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THE SUSTAINABLE
FUTURE
BEGINS IN
PARIS

FROM THE EUROPEAN ACTION PLAN TO THE RENEWED SUSTAINABLE FINANCE STRATEGY

Decryption of regulatory advances

| May 2020 |

EDITORIAL

Sustainable finance has now reached a central status in the European policy agenda. This was achieved notably thanks to the work initiated by the High-Level Expert Group (HLEG) on sustainable finance, mandated by the European Commission at the end of 2016, and followed by the Technical Expert Group (TEG). Since 2018, an Action Plan is under implementation based on the initial recommendations of the HLEG. It aims to define a global strategy to make sustainable finance the framework of the European financial system, in order to build a low-carbon and inclusive economy, in adequation with the challenges of our time.

The momentum now carried by the "Green Deal", for the carbon neutrality of the European continent by 2050, is unprecedented. Accompanied by a massive investment plan estimated at 1000bn euros from public and private sources, it sets the ecological transition at the forefront of the growth strategy in Europe for the next decade.

In this context, the European Commission is currently defining its "Renewed Sustainable Finance Strategy" with a public consultation open until July 2020. It aims to strengthen, develop, and accelerate the action plan, aiming to mobilize all the financial capital necessary for the ecological transition.

In March 2020, the proposal for a taxonomy of sustainable economic activities by the European Technical Expert Group was an essential step. This taxonomy will have to define a common language, which will constitute a major lever to pursue tangible objectives for the transformation of the economy and the financial system. It is considered to be the basis for the development of the overall ten strategic axis of the plan.

With its members, Finance for Tomorrow will contribute to improve the formulated proposals, to support their impact and ambition, and to secure that they can be effectively implemented, everywhere in the world. The working group "Impact of the Green Deal and Taxonomy" is coordinating a substantial response to those rich texts proposals, to ensure that they are effective in the short and medium term, and allow for the full achievement of the Paris Agreement and the UN Sustainable Development Goals over the long-term.

Produced by our "Commission Policy", this decryption has vocation to present an overview of the regulatory advances of the action plan in order to enable economic and financial actors to take ownership and participate to their improvement in the forthcoming months. It explains the implementation of the first legislative proposals from 2018, presents the ongoing development of norms and standards, and introduces the work of the financial supervision authorities in view of the next steps to come. The aim is, on the one hand, to foster the capacity of stakeholders to anticipate the implementation of new processes and, on the other hand, to encourage their mobilization in the context of the ongoing work of the European Commission and its public consultations, and the work carried out by Finance for tomorrow and its members to make a constructive contribution.

Given the environmental emergency, and the health crisis facing us, the opportunities provided by sustainable finance are more and more essential every day. The transition towards a more sustainable and resilient economy must be a cornerstone of our economic recovery post-COVID 19. For this, it is fundamental to provide political and regulatory tools to financial actors, in order to guarantee their genuine support of the companies' transition towards sustainability. It is a key element of the *Roadmap to Recovery* of the European Council, as well as the message conveyed by the members of the technical expert group on sustainable finance. This objective should be based on the work undertaken by the most mobilized institutions, in France as in Europe. It is also the ambition Finance for Tomorrow will continue to carry.

Anne-Claire Roux

Managing Director of Finance for Tomorrow

SUMMARY

CALENDAR

EUROPEAN COMMISSION

WORKS

2016

DEC. Establishment of the High-level expert group on Sustainable Finance (HLEG)

2017

JUNE Publication of the guidelines on non-financial reporting (NFRD)

JULY Publication of the HLEG interim report on Sustainable Finance

2018

JAN. Publication of the HLEG final report on Sustainable Finance

MAR. Adoption of the Action Plan on Sustainable Finance and its 10 strategic axis –Creation of the TEG and the Member States Expert Group (MSEG)

MAY Legislative proposals: Taxonomy, Disclosures and Benchmarks

JULY Start of the Technical Expert Group on Sustainable Finance (TEG): EU Taxonomy, EU Green Bond Standard, EU Climate benchmarks (mandated until September 30, 2020)

DEC. Publication of the TEG's first report on EU Taxonomy: Early feedback Report

2019

MAR. Publication of the TEG's first report on EU Green Bond Standard: Interim Report

APRIL The European Parliament endorsed the legislation setting the building blocks of a Capital Market Union

JUNE Publications of the TEG:
- first version of its technical report on EU Taxonomy
- preliminary report on EU - GBS
- interim report on Benchmarks

JUNE New guidelines on reporting climate-related information (NFRD)

SEPT. Publication of the TEG's final report on Climate Benchmarks and Benchmarks ESG Disclosures.

DEC. Publication of the TEG: Handbook on climate benchmarks & benchmarks' ESG disclosures

DEC. - Presentation of the European Green Deal by Ursula Van Der Leyen
- Political agreement between the Council and the European Parliament on the Taxonomy Regulation
- Official release of the "Regulation on sustainability-related disclosures in the financial services sector" ("Disclosures Regulation")
- Conclusions of the Council on the new strategy for the Capital Markets Union
- Signature of the Directive (EU) 2019/2177 amending Solvency II and MiFID II Directives, giving new powers to the financial European Supervisory Authorities (ESA).

