Sustainable Finance

Fédération Bancaire Française

18 mai 2022

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Building a better working world

ESG regulations are numerous and complex but consistent

Building an European sustainable framework

European Green Deal

- The European Green Deal (EGD) is a set of multifaceted policy initiatives proposed by the European Commission (EC), with the goal to make Europe climate neutral by 2050. The proposals will turn the political will into a legally binding framework.
- The implications of the EU EGD set up ambitious domestic and global goals.
- At least, EUR 1t will have to be mobilized to achieve these ambitions.

Decoupling the **economic growth** from the use of natural resources	Securing **clean and affordable energy**	Moving towards **circular economy** and **sustainable value chains**	Achieving **carbon neutrality** by 2050

Fit for 55

- In July 2021, the EC adopted the **Fit for 55 package**, binding climate targets to reduce GHG emissions by at least 55% by 2030.
- A significant burden will be placed on the Emission Trading System (ETS) sectors, whose decarbonization will likely have to happen much sooner than the 2050 target, and CBAM. CBAM refers to carbon price linked to ETS, and charged on certain goods imported to the EU to prevent the carbon leakage, namely the shift of businesses production outside the EU to avoid additional costs of European climate policies.
- Fit for 55 consists of **13 interconnected legislative proposals**, including revisions to existing laws and proposals of new legislation.

> “Fit for 55 will align our laws with our ambition. We will strengthen the EU Emission Trading System, update the Energy Taxation Directive, and propose new CO2 standards for cars, new energy efficiency standards for buildings, new targets for renewables, and new ways of supporting clean fuels and infrastructure for clean transport.”
>
> *Frans Timmermans, European Commission Vice-President and leading the Commission’s work on the EGD*

The renewed sustainable finance strategy

The European Commission adopted on 21 April 2021 an ambitious and comprehensive package of measures to help improve the flow of money towards sustainable activities across the European Union. By enabling investors to re-orient investments towards more sustainable technologies and businesses, these measures will be instrumental in making Europe climate neutral by 2050. The sustainable strategy falls among the many European initiatives aimed at giving more credibility and solidity to sustainable finance.

1

Expanding the current legislative framework on sustainable finance to **facilitate access to financial flows for the transition**

2

Making **sustainable finance more inclusive to SMEs and consumers** by providing them with the proper tools and incentives to access transition financing

3

Strengthening the **resilience of the economic and financial system to sustainability risks**

4

Increasing the **financial sector's contribution to sustainability**

5

Ensuring the **integrity of the EU financial system** and monitoring **its orderly transition**

6

Building **international sustainable finance initiatives and standards** and supporting EU partner countries

Sustainable Finance regulations change the way firms interact with their customers and …

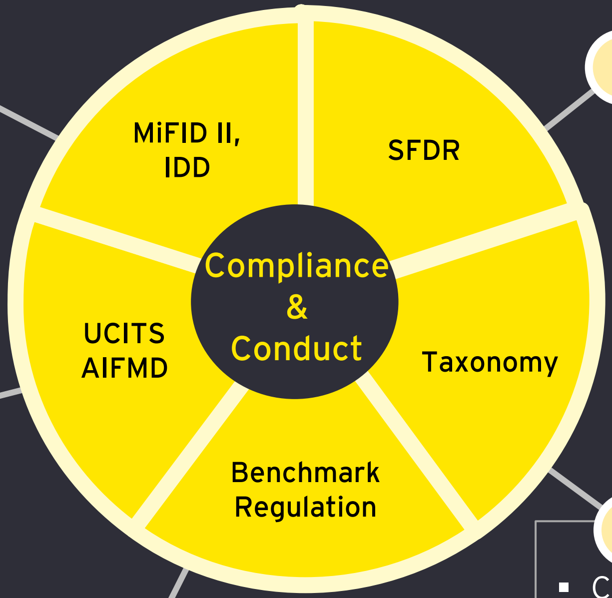
Compliance & Conduct (Action 4, 5, 6, 7 of the EU Action Plan)

5

- Integration of customer expectation and targets related to ESG into advisory processes, incl. Suitability and appropriateness process).
- Product-Governance – Definition of target market in relation to ESG preferences.

