governance, products and disclosures. The EBA also monitors green banking market practices through its RAQ. First results for Q1 2019 show that the EU green finance market is gaining attention, with a high share of EU banks having or planning to develop products and services based on ESG considerations.

The EBA's preparatory work is intended to lay the foundations for the delivery of future EBA legal mandates included in the revised CRR/CRD framework, in (i) the areas of disclosure of ESG-related risks (Pillar 3), in (ii) assessment of potential inclusion of ESG risks in the SREP (including broader Pillar 2 considerations like risk management and stress-testing) and (iii) assessment of prudential treatment for green and social assets.

National competent authorities are involved in this work through the recently established EBA Sustainable Finance Network.

Source: Joint committee report on risks and vulnerabilities in the EU Financial System, 2019



1.3. HOW TO MEASURE THE IMPACT *OF* AND *ON* CLIMATE INVESTMENTS



A number of tools to measure the environmental or climate-related impacts of lending and investment decisions have been developed over the last few years. They can be categorized into two main types of indicators: (a) those to measure the impact *of* the investment, and (b) those to measure the impact *on* the investment reflected in part one of our study (See part one of our Sustainable finance series: Sustainable finance, it's decision time, page 5).

In simple terms, the impact *of* the investment can be addressed by integrating ESG factors into investment decisions with the aim of creating an outcome, and even a longterm impact, that is ESG, and financially positive.

Conversely, the impact *on* the investment consists of risks and opportunities that may arise regardless of the activity and of the asset.

Tools and indicators to measure the impact *of*, or the impact *on*, investments have different objectives. Looking more specifically at climate issues, the French Sustainable Investment Forum (FIR), has illustrated this concept in the table below, taking into consideration the environment already in place from Article 173-VI.

THE SUBTLE DIFFERENCE BETWEEN THE IMPACT *OF* AND THE IMPACT *ON* THE INVESTMENT

		—	+
	CLIMATE IMPACT <i>OF</i> THE INVESTMENT	NEGATIVE IMPACT Activities contributing to climate change	POSITIVE IMPACT Activities contributing to the Energy and Ecological Transition and 2°C target
	CLIMATE IMPACT <i>ON</i> THE INVESTMENT	RISK Financial risk created by climate change (physical risk and transition risk)	OPPORTUNITY Exposure to the growth momentum of activities related to the Energy and Ecological Transition

1.4. HOW TO NAVIGATE THE ROAD AHEAD FOR CLIMATE REPORTING

Leading asset managers are now providing indicators on the impact of their investments for some of their investment portfolios — indicators such as: portfolio carbon footprint, carbon performance and, in some cases, estimated avoided emissions.

Regarding the impact on investments, asset managers and banks tend to focus on:

- measuring the exposure of their portfolios to stranded assets (i.e. fossil fuel)


- assessing the share of brown vs. green assets in their portfolios (in order to ultimately adjust them)

- their ability to align (or their existing alignment) to a 2°C scenario¹

While these are very welcome developments from the financial industry, strong data quality, sound methodologies, and efficient processes and controls will be essential in order to calculate these indicators and to avoid greenwashing. Above all, clarity and transparency must remain at the heart of such measurements.

¹ The 2°C scenario lays out an energy system pathway and a CO₂ emissions trajectory consistent with at least a 50% chance of limiting the average global temperature increase to 2°C by 2100.










Source: International Energy Agency.



While the financial industry made important advancements in climate reporting, strong data quality, sound methodologies, and efficient processes and controls will be essential in order to calculate these indicators and to avoid greenwashing.

Above all, clarity and transparency must remain at the heart of such measurements.

EXAMPLES OF TOOLS TO MEASURE CLIMATE IMPACTS, RISKS AND OPPORTUNITIES

Indicators relating to the issuer's direct climate impact	IMPACT METRICS	 CARBON FOOTPRINT	 CARBON PERFORMANCE	 AVOIDED EMISSIONS
Indicators relating to the issuer's activities that are climate impact "drivers"	IMPACT DRIVER METRICS	 GREEN/BROWN SHARE	 EXPOSURE TO FOSSIL FUELS	 2°C ALIGNMENT
Composite indicators to take account of a more complex reality	CLIMATE SCORES	 RATING OF CLIMATE RISK MANAGEMENT	 RATING OF EXPOSURE TO PHYSICAL RISKS	 RATING OF CLIMATE-RELATED FINANCIAL RISKS

Source: Article 173-VI: Understanding the French regulation on investor climate reporting, French Sustainable Investment Forum (FIR), October 2016



02.