2020

JAN. - Presentation of the Green Deal Investment Plan
- Launch of the consultation on the review of the NFRD
- Mission to EFRAG to propose a European standard for non-financial reporting

FEB.. - EFRAG's report on companies' climate-related reporting

MAR. Publications of the TEG:
- Final report on EU Taxonomy
- Usability guide for the EU Green Bond Standard

MAR. - Proposal for a European climate law
- Public consultation on the European Climate Pact
- Launch of the consultations on ESG factors in financial benchmarking

APRIL - Launch of a consultation on the renewed sustainable finance strategy
- Launch on the consultation on the technical standards (RTS) for the Regulation Disclosure

A TRANSFORMATION PLAN FOR THE FINANCIAL SECTOR

The action plan aims to create stable market standards and coherent incentives, in order to mobilize the financial flows needed for the achievement of the United Nations' Sustainable Development Goals and the alignment of the European economy with the objectives of the Paris Climate Agreement.

In October 2016, the European Commission announced the creation of a High-Level Expert Group (HLEG) on Sustainable Finance, in the context of the establishment of the Capital Markets Union.

In March 2018, based on the recommendations of the HLEG, the Commission submitted its action plan targeting three goals:

- Reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth,
- Manage financial risks stemming from climate change, environmental degradation and social issues,
- Foster transparency and long-termism in financial and economic activity.

The European Commission then assigned a Technical Expert Group (TEG) to develop the tools necessary for enabling the convergence of market practices and thus ensuring the operational implementation of the action plan.

The regulatory developments implied by the action plan are the result of negotiations between the Commission, the Parliament, and the European Council, which represents the Member States. They frequently lead to public consultations.

10 STRATEGIC AXES OF THE ACTION PLAN ON SUSTAINABLE FINANCE

1 ESTABLISHING AN EU TAXONOMY FOR SUSTAINABLE ACTIVITIES	2 CREATING STANDARDS AND LABELS FOR GREEN FINANCIAL PRODUCTS	3 FOSTERING INVESTMENT IN SUSTAINABLE INFRASTRUCTURE PROJECTS	4 INCORPORATING SUSTAINABILITY WHEN PROVIDING FINANCIAL ADVICE	5 DEVELOPING SUSTAINABILITY BENCHMARKS
6 INTEGRATING SUSTAINABILITY IN RATINGS AND MARKET RESEARCH	7 CLARIFYING INVESTORS' DUTIES	8 INCORPORATING SUSTAINABILITY IN PRUDENTIAL REQUIREMENT	9 STRENGTHENING SUSTAINABILITY DISCLOSURE AND IMPROVING ACCOUNTING RULE-MAKING	10 FOSTERING SUSTAINABLE GOVERNANCE AND ATTENUATING SHORT TERMISM

AT THE TIME OF THE EUROPEAN "GREEN DEAL"

The Sustainable Finance Action Plan is part of a long-term vision and takes place within a set of public policies for the decarbonization of the European economy.

On December 11, 2019, Ursula von der Leyen, newly elected President of the European Commission, presented her proposal for a new "Green Deal" for Europe. Its main objective is to achieve climate neutrality for the EU by 2050 and to enshrine it in a climate law, the draft of which was presented on March 4, 2020. Thought as Europe's new growth strategy, the Green Deal is enacted in the form of a European investment plan for the next decade, seeking to mobilize 1,000 billion euros with the leverage of European financial instruments such as InvestEU on private financing. It also plans for a Just Transition Mechanism (JTM) to provide funding and technical assistance tools, in order to alleviate the socio-economic impact of the transition in the most affected regions.

To support this strategy, the European Investment Bank (EIB) has adopted a new policy, foreseeing the end of fossil fuel loans by 2022 and with the ambition of committing 50% of its financing to climate objectives. Similarly, the European financial supervisory authorities - ESMA, EBA, and EIOPA - are building up their climate and sustainability expertise to introduce these risks into their supervision missions. Lastly, when nominated as Governor, Christine Lagarde stated that the European Central Bank (ECB) would have a part to play in the ecological transformation of the economy. In 2017, the Banque de France, along with other central banks, structured an international network of supervisors and central banks for the greening of the financial system (NGFS).

The action plan on Sustainable Finance will be pursued within the framework of the Green Deal, under the title of «Renewed Sustainable Finance Strategy» for a low-carbon and inclusive European economy, enabling the continent to achieve its climate neutrality by 2050.

This strategy should be adopted in the fall of 2020 after public consultation.

To address the progress of the action plan, it is possible to start from the three legislative proposals of the European Commission from March 2018. Presented as an integral part of the founding elements of the Capital Markets Union, they were adopted in December 2019.

- **The adoption of the "Taxonomy Regulation",** a classification tool for environmentally sustainable activities;
- **The adoption of the "Disclosure Regulation"** on sustainability risks and impacts in finance;
- **The update of the "Benchmark Regulation",** creating two categories of sustainable benchmarks and introducing ESG transparency of the indices.

"TAXONOMY" REGULATION

The Taxonomy of environmentally sustainable economic activities is an asset classification system that creates a common language to foster sustainability in decision making.

According to the recommendation of the HLEG, the implementation of this taxonomy is the first strategic axis of the action plan. It constitutes a necessary condition, by providing a set of common definitions that will serve as a reference for future regulations and tools concerning sustainable finance and Environmental, Social and Governance (ESG) criteria. This reference will allow for greater transparency of the information on economic activities. It will help to avoid greenwashing by providing a market signal to align all actors on common standards and objectives. It will also aim to reduce European market fragmentation, by easing the analysis and comparison of financial products and sustainable projects.