4

- Integration of ESG risks and factors in investment process and risk management
- Performance of ESG / climate scenario analysis to reflect future ESG risks



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- 2 ESG benchmarks are already defined (climate transition benchmark and the benchmark aligned with the goals of the Paris Agreement)
- If banks use these benchmarks they need to meet all the requirements in the benchmark regulation

1

- Disclosure of ESG information on product level as well as on entity level when offering financial instruments (website, periodical reports, pre-contract information, i.e.
  - Integration of ESG risks into investment process
  - Adverse sustainability impacts
  - ESG strategy
- Marketing communication need to be aligned with disclosure requirements
- New ESG product classification

2

- Classification system for sustainable economic activities
- Economic activity must qualify for technical screening criteria, i.e.how the activity contributes to the 6 environmental goals and DNSH

… also impacts capital and risk frameworks within our clients organization

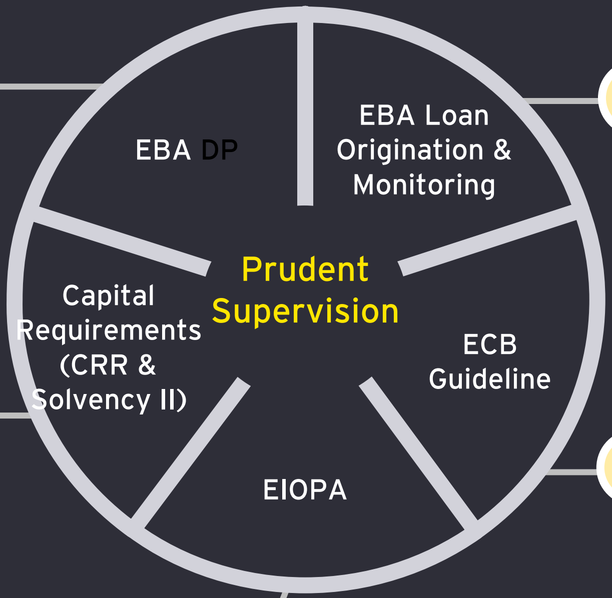
Prudential Regulation (Action 8 of the EU Action Plan)

5

- Banks need to define strategic ESG target and align business activities (Alignment Method)
- Banks need to reflect ESG risk and factors into their Risk Management (Risk Framework Method)
- Banks need to prepare for ESG integration into SREP by 2022/23
- EBA will amend existing GL accordingly

1

- Requires banks to incorporate ESG into their credit business strategy
- Banks need to express their appetite to grant ESG related loans
- Banks need to amend exsiting procedures accordingly when offering ESG related loans (originating criteria, controls, etc.)



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- Integration into capital requirements can lead to
  - Higher capital requirements for brown assets / rising physical risks
  - Lower capital requirements for green assets
- FS firms need to disclose their risk exposure towards ESG in pillar 3 reporting

2

- ECB's expectation on integration of climate change and other environmetal risks SREP elements, i.e.
  - Business Model
  - Internal Governance (RA, Culture, etc.)
  - ICAAP
  - Reporting
  - Stress Testing
- Banks need to perform self assessment early 2021 and take action to be ready for SREP in 2022

3

- Insurers need to manage and mitigate ESG risks and factors through their underwriting activities
- Insurers need to adopt sustainable approach in their investments
- Insurers need to integrate climate change scenarios in their ORSA

And the pace will certainly not slow down

2019

December 2019
Presentation of the European Green Deal

2020

January 2020
European Green Deal Investment Plan

July 2020
Taxonomy Regulation

December 2020
Climate Benchmarks Regulation

2021

March 2021
Sustainable Finance Disclosure Regulation (SFDR)

April 2021
Proposal of the CSRD

July 2021
- Renewed Sustainable Finance Strategy
- Adoption of Fit 55 package
- EU GBS Regulation Proposal
- EU Taxonomy Delegated Act

2022

August 2022
MiFID II Delegated Regulation

October 2022
Adoption of first set of EU sustainability reporting standards

November 2022
MiFID II Delegated Directive

December 2022
Deadline to transpose CSRD

2023

January 2023
Applicability of CSRD

CBAM: Start of transition period (until 2026)

ETS: start of gradual inclusion of maritime transport

Effort Sharing Regulation: Change of annual emissions allocation to Member states

2026

January 2026
CSRD applicable to SMEs

ETS Road transport fully covered

CBAM fully operational

2030

Goal: 55% CO2 emission reduction

2050

Goal: Climate neutral EU

Many elements need to be addressed for external reporting

Regulatory compliance

ESG regulations and reporting standards are **evolving rapidly and constantly**.