THE UNGRASPABLE SOCIAL and governance risks

2.1. WHAT ABOUT SOCIAL AND GOVERNANCE RISKS?

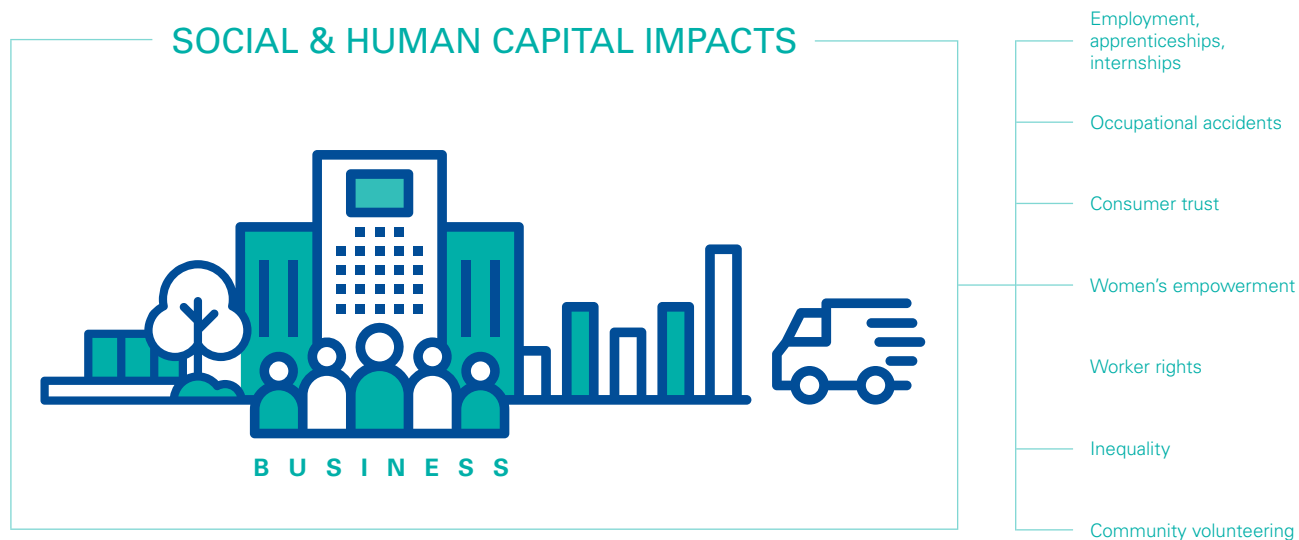
While ESG risk discussions and work tend to focus on climate-related financial risks, there are also a number of social and governance-related financial risks that should be taken into account.

To accelerate progress on this front, the World Business Council for Sustainable Development (WBCSD) led the development of the Natural Capital Protocol (2016), on behalf of the Natural Capital Coalition, as well as the Social and Human Capital Protocol (2019), on behalf of the Social & Human Capital Coalition.



Companies are struggling to identify fit-for-purpose approaches to integrating social measurement, management and valuation within their organizations. Many tools exist and more are emerging, however, they are based on different assumptions, offer different functionalities, suit different purposes, and increasingly compete for uptake. As a result, credibility and comparability suffer.

EXAMPLES OF SOCIAL AND HUMAN CAPITAL IMPACTS



08. WHAT DISCLOSURE IS REQUIRED from financial market players?



3.1. ESG RISKS: THE IMPACT ON DISCLOSURES' REQUIREMENTS

Various activities that require or urge the financial sector to take action on climate-related issues are ongoing.

These include the recommendations on climate-related financial disclosures from the TCFD; Article 173 of the French energy transition law; the EU Guidelines on reporting climate-related information; the EU regulation on sustainability-related disclosures in the financial services sector; the forescreen delegated acts to UCITS and AIFMD; and the CRR/CRD revision.



PETRA PFLAUM

**DWS Group,
CIO for Responsible Investments**

[Click to watch Petra Pflaum explain how DWS measures climate risks in portfolios](#)

2015 FRENCH ARTICLE 173-VI

Article 173-VI of France's Law on Energy Transition for Green Growth (LTECV) came into force in 2016 and requires mutual funds, institutions regulated by French insurance law, French "institutions de prévoyance", public institutions, public pension funds and investment companies with variable share capital to "mention in their annual report, and make available to their beneficiaries, information on how their investment decision making process takes social, environmental and governance criteria into consideration, and the means implemented to contribute to the energy and ecological transition."