On December 18, 2019, the European Commission, the Council, and the European Parliament reached an agreement, allowing the adoption of the regulation institutionalizing the existence and principles of the taxonomy. The European Council adopted its position at first reading on April 15, 2020, which must now be adopted by the European Parliament at second reading. This regulation will be supplemented by delegated acts by the Commission, specifying its technical contents. To prepare this classification, the TEG published two reports submitted for public consultation, in December 2018 and June 2019, and a final report in March 2020.

To be considered sustainable and in line with the Taxonomy, an activity must:

- **Contribute substantially to at least one of the 6 environmental objectives** (below), based on performance thresholds and/or processes for risk management defined for each economic activity;
- **Do no significantly harm any of the 6 environmental objectives** (DNSH), over the entire life cycle of the activity's products and services; (Article 17 of the Taxonomy Regulation)
- **Be conducted in compliance with minimum social and governance standards** ("minimum social safeguards" - Article 18): the OECD Guidelines for Multinational Enterprises, the United-Nations Guidelines on Business and Human Rights, the eight conventions of the International Labour Organization (ILO), and the International Declaration of Human Rights.

"Based on a learning dynamic and a strong consensus between the diverse stakeholders, the Taxonomy is the tool that can achieve the European ecological transformation."

Helena Vines Fiestas, Head of Sustainability Research,
BNP Paribas AM, member of the TEG

"TAXONOMY" REGULATION

WHICH INSTITUTIONS ARE AFFECTED BY THE TAXONOMY?

The taxonomy applies to three types of actors (art. 1 of the Regulation):

- Member States and EU institutions that implement sustainable financial tools and public policies.
- Large companies covered by the Directive "NFR" that will have to publish their turnover, capital and operating expenditure (CAPEX and OPEX) falling within the scope of the taxonomy.
- Financial actors, i.e. institutional investors and managers that offer financial products, will have to disclose the alignment of their products with the taxonomy.

TAXONOMY STRUCTURE

The Taxonomy is organized based on the General Classification of Economic Activities in the European Communities (NACE) and covers the large majority of economic activities in 7 macro-sectors: Agriculture and Forestry; Industry; Electricity, Gas, Steam and Air Conditioning; Water; Transport; Information and Communication Technologies; Building.

The taxonomy covers six environmental goals (Article 9):

1. Climate change mitigation	**2.** Adaptation to climate change	**3.** Sustainable use and protection of hydrological and marine resources
4. Transition to a circular economy, including waste prevention and recycling	**5.** Prevention and pollution control	**6.** Protection and restoration of biodiversity and ecosystems

STATE OF PROGRESS

In the technical annex to its final report of March 2020, the TEG listed 70 economic activities and proposed technical criteria and levels of harm ("DNSH" for "Do Not Significant Harm") for the first two objectives: mitigation and adaptation to climate change. This document constitutes the taxonomy proposal to date.

At this point, most of the criteria for applying the DNSH principle to other environmental objectives are aligned with existing European laws and standards.

The Commission will take a delegated act to officialize, following or not the recommendation of the TEG, this first taxonomy by the end of 2020 for an entry in force by the end of 2021. Then, the Platform for Sustainable Finance, while continuing the work of the TEG, will have as part of its missions to cover the next environmental objectives, with a timetable of adoption by the end of 2021 and set up by the end of 2022.

"TAXONOMY" REGULATION

CLIMATE CHANGE MITIGATION (ARTICLE 10)

Technical criteria are proposed to ensure the taxonomy is consistent with the 55% emission reduction objective in Europe by 2030 and carbon neutrality by 2050.

Under the regulation, they exclude all forms of solid fossil fuels (coal, lignite) for electricity production and exclude the activities of transportation and storage of fossil fuels.

For the energy sector, the TEG proposes a criterion of <100g of CO2e / kWh to be reduced towards 0g CO2e / kWh.

Three categories of activities:

- **Sustainable activities:** already compatible with a zero-carbon economy by 2050.
- **Transition activities:** contribute to the reduction of greenhouse gas (GHG) emissions when there are no alternative activities that are already sustainable. These activities will be reviewed regularly with increasingly strict requirements.
- **Enabling activities:** which support the development of sustainable activities.

ADAPTATION TO CLIMATE CHANGE (ARTICLE 11)

The approach is more qualitative and contextual (in time and in geography). As it cannot be based on a list of activities with numerical threshold criteria, it first requires to estimate the risks for an activity in its context and to demonstrate how the activity addresses them.

- Two inputs table: activities allowing the mitigation of climate change, and the "climate sensitivity" of each economic activity.

Activities that contribute substantially to adaptation do not increase the climate risks for other activities and do not increase the risks of adverse climate impacts on other people, nature, and assets.

Two categories of activities:

- **Adapted activities:** all measures that reduce physical risks have been taken. They are quantified in terms of the volume of expenditures devoted to these measures.
- **Enabling activities:** allow the adaptation of other economic activities. For these activities, such as fire services or weather warning systems, either expenditures or revenues can be counted.

DEVELOPMENT OF THE TAXONOMY

The work will be carried forward by the **Platform on Sustainable Finance** that will succeed to the TEG in 2020. It will be a multi-stakeholders platform of expertise, with the European Environment Agency, the European supervisory authorities, the European Investment Bank, and experts representing the financial, non-financial and academic fields and civil society. It will extend the taxonomy to other environmental objectives and review the technical criteria every 3 years. The taxonomy will also be reviewed considering its influence on "stranded assets" and its effectiveness in redirecting capital flows. The TEG expressed its positive opinion for the development of a Taxonomy of Environmentally Harmful Assets and a Taxonomy with a Social Dimension. The Platform will also be tasked with providing tools to promote the operational use of the taxonomy.