Institutions must respond to regulatory requirements in a developing and sometimes not fully implemented framework.

Moreover, the disclosures must meet the expectations of **widely varying stakeholder**, in particular market regulators, NGOs and rating agencies.

Data avalaibility

To respond properly to regulatory requirements, institutions must have **access to large amounts of data**.

This leads to two different challenges:

1. Certain information, as per SMEs or sovereigns, could be **difficult to collect.**
2. For the information available, in particular that given by the rating agencies, it is the **quality of the data** and the **methodologies** that must be challenged

Governance

To successfully adress and manage large amounts of data, it is crucial to structure a **clear and robust governance**.

Companies need to identify roles and responsibilities, in order to understand who – internally – **generates, monitors, validates and updates ESG data**.

IT systems

Institutions are often unprepared to handle big volumes of non financial information.

In this context, there is a need to **enhance internal IT system** or use **external support** for collecting, storing and sharing of ESG data.

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One of the immediate challenges is about ESG data

To achieve a successful implementation of the European Green Deal and the Sustainable Finance Action Plan, it is essential to address a better ESG data collection and assessment, both externally and internally.

Regulation	Challenges	Potential solutions
MiFID 2	• Potential mismatch between investors' high expectations for sustainable finance and the availability of products that meet these preferences. • Data collection system are not prepare to handle all the data requested from different sources, such as other ESG regulations (SFDR, EU Taxonomy), and different data providers.	• Gradual response to investors' expectations as more sustainable finance products arrive in the market • Development of a single data center that store all ESG data : European Single Access Point
SFDR	• Difficulty in the understanding of how ESG factors impact the investment process from non-ESG expert clients. • Lack of availability of non-financial data needed to measure impact and metrics of ESG factors on the investment universe. This could also have an impact on the credibility of the information reported.	• Introduction of a greater flexibility in regulation that ensures investment firms can use "plain language" when discussing sustainable finance (rather than legal concepts). • Use of a "best effort basis" approach to obtain information and set a solid dialogue and cooperation with third parties
EU Taxonomy	• Large amounts of nonfinancial data to be collected and lack of systems set up specifically for this purpose • Dialogue with several counterparties and different data providers • Regulation still evolving, which makes it difficult to correctly interpret the information to be reported	

Our benchmark shows various capabilities across ESG data vendors

An AMF study: Provision of non-financial data: mapping of stakeholders, products and services

Sample of the analysis:

25 Companies based and/or operating in Europe

<20 1/3 of the analysed company has less than 20 ESG analyst.

ESG data providers are primarily remunerated based on the **investor pays model**, and the provision of the ESG data underlying the rating. Only a marginal part of the sample operates on the **issuer-pays** model for its ESG rating activities.

ESG data providers

- **Market data providers** (general financial information providers, index producers, stock exchanges), who invested heavily in the ESG sector in the last decade, by acquiring specialised data providers.
- **Major credit rating agiencies**, incorporating ESG criteria into their analyses and credit ratings.
- **Technology start-ups**, new players that stand out in the recent years thanks to the bulk and diversity of ESG data required and the develpment of new technologies.

Diversification of services offered

- Provision of raw environmental, social and governance data
- Production of scores/ratings
- Assessment of non-financial performance of companies
- Portfolio analysis
- Construction of financial indices
- Advisory services to companies in defining their ESG strategy

Raw data

In recent years, the supply of raw data increased in coverage in terms of geography, sector and asset classes analyzed.

Raw data providers use different collection processes, with a variety of vectors and channels.

Processed data

Investors use raw ESG data to create their own analysis and evaluations.

Part of the data will then be used to determine scores and ratings.

Despite the public guidance of rating agencies' methodologies, the information provided is often incomplete.

Due to their **varying degrees of availability and the low level of standardization**, the issue of the quality of non-financial data collected is taking a central dimension.

There is therefore a need for greater transparency concerning:

- the sources and the methods used to make sure data are reliable and more exhaustive;
- the methods, processes and modes of remuneration of ratings;
- the identification and management of conflicts of interest.