Adoption date: 22 July 2015 / Application date: 1 January 2016

2017 CLIMATE-RELATED FINANCIAL DISCLOSURES RECOMMENDATIONS

To help identify the information needed by investors, lenders and insurance underwriters and to appropriately assess and price climate-related risks and opportunities, the Financial Stability Board established an industry-led task force, the TCFD. In June 2017, the TCFD came up with its recommendations and structured these around four thematic areas that represent core elements of how organizations operate: governance, strategy, risk management and metrics and targets. The task force published its progress report in June 2019.

Report publication date: 29 June 2017

2019 EU GUIDELINES ON REPORTING CLIMATE-RELATED INFORMATION

The EU Guidelines supplement the general non-binding guidelines on non-financial reporting adopted by the EC in 2017, covering climate-related information only. They are intended to large public-interest entities with more than 500 employees. This includes listed companies and some unlisted companies (e.g. banks, insurance companies and other companies.)

Major focus points are:

- Key concepts explanations of the Non-Financial Reporting Directive;
- Further guidance applicable for banks and insurance companies;
- Propositions on climate-related content to report;
- Guidance on how to combine the guidelines with the TCFD recommendations.

Publication date: 26 June 2019 / Application date: Not legally binding

2019 EU DISCLOSURE REGULATION

The EU Regulation on sustainability-related disclosures foresees new mandatory transparency requirements both at the investment firm and financial product level. The investment firms/asset managers will have to disclose how sustainability risks and factors are integrated into investment decision-making and advice; how is considered the principal adverse impact of an investment decision on sustainability factors, and how remuneration policies are linked to the integration of sustainability risks.

At the product level, disclosures will have to be made on the manner in which sustainability risks are integrated in investment decisions, their impact on the return and how the principal adverse impacts on sustainability factors are considered. The products marketed as "sustainable" will have additional disclosure requirements related to pre-contractual disclosures (e.g. Prospectus), websites and periodical reports, which will have to include information on how the ESG characteristics are met and assessed.

Adoption date: 27 November 2019 / Application date: 10 March 2021

2020 DELEGATED ACTS TO UCITS & AIFMD

Following the European Commission's request, ESMA has provided technical advice on the sustainability-related amendments to existing legislation. Asset managers will mainly be impacted by the amended UCITS (Commission Directive 2010/43/EU) and AIFM (Commission Delegated Regulation EU 231/2013) directives that bring changes to three main areas: Organizational Requirements, Operating Conditions, and Risk Management.

Adoption date: Expected Semester 1, 2020 / Application date: 12 months after adoption

2021-2025 CRR/CRD

The EU banking reform package adopted in April 2019 with revised rules on capital requirements (CRR II/CRD V), mandates the European Banking Authority (EBA) to prepare two reports: one on how to incorporate ESG risks into the supervisory process and one on the prudential treatment of assets associated with environmental or social objectives. In addition, it requires large institutions to publicly disclose information on ESG-related risks that they are exposed to.

EBA Report issuance date: CRD V: 28 June 2021 / CRR II: 28 June 2025

3.2. ESG: LESSONS FROM FRANCE

As mentioned previously, France has already made climate reporting mandatory for some financial entities. As a result, information is available on how the largest institutional investors have chosen to report on it.

According to Novethic, having analysed the responses of France's largest institutional investors to the reporting requirements of Article 173-VI, only 73 of the 100 largest investors constituting the Study Panel have fulfilled this obligation.

One of the major findings of the study is that, as it stands, *"most investors focus their quantitative reporting on divestment, especially coal, and their investments in green assets. They are much less likely to quantify the amount of assets on which climate risk analysis is based."*

The table below shows the practices in terms of climate reporting.

CLIMATE REPORTING PRACTICES OBSERVED

CLIMATE ANALYSIS		VOLUME OF CORRESPONDING ASSETS (€ BN)	NUMBER OF INVESTORS	% OF TOTAL ASSETS
CARBON FOOTPRINT		1380	60	58%
ANALYSIS OF PORTFOLIO CLIMATE SCENARIOS		459	24	19%
ANALYSIS OF ISSUERS' CLIMATE RISKS	TRANSITION RISKS	514	28	22%
	PHYSICAL RISKS	382	28	16%
QUANTIFICATION OF THE FINANCIAL IMPACT (LOSSES OR GAINS) OF THESE CLIMATE RISKS	TRANSITION RISKS	151	4	6%
	PHYSICAL RISKS	121	6	5%

Source: *Shades of reporting, Season II: Climate and ESG reporting of French institutional investors, Novethic, 2018*





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