A member states expert group was also set up in 2018. It now finds legal existence through the Taxonomy Regulation, aiming to provide advice to the European Commission on delegated acts for all the environmental objectives of the taxonomy .

The International Platform on Sustainable Finance will aim to provide tools to harmonize taxonomies from different regions of the world, to ensure the influence of the European tool and to share best practices throughout the international financial sector.

“TAXONOMY” REGULATION

APPLICATION OF THE TAXONOMY BY FINANCIAL ACTORS (ARTICLE 4 - 8)

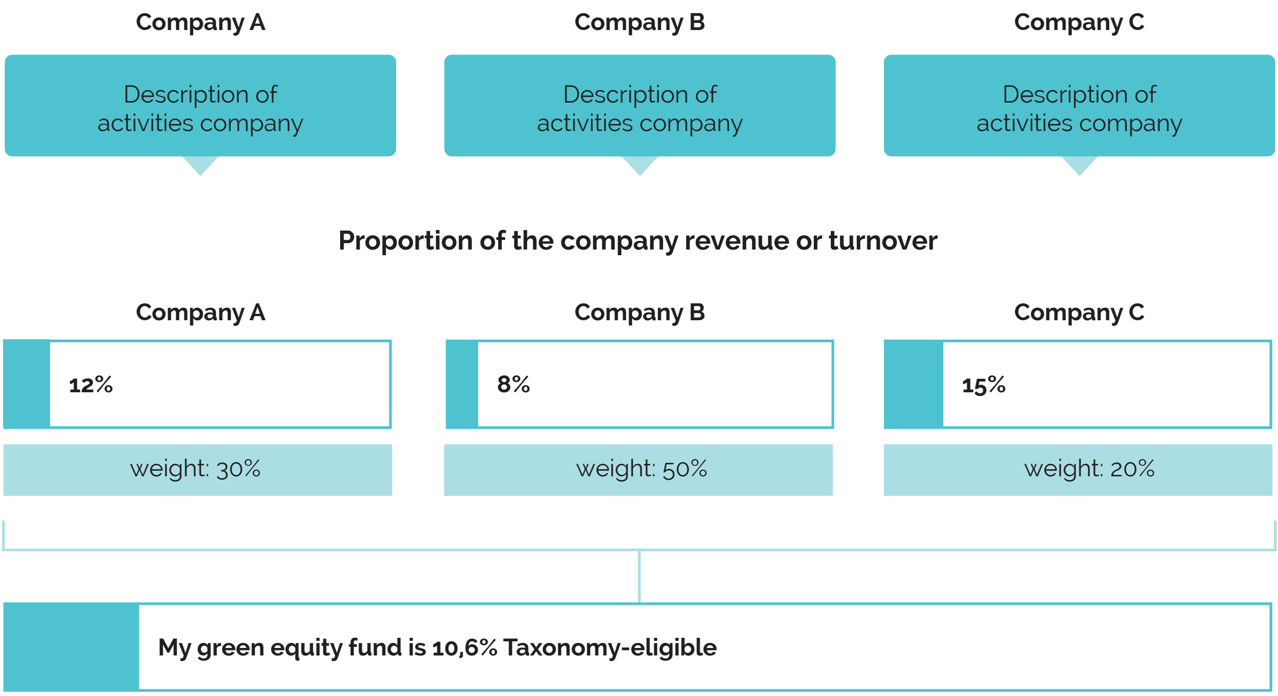
Are concerned financial actors in Europe, providing: portfolio management, alternative investment funds, venture capital funds, UCITS, retirement and pensions products, and insurance-based investment products (based on the definition of the “Disclosure Regulation”).

For financial products that qualify as environmentally sustainable or that display ESG characteristics in their management strategies, their commercial and regulatory presentation documents and periodic reports will have to specify **“how and to what extent”** their investments fall within the scope of the taxonomy. Other financial products *(mainstream)* will be required to indicate that their investments do not take account of the taxonomy.

Steps for analysis:

- 1: Identify the activities of the companies or issuers financed, or included in the financial product, that are aligned with the environmental purpose of the taxonomy;
- 2: for each activity, check that it meets the associated technical standard;
- 3: check that the principle of non-harm is respected (DNSH due diligence);
- 4: verify that social principles are respected (social safeguards due diligence);
- 5: Calculate the alignment of the investment with the taxonomy, expressed as a percentage.

How to apply the taxonomy to an equity portfolio



Source: TEG’s final report on EU Taxonomy, March 2020

“DISCLOSURE” REGULATION

The Regulation on sustainability related disclosures in the financial services sector lays down harmonized rules on the disclosure of information with respect to sustainable financial products and more generally, on the integration of sustainability risks and principal adverse impacts in investment policies.

It applies to financial market actors and financial advisers, and the investment and insurance products they offer. It was published on December 2019 and amends Directive (UE) 2016/2341.

Definitions

A sustainability risk is an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential negative impact on the value of the investment.

A principal adverse impact is a decision that result in negative effects on sustainability factors (environmental, social and employee issues, respect for human rights, anti-corruption issues).