The next challenge will be about disclosure

Timeline

Level 1: Directive

April 2021
Proposal of the CSRD

February 2022
European Council and Parliament postpone first disclosures in FY24

June 2022
Adoption of the Directive

December 2022
Transposition of the Directive into national law

Spring 2024/2025
First CSRD Non Financial Statements (except SMEs)

January 2026
CSRD applicable to SMEs

Level 2: Standard

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June 2021 - March 2022
PTF ESRS: Standard Content Exposure Drafts

April – August 2022
Public consultation on the first set of Draft ESRS

October 2022
Adoption of the first ESRS set

October 2023
Adoption of the second ESRS set

IFRS

March 2022
Pubblication of Exposure Draft ISSB

April – July 2022
Consultation on Exposure Draft (General Information and Climate Disclosures)

December 2022
Publication of the first ISSB Standard set

March 2022
Proposal of mandatory climate disclosures (TCFD-based)

March - June 2022
Consultation on climate disclosures (TCFD-based)

December 2022
Adoption of the climate disclosure proposal

Spring 2024
First climate disclosure on FY23 for "large accelerated filer"

The next challenge will be about disclosure

The evolving framework of reporting standard


COVER NOTE FOR PUBLIC CONSULTATION
DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS
April 2022
Open for comments until 8 August 2022
PTF-ESRS
EFRAG

EFRAG Public consultation on the first set of Draft ESRS

The European Commission's proposal for CSRD envisages the adoption of **EU Sustainability Reporting Standards** (ESRS), currently under consultation.

In this context, **EFRAG publish the basis of the Exposure Drafts 5 (EDs),** the first set of European Sustainability Reporting Standards, currently under consultation until 8th August 2022.

Focus next slide


IFRS Sustainability
Exposure Draft
[Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
IFRS Sustainability
Exposure Draft
[Draft] IFRS S2 Climate-related Disclosures
International Sustainability Standards Board

IFRS Exposure Draft IFRS ISSB

The International Sustainability Standards Board (ISSB) has published:

- **Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information** (General Requirements Exposure Draft): overall requirements to disclose sustainability-related financial information about all its significant sustainability-related risks and opportunities
- **Exposure Draft IFRS S2 Climate-related Disclosures** (Climate Exposure Draft): built upon the recommendations of the TCFD and incorporating industry-based disclosure requirements derived from SASB Standards.

Enhancement and Standardization of Climate-Related Disclosures for Investors

The Securities and Exchange Commission ("Commission") is proposing for public comment amendments that would require registrants to provide certain **climate-related information in their registration statements and annual reports**. The proposed rules would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition. The disclosures would also include a registrant's GHGs emissions, and certain climate-related financial metrics.

The next challenge will be about disclosure

Focus EFRAG: EU Sustainability Reporting Standards

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The Project Task Force on EU Sustainability Reporting Standards (PTF ESRS) has developed 13 different ESRS Exposure Drafts, broken down by ESG pillars, including 137 disclosure requirements overall.

Cross-cutting Exposure Drafts	
ESRS 1	General principles
ESRS 2	General, strategy, governance and materiality assessment
Topical standards - Environment	
ESRS E1	Climate change
ESRS E2	Pollution
ESRS E3	Water and marine resources
ESRS E4	Biodiversity
ESRS E5	Resource use and circular economy
Topical standards - Social	
ESRS S1	Own workforce
ESRS S2	Workers in the value chain
ESRS S3	Affected communities
ESRS S4	Consumers & end-users
Topical standards - Governance	
ESRS G1	Governance, risk management and internal control
ESRS G2	Business conduct

ESRS Exposure Drafts index

ESRS 1 - General principles Disclosure principles	Corresponding Application Guidance
DP 1-1 – On policies adopted to manage material sustainability matters	AG 1 to AG 9
DP 1-2 – On targets, progress and tracking effectiveness	AG 10 to AG 18
DP 1-3 – Actions, action plans and resources in relation to policies and targets	AG 19 to AG 26
6.2 Structure of the sustainability statements *Presentation of disclosures required by sector-agnostic ESRS*	AG 27 to AG 35
6.2 Structure of the sustainability statements *Presentation of disclosures required by sector-specific ESRS*	AG 36
6.2 Structure of the sustainability statements *Presentation of entity-specific disclosures required by ESRS*	AG 37
6.2 Structure of the sustainability statements *Presentation of the disclosures pursuant to article 8 of the Taxonomy regulation (2020/852)*	AG 38