A definition of a **sustainable investment** should provide that the investee companies follow good governance practices and the precautionary principle of “do no significant harm” to environment or society → future harmonization with the EU Taxonomy.

THE FOLLOWING INFORMATION SHOULD BE MADE AVAILABLE AND KEPT UP TO DATE IN PRE-CONTRACTUAL DISCLOSURES, IN ANNUAL REPORTS AND ON WEBSITES, AT THE ENTITY LEVEL OR/AND THE PRODUCT LEVEL:

- **Policies on the integration of sustainability risk in decision-making processes for investment.**
  - Information on the methodologies used, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used.
  - The extent to which it may impact the performance of the financial product should be disclosed either in qualitative or quantitative terms.
- **Due diligence policies on negatives principal adverse impacts, and actions taken.**
  - Identification and prioritization of principal adverse sustainability impacts and indicators.
  - Coherence of remuneration policies incentives.
  - Compliance to responsible business standards.
- **Depending on the level of ambition of the product: description of the environmental / social characteristics or of the sustainable objective pursued**
  - Explanation of evaluation and monitoring methods.
  - If an index is used, how is it aligned to the characteristics described.
  - For the objective of reducing emissions: specific provisions with reference to alignment with the Paris Agreement on climate.

STATE OF PROGRESS

Market players will have to publish the information required from March 2021 for sustainability indicators and risks, and by the end of December 2022 for information on the main negative impacts. The European financial supervisory authorities are developing, through a joint committee, draft technical standards specifying the content, methodologies, and presentation of the information. The publication of regulatory technical standards (RTS) for indicators related to negative impacts on climate and the environment is scheduled for December 2020, and related to social, human rights and anti-corruption issues for December 2021.

Note: France has transposed the Disclosure regulation in advance into article 29 of the “Energy Climate” law of November 8, 2019, thus modifying the provisions of article 173 of the TECV law of 2015. This article notably extends transparency required for biodiversity risks.

A consultation is underway on the first RTS project resulting from this mandate - see p.17

"BENCHMARK" REGULATION

The TEG experts working on benchmarks published their final report in September 2019. It defines specifications, setting constraints from a starting universe, to allow a form of "labeling" for sustainable indices.

The Benchmark Regulation was published on December 2019, amending Regulation (EU) 2016/1011 on this subject. It concerns equity investors, institutional players and pension funds.

THE BENCHMARK REGULATION INTRODUCES TWO NEW TYPES OF CLIMATE BENCHMARKS

- **EU Climate Transition Benchmark,** whose underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonization trajectory to support the transformation of the economy.
- **EU Paris-Aligned Benchmark,** whose underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio's carbon emissions are aligned with the objectives of the Paris Agreement regarding the limitation of long-term global warming.

In its report, the TEG also made a proposal on the following criteria: integrating Scope 3 data, exposure to polluting sectors to make them progress; excluding controversial sectors and a maximum for coal-related revenue.

The underlying assets must comply with the principles of do not significantly harm (DNSH) to other environmental objectives. The European Commission will adopt delegated acts in the first semester of 2020 to specify asset selection criteria as well as the decarbonization trajectory.

THE REGULATION REINFORCES THE SUSTAINABILITY TRANSPARENCY REQUIREMENTS FOR BENCHMARKS

All benchmark administrators should be required to explain how their methodology considers ESG factors for each benchmark or family of benchmarks, except for interest rate and foreign exchange benchmarks. The European Commission shall adopt delegated acts before 2021 to specify the content and format of the required information.

Three consultations were opened from April to May 2020 concerning climate and ESG indicators in benchmarks.

Simultaneously with regulatory advances, the TEG and the Commission progressed on the development of norms and standards to further the 10 Strategic Axes of the Sustainable Finance Action Plan:

- **EU Green Bond Standard;**
- **EU Eco-Label** on financial product for retail clients;
- **Corporate reporting:** the guidelines on climate-related information are part of the consultation on the Directive on Non-Financial Reporting (NFR) revision, and could lead to a "EU Reporting Standard".

EU GREEN BOND STANDARD

In June 2019, the Technical Expert Group published a report to prepare the creation of a European green bond standard. This voluntary standard will have the vocation to improve the efficiency, the transparency, the comparability, and the credibility of the green bond market. It will also aim at encouraging market players to increase issuance and to invest in European green bonds.

This draft standard is based on best market practices, such as the Green Bond Principles (GBP) developed by the International Capital Market Association (ICMA).

THE EUROPEAN GREEN BOND STANDARD WOULD INCLUDE FOUR ESSENTIAL ELEMENTS

- Green bonds funds must finance projects aligned with taxonomy (minimum threshold under discussion), not harm other environmental objectives and respect the minimum social guarantees.
- The publication by the issuer of a green bonds framework.
- The compulsory publication of reports on the use of products (allocation report) and on the environmental impact (impact report).
- The compulsory verification of the green bonds framework and the final allocation report by an external examiner.

In addition to its recommendations, the TEG published in March 2020 a Guide to using the "EU Green Bond Standard" which aims to support issuers, auditors and potential investors of EU green bonds.

ISSUES REGARDING THE FORMALIZATION OF THE STANDARD

The European Commission is proposing to formalize the European standard for green bonds in the form of a law. This proposal is included in the public consultation on the renewed sustainable finance strategy launched in April 2020. The question of the European approval of auditors also remains open. The TEG proposed that it be ensured in the long term by ESMA and, before this competence was officially assigned to it, by an intermediate solution. The Commission will launch a consultation on this subject.

However, the TEG proposes that the EU Green Bond Standard remains a voluntary standard offered to issuers who wish to align themselves with best market practices. Green bond issuers who do not want to use the standard and prefer to opt for other market practices would not be obliged to follow the four components of the EU Green Bond Standard.

"The European standard for green bonds corresponds to best market practices in Europe, which are already widely applied in the Paris financial center. We are confident that the establishment of this standard will contribute to further advancing this market towards more transparency and accountability."

Tanguy Claquin, Head of Sustainable Banking, Crédit Agricole CIB
Jochen Krimphoff, Deputy Director – Sustainable finance, WWF France
Members of the TEG & members of the board of Finance for Tomorrow

EU ECO-LABEL ON FINANCIAL PRODUCTS

In development since early 2019 under the leadership of the European Commission and in collaboration with stakeholders, the future Eco-Label will strengthen the integrity of the financial products offered to retail clients.

It concerns retail products: investment funds (UCITS) and investment funds open to individuals (FIA), insurance products with an investment component (unit-linked life insurance), and term and savings deposit accounts.

As an indication, the Eco-label criteria correspond to 10-20% of the best products available on the market at the time of their adoption, from the point of view of environmental performance throughout the life cycle.

The functioning of the Ecolabel requires that the management company be declared the holder of the eco-label, so that the logo can be placed on the eligible products. All the criteria are mandatory, and the evaluation and verification requirements are specified for each criterion.

THE ON-GOING WORKING GROUP PROPOSED 6 CRITERIA

1. Investment in green and transition economic activities, defined on the basis of the European taxonomy, with specific minimum shares for equity funds, bond funds, funds of funds and savings accounts;
2. The exclusion of environmentally harmful activities - for example pesticides or fossil fuels, and the exclusion of sovereign bonds - for example if the issuers have not ratified international agreements like the Paris Agreement;
3. Respect for social principles and governance on the basis of standards and legal texts of international reference;
4. A commitment policy, in particular through voting at general shareholders' meetings (AGM);
5. Regular information to the consumer, for example on the distribution of investments, but also on internal control and governance procedures;
6. Compliance with eco-label information rules.

STATE OF PROGRESS

These proposals are subject to consultation and the adoption of the label by the Commission must be linked to the entry into force of the taxonomy and of the European Green Bond Standard.

"Directing household savings towards products that finance the energy transition is a key issue for successfully transforming the European economy into a low-carbon model. The Eco-Label on financial products will provide the information and confidence necessary for meaningful investments."

Adrienne Horel-Pagès, Strategic Projects Manager, La Banque Postale AM
Member of the Stakeholder Working Group responsible for defining the criteria for the European Eco-label

CORPORATE REPORTING

The Non-Financial Reporting Directive (NFRD) of 2014 lays down the rules on disclosure of non-financial information and corporate social responsibility policies for companies with more than 500 employees for european companies – covering approximately 6,000 large companies, listed and unlisted, including financial actors (investors, banks, insurance companies...).

In their annual reports, companies within the scope publish information concerning the five areas of the Directive: business model, policies pursued and due diligence processes implemented, the outcomes of those policies, the principal risks and their management, with key performance indicators.

Within this framework, the European Commission published in June 2017 its "Non-binding Guidelines on non-financial reporting" specifying the methodology to be applied to allow companies to disclose comparable information. In January 2019, it published its **new guidelines on reporting climate-related information**, to integrate recommendations from the TCFD (TaskForce on Climate-related Financial Disclosures) and from the TEG report.

- Explanations of key concepts: double materiality (environmental & social materiality; financial materiality); climate-related risks and opportunities for the business model; and natural capital dependencies.
- Definition of commitment policies, with objectives and indicators.
- Recommendations on the types of climate-related information to be provided: emissions, energy, risks over different timeframes and within the value chain, green financing.
- Annex: specific issues for banks and insurance companies.
- Annex: complementarity of the new guidelines with the NFRD and with the TCFD.

As part of its communication on the European "Green Deal" of December 2019, the Commission mentioned the review of the Directive "NFR" in 2020.

A consultation has been launched to help to standardise and simplify company reporting at the European level, including through an EU Reporting Standard, but also to implement the changes required by the "Disclosure" and the "Taxonomy" Regulations.

At the same time, Vice-President Valdis Dombrovskis launched a first phase of work on non-financial reporting led by the European Financial Reporting Advisory Group (EFRAG).

EFRAG had already published a report, via the European Reporting Lab, on February 6, 2020: "How to improve climate-related reporting – A summary of good practices from Europe and beyond".

By bringing together good practices in non-financial reporting and by assessing the degree of maturity in implementing TCFD's recommendations, this report aims to help companies improve their processes for transparency on climate and to foster resilient decision-making. It also presents an in-depth review of existing methods for scenario analysis reporting.

To ensure the implementation and the compliance with the regulatory changes resulting from the Action Plan on Sustainable Finance, the European Supervisory Authorities (ESAs) are strengthening their expertise on sustainability risks and integrate them into their scope of activity. Their importance on the subject is growing and they are actively preparing the future regulatory developments brought by the Commission.

MOBILIZATION OF THE EUROPEAN SUPERVISION AUTHORITIES

The European Supervisory Authorities (ESAs) work mainly on the harmonization of the financial supervision within the European Union and to this end develop a unique regulatory corpus, namely a set of prudential standards aimed at financial institutions. They are also mandated to assess risks and vulnerabilities in the financial sector.