Disclosure Requirements and application guidance index by ESRS Exposure draft

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The next challenge will be about disclosure

Several links with the ESG regulation and among standards

Overview of ESRS Exposure Drafts and SFDR Principal Adverse Impacts indicators

	Total number o DR per ED	Number of DR covering SFDR PAI indicators	Number of SFDR PAI indicators covered per ED
ESRS 1 – General principles	0	0	0
ESRS 2 – General, strategy, governance and materiality assessment	22	4	12
Total General	**22**	**4**	**12**
ESRS E1 – Climate change	17	8	7
ESRS E2 – Pollution	7	1	3
ESRS E3 – Water and marine resources	7	4	3
ESRS E4 – Biodiversity and ecosystems	10	0	0
ESRS E5 – Resource use and circular economy	9	1	2
Total Environment	**51**	**14**	**15**
ESRS S1 – Own workforce	26	6	12
ESRS S2 – Workers in the value chain	6	1	5
ESRS S3 – Affected Communities	6	1	5
ESRS S4 – Consumers and end-users	6	1	5
Total Social	**44**	**9**	**27 (1)**
ESRS G1	10	1	1
ESRS G2	10	2	7
Total Governance	**20**	**3**	**8**
Total	**137**	**30**	**62 (1)**

Because of the way the social ESRS Exposure Drafts are built (covering the whole value chain in four segments), some of the SFDR Principal Adverse Impacts indicators are individually covered by all four social ESRS Exposure Drafts.

Several supporting papaers are available to guide comparison and consistency among the proposed standards.

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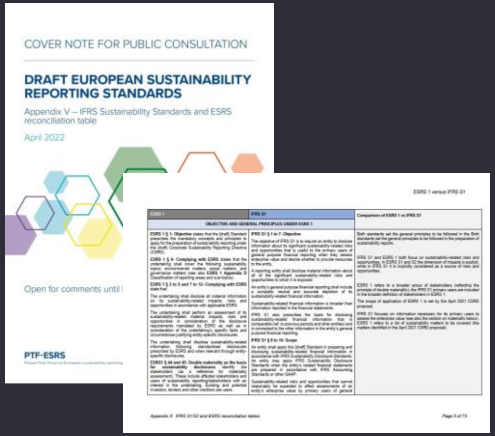
IFRS



- ESRS 1 versus IFRS S1
- ESRS 2 versus IFRS S1
- IFRS S1 versus ESRS 1 and ESRS 2
- ESRS E1 versus IFRS S2
- IFRS S2 versus ESRS E1

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Prudential rules will be integrating more and more ESG criteria

Today → Tomorrow

2020
Guide on climate-related and environmental risks

The European Central Bank (ECB) published guidance outlining how banks should safely and prudently manage climate and environmental risks and communicate them with transparency within the existing prudential framework.

2021
Report on management and supervision of ESG risks

The European Banking Authority (EBA) provided a comprehensive proposal on how ESG factors and ESG risks should be included in the regulatory and supervisory framework for credit institutions and investment firms.

2022
Integration of ESG information in Pillar 3

The EBA ESG Pillar 3 package aims at address shortcomings of institutions' current ESG disclosures at EU level by setting mandatory and consistent disclosure requirements on ESG risks.

2022
ECB climate stress tests

Exercise to assess the readiness of banking sector for the financial and economic shocks that climate risks are likely to cause.

Proposal of Directive amending the CRD IV, regarding supervisory powers, sanctions, third-country branches, environmental, social and governance risk ("CRD Proposal")

In October 2021, as part of the Banking Package 2021, the European Commission presented a proposal of Directive, amending the Capital Requirements Directive (CRD IV).

The aim of the Proposal is to establish a harmonized framework for the provision of banking services, ensuring a stronger sector resilience to potential future economic shocks.

To pursue this goal, the European Commission Introduces additional ESG risk requirements for credit institutions and provides more robust enforcement tools for EU credit institution supervisors.

By June 2022, the European Commission is expected to review the adequacy of macroprudential regulation. If so, by December 2022, the commission will submit a legislative proposal to Parliament and the Council.

Prudential rules will be integrating more and more ESG criteria

Today: ECB efforts in climate-related disclosures

In November 2020, the ECB published **Guide on climate-related and environmental risks**, a non-binding guidance to help credit institutions to consider climate-related and environmental risks as drivers of existing categories of risk. The Guide is structured in four sections and 13 expectations.