The European Financial Supervisory System (ESFS) is organized in a network around the three European Supervisory Authorities (ESAs), the European Systemic Risk Board (ESRB) and the national prudential supervisory authorities. The European Central Bank, responsible for European banking supervision, cooperates closely with the ESAs, in particular the European Banking Authority (EBA).

The three financial European Supervisory Authorities (ESAs) are:

European Banking Authority **(EBA)** for banks;

European Insurance and Occupational Pensions Authority **(EIOPA)** for insurance and pensions;

European Securities and Markets Authority **(ESMA)** for financial market.

GROWING IMPORTANCE IN THE CONTEXT OF THE ACTION PLAN ON SUSTAINABLE FINANCE

In December 2019, the signing of the Regulation on "anti-money laundering and counter terrorist financing" strengthened the role and powers of ESAs, to make possible an operational Capital Markets Union. Regarding sustainable finance, the ESAs have each published strategies and action plans to publicize the strengthening of their expertise in the field. The ESAs will be members of the platform on sustainable finance and they will ensure the supervision of the new European rules.

The Commission requested technical advice from ESAs in July 2018 for the revision of the Solvency II and IDD Directives (insurance) and the MiFID II Directives (management companies), UCITS and AIFMD (investment funds). The ESAs have also produced work and recommendations on prudential rules, on ESG preferences of individual investors, on ESG factors in credit ratings, on occupational pensions in Europe and on undue short-term pressures on companies by the financial sector.

"ESG DISCLOSURES" CONSULTATION

The ESAs published a joint consultation in April 2020, open until September 2020, under articles 2a, 4 (6) and (7), 8 (3), 9 (5), 10 (2) and 11(4) of the Disclosure Regulation. They propose a technical criteria of application which will then be adopted by the Commission, concerning: content and models for the presentation of information concerning the principal adverse impacts of financial products, in relation to the principle "DNSH" (do not significant harm), as well as for the description of the environmental and social characteristics or objectives of financial products, with the indicators, methodologies and data used.

Issues and questions of the consultation:

- **Principal adverse impacts & "DNSH" principle:** proposal of a set of mandatory indicators which are always negative and of a set of complementary indicators;
- **Models for presenting the information:** search for uniformity between the different reporting formats (website, pre-contractual and periodic reports), and between the various sectors concerned;
- **Information to be disclosed:** make sure that the level of granularity and the cost associated with finding information does not exclude small businesses; ensure that only the ESG criteria used into investment policies are put forward, for fair and precise information.

GUIDING PRINCIPLES FOR OVERALL PROCESSES, UNDERSTOOD FROM THE COORDINATION OF ESAS

- Integrate ESG issues in policies, general organizational requirements and procedures, including the compliance and internal audit functions.
- Ensure that senior management is responsible for the integration of ESG issues.
- Devote sufficient resources to this integration. For example, ensure that staff possess skills, knowledge and expertise for the assessment of sustainability risks.
- Adopt a prospective approach based on scenarios.

PRUDENTIAL RULES

For insurance, EIOPA has warned that insurability is likely to become an increasing concern. It recommends (potentially temporary) public policy solutions to maintain risk transfer mechanisms. The Commission requested EIOPA technical advice on the integration of sustainability risks and sustainability factors in Solvency II, which is expected in June 2020.

For banks, EBA received a mandate in the context of the last CRR/review (macro-prudential financial stability analysis tool) to assess and possibly issue guidelines regarding the inclusion of ESG risks in the supervisory review and evaluation process, and in the prudential treatment of exposures.

SUSTAINABILITY PREFERENCES OF RETAIL INVESTORS

In January 2019, the Commission published a draft amendment to integrate these preferences into investment advice and portfolio management, and into investment advice for insurance-based investment products. It now plans delegated acts as part of the revision of MiFID.

ESMA recommends that manufacturers and distributors of financial products consider customers' ESG preferences within the target market for investment products and as part of mandatory product process reviews.

CREDITS RATINGS

ESMA issued guidelines on disclosure requirements for credit ratings and rating outlooks to improve the quality and comparability of the information, enabling users to better evaluate how ESG factors are considered by credit ratings agencies.

PENSION SCHEMES

EIOPA run a stress-test in 2019 assessing the integration of ESG factors in the risk management and investments processes of the institutions for occupational retirement provision (IORPs): only about 30% of IORPs in the EU have a strategy in place to manage ESG related risks to their investments; only 19% assess the impact of ESG factors on investments' risks and returns.

SHORT-TERM PRESSURE

ESAs issued various recommendations, such as to adopt more explicit legal provisions on sustainability for credit institutions and to define clear objectives on portfolio turn-over ratios and holdings periods for institutional investors. It also proposes for Member States to monitoring the quality of information disclosed in remuneration reports.

The Commission is considering a revision of the "Shareholder Rights" Directive to integrate ESG factors into compensation policies, and to harmonize the voting rules allowing long-term shareholder engagement in Europe.

In order to accelerate the implementation of the 10 strategic axes of the Action Plan and to mobilize all the necessary capital for the ecological transition, from public and private sources, the European Commission has launched a consultation on its renewed sustainable finance strategy.