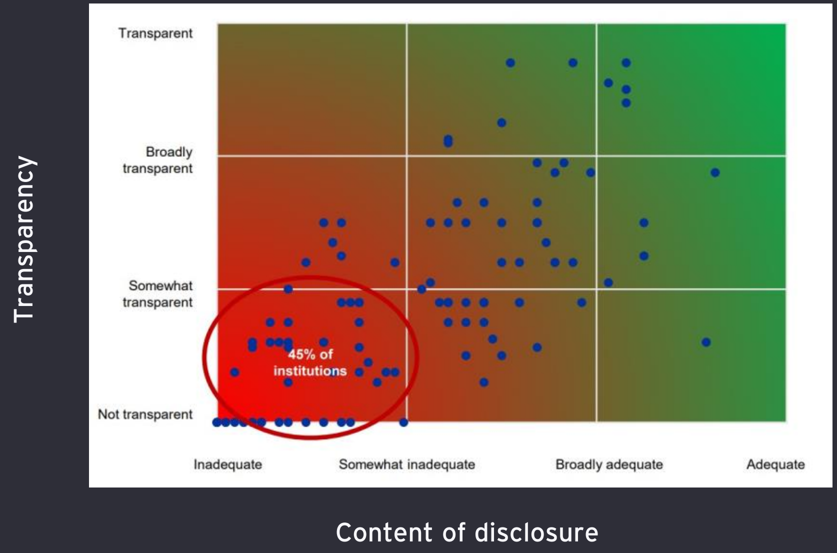
Business models and strategy	Governance and risk appetite
Reporting	Risk Management

13 Supervisory expectations

The expectations cover not only the content of the disclosures, but also the **policies, processes, methodologies, definitions** and **criteria** associated with them. In terms of content, institutions are expected to disclose **climate-related risks that are material**, **their GHG emissions** for the whole group, including downstream emissions, as well as the **KPIs and key risk indicators (KRIs)** they use for strategy-setting and risk management.

In 2022, for the second year in a row, the analysis of institutions' disclosures showed that **virtually none of the banks disclose all the basic information on climate-related and environmental risk that would align with all of the ECB's expectations**.

45% of institutions have the worst positioning in terms of content and transparency of materiality of risk and methodologies.



Prudential rules will be integrating more and more ESG criteria

Tomorrow: a comprehensive framework to manage ESG risks

Context of the CRD Proposal

The Banking Package aims at is implement in EU law the **Basel III international standards**, supporting the recovery from the impact of the Covid-19 pandemic and transition to climate neutrality.
The Basel III standards targets to ensure a **better capitalization of worldwide banks and a stronger resilience to economic crises**.
In line with the EU Sustainable Finance Strategy, the Proposal CRD introduces new rules to **manage and supervise ESG risks**, and it requires supervisors to assess ESG risks as part of **regular supervisory reviews**.

Main measures

The integration of ESG factors into the EU Prudential framework will consider:

a) **Systemic risk buffer**
b) Internal **capital adequacy**
c) Internal **governance**
d) **Management of risks**, in terms of management bodies, strategies and policies
e) Standards, methodologies, targets and timeline related to **ESG risks**
f) **SREP mandate**
g) **Supervisory stress testing**
h) **Supervisory powers**
i) **Harmonization** of ESG risks
j) **Reporting requirement & disclosure** of ESG risks
k) **Prudential treatment of exposures** to ESG factors

ECB Opinion on Proposal CRD – 27/04/2022

ECB welcomes the Banking Package as a step forward in the strengthening the EU prudential framework, tackling emerging risks and in the harmonization at Union level.

Furthermore, the new rules are aligned with ECB supervisory expectations of banks' management and disclosure of climate-related and environmental risks.

Specifically, the Proposal marks a progress regarding:

- Providing **more adequate tools** for supervisors to require banks to address ESG risks more rapidly and effectively;
- Assessing the financial, legal and reputational risks for banks caused by **misalignment with the EU transition pathway**;
- The importance of strengthening the **governance of banks**, ensuring a suitable and experienced management with the same standards of conduct, experience and reputation in all EU countries;
- Conferring **sanctioning powers** to ECB
- Addressing differences across borders and setting common rules for **third-country branches**

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