The Action Plan on Sustainable Finance redefines the regulatory architecture of the European financial system, with the aim to decarbonize the economy. Despite the scale of the achievements, these are still not sufficient to cope with the threat of climate change. To achieve carbon neutrality in Europe in 2050, the transformation of the economy is a requisite. To do so is the aim of the Green Deal investment plan, and it is even more essential now to ensure the sustainable and resilient economic recovery of the continent, made necessary by the coronavirus epidemic. It is the message carried by the members of the Technical Expert Group on Sustainable Finance, calling for the concrete use of sustainable finance tools in the *Roadmap to Recovery* for Europe.

THEMES OF THE RENEWED SUSTAINABLE FINANCE STRATEGY

1. Strengthening the foundations for sustainable investment:	• Create an enabling framework to focus on long-term development and sustainability-related challenges and opportunities, with appropriate tools and structures – such as the EU Green Bonds Standard. • Improve corporate reporting, referring to the revision of the Directive NFR but also to environmental accounting, ESG research and ratings. Perspectives on shareholders long-term interest, referring to the Share-holders' Right Directive. • Which market infrastructure could support the development of green securities?
2. Increased opportunities to have a positive impact on sustainability for citizens, financial institutions and corporates:	• Maximize the impact of the framework and tools to "finance green" – such as sustainable fintechs, public incitations and increased support to ground-level projects. • Mobilisation and protection of citizens, notably through the EU Eco-label. • Harmonisation of tools and practices at the European and international levels, to reduce barriers and multiply opportunities.
3. Fully manage and integrate climate environmental risks:	• « Greening finance » by reducing exposure to climate and environ-mental risks, as well as integrating ESG factors into credit ratings. • Anticipation of financial stability issues, reflecting on prudential rules in the light of the risks – public consultation on Solvency II. • Resilience of economic systems and natural capital in the face of cli-mate risks.

This consultation is open to experts from the financial sector, public authorities but also to citizens, until July 15, 2020. The mobilization of the private sector and of civil society is a major condition for the success of this political and regulatory dynamic.

Finance for Tomorrow hopes this decryption will facilitate your participation.

RESOURCES

Final Recommendations Report of the Task Force on Climate-related Financial Disclosures (TCFD), June 2017

https://www.fsb-tcfd.org/publications/final-recommendations-report/

Final report of the High-level Experts group on Sustainable Finance (HLEG), January 2018:

https://ec.europa.eu/info/publications/180131-sustainable-finance-report_fr

European Action Plan on Sustainable Finance, March 2018:

https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

Legislative proposals of the European Commission, May 2018

https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_fr#risks

Guidelines on non-financial reporting, updated in June 2019

https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en

Final reports of the European Technical Experts Group on sustainable finance

- EU Green Bond Standard, June 2019

https://ec.europa.eu/info/files/190618-sustainable-finance-teg-report-green-bond-standard_en

- EU Green Bond Standard, Utilisation guide, March 2020

https://data.consilium.europa.eu/doc/document/ST-5639-2020-INIT/en/pdf

- Benchmark, September 2019

https://ec.europa.eu/info/files/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en

- Benchmarks, Handbooks, december 2019

https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/192020-sustainable-finance-teg-benchmarks-handbook_en_0.pdf

- Taxonomy, March 2020

https://ec.europa.eu/info/files/200309-sustainable-finance-teg-final-report-taxonomy_en

Report "EU Eco-Label on financial products" by the Joint Research Center, December 2019

https://susproc.jrc.ec.europa.eu/Financial_products/docs/20191220_EU_Ecolabel_FP_Draft_Technical_Report_2-0.pdf

EFRAG report on climate-related reporting, Février 2020

http://www.efrag.org/Lab1?AspxAutoDetectCookieSupport=1

TEG Statement on post COVID-19 Recovery, April 2020

https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200426-sustainable-finance-teg-statement-recovery_en.pdf

Regulatory texts:

Regulation "Disclosure", Novembre 2019

https://eur-lex.europa.eu/eli/reg/2019/2088/oj

Regulation "Benchmark", Novembre 2019

https://eur-lex.europa.eu/eli/reg/2019/2089/oj

Approval of the Council on the Regulation "Taxonomy", December 2019

https://data.consilium.europa.eu/doc/document/ST-14970-2019-ADD-1/en/pdf

Version of the Regulation "Taxonomy" adopted by the European Council, April 2020

https://data.consilium.europa.eu/doc/document/ST-5639-2020-INIT/en/pdf

Consultations:

European Climate Pact

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12219-European-Climate-Pact/public-consultation

"Benchmark" - climate standards:

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12020-Minimum-standards-for-benchmarks-labelled-as-EU-Climate-Transition-and-EU-Paris-aligned-Benchmarks

"Benchmark" - ESG factors

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12019-References-to-ESG-factors-enabling-market-participants-to-make-well-informed-choices

"Benchmark" - methodology

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12018-Key-elements-of-the-methodology-reflecting-environmental-social-or-governance-ESG-factors

Renewed sustainable finance strategy

https://ec.europa.eu/info/consultations/finance-2020-sustainable-finance-strategy_en

Directive "NFR" - Revision

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation

"ESG Disclosures"

https://www.esma.europa.eu/document/joint-esa-consultation-esg-disclosures

ESMA Website

https://www.esma.europa.eu/policy-activities/sustainable-finance

EIOPA Website

https://www.eiopa.europa.eu/topics/sustainability_en

EBA Website

https://eba.europa.eu/financial-innovation-and-fintech/sustainable-finance

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