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EU SUSTAINABLE FINANCE – AN UPDATE

3 DECEMBER 2019

AGENDA

- ❑ Sustainable Finance – the hot topic
- ❑ What is “sustainable”?
- ❑ “Hard requirements”
- ❑ “Soft Requirements”
- ❑ Investor requirements

WHAT IS SUSTAINABILITY?

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."
- Brundtland (1987)

REGULATORY AND POLICY DEVELOPMENTS

EU SUSTAINABLE FINANCE ACTION PLAN

In January 2018, the EU High Level Expert Group on Sustainable Finance produced its final report. In March 2018, the Commission published the Sustainable Finance Action Plan, its "roadmap" for implementing sustainability into the EU financial system.

1. Establishing an EU classification system for sustainable activities ("The Taxonomy")

2. Creating Standards and labels for green financial products

3. Fostering investments in sustainable projects

4. Incorporating sustainability when providing financial advice

5. Developing sustainability benchmarks

6. Better integrating sustainability in ratings and market research

7. Clarifying Institutional Investors' and asset managers' duties ("The Disclosure Regulation")

8. Incorporating sustainability in prudential requirements

9. Strengthening sustainability disclosures and account rule making

10. Fostering sustainable corporate governance and attenuating short-termism in the capital markets

REGULATORY AND POLICY DEVELOPMENTS

EU SUSTAINABLE FINANCE ACTION PLAN – TAXONOMY

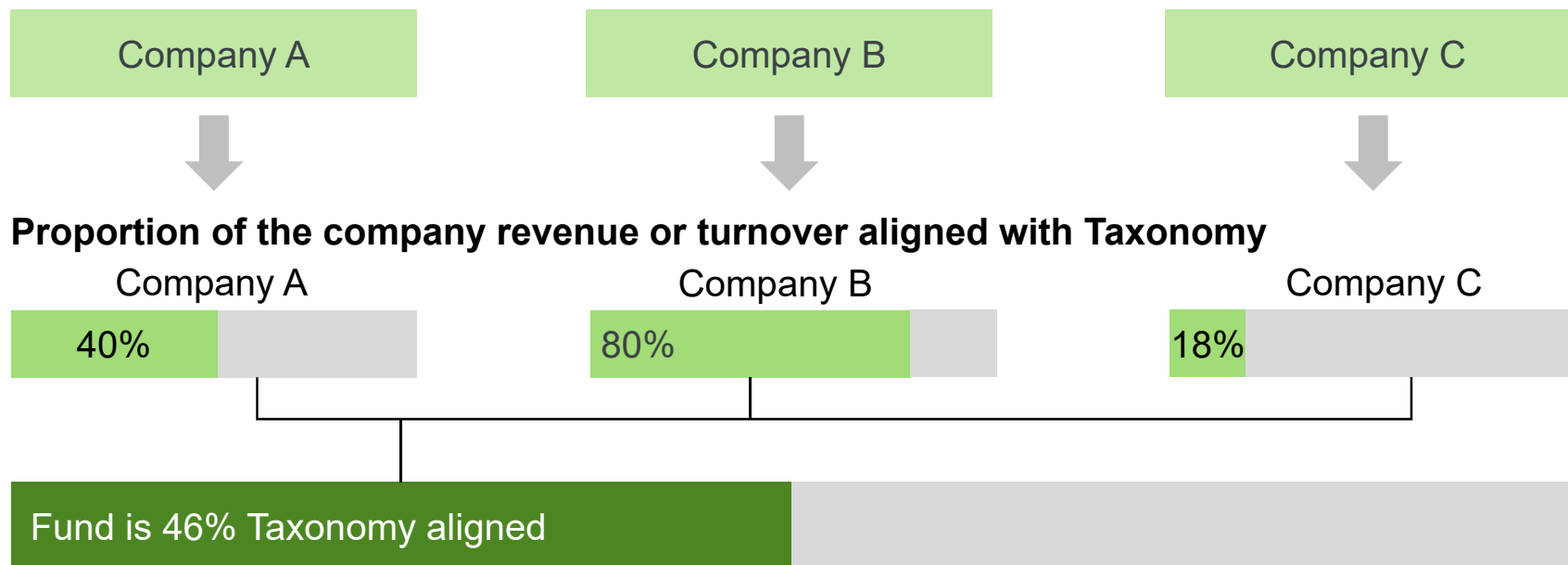
The Taxonomy is the EU's attempt to develop a classification system for determining if an economic activity is environmentally sustainable and is seen as the cornerstone of much of the Sustainable Finance Action Plan.



REGULATORY AND POLICY DEVELOPMENTS

EU SUSTAINABLE FINANCE ACTION PLAN – TAXONOMY

The EU Commission taxonomy proposal applies to the marketing of sustainable financial products by AIFMs, UCITS management companies and MiFID investment firms providing portfolio management. The EU Parliamentary amendments were wider, bringing Credit Institutions and Issuers in scope, but would need to be agreed through Trilogue.



REGULATORY AND POLICY DEVELOPMENTS

EU SUSTAINABLE FINANCE ACTION PLAN – BENCHMARKS

Minimum standards for two new sustainability benchmarks and minimum ESG disclosures for all benchmarks. The aim is to mitigate the risk of greenwashing, create reliable reference tools for investors and increase transparency.

EU Climate Transition Benchmark

- Benchmark is on a “decarbonisation trajectory”
- That is a measurable, science-based and time-bound trajectory to reduce scope 1, 2 and 3 carbon emissions towards alignment with the Paris Agreement

EU Paris-aligned benchmark

- Portfolio carbon emissions aligned with Paris Agreement

Minimum ESG disclosures for all benchmarks

- All benchmarks should also disclose whether or not they pursue ESG objectives
- As of 31 December 2021, all benchmarks with the exception of interest rate and currency benchmarks should include information on their degree of alignment with the Paris Agreement

REGULATORY AND POLICY DEVELOPMENTS

UK DEVELOPMENTS

UK Green Finance Strategy (July 2019)

- **Greening finance** – fostering transparency and long-term approach to investments
- **Financing green** – addressing market barriers and building capability
- **Capturing the opportunity** – positioning the UK as a global hub

Joint Declaration of the FCA, PRA, Pensions Regulator and Financial Reporting Council (July 2019)

- **Regulators will participate in Government's Taskforce** – enhancing climate-related disclosures
- **The Climate Financial Risk Forum** - FCA and PRA joint approach to climate change

FCA Feedback Statement FS19/6 (October 2019) – Climate Change and Green Finance

- **Disclosure by Issuers**– guidance on how climate risks should be disclosed within existing framework. Comply or explain for TCFD? Consultation Paper to be published in early 2020
- **Pensions** – Finalising proposed rule changes requiring Independent Governance Committees (IGCs) to oversee and report on firm's ESG and stewardship policies by end of 2019
- **Collaboration with Government, other regulators and industry**
- **Regulatory expectations around green financial products and services**– challenge potential greenwashing, clarify expectations and take appropriate action to prevent consumers being misled and create an enabling environment for the creation of new green financial products
- **Integration of climate change risk by regulated financial services firms / Stewardship**– regulated firms could be required to report on how they manage climate risks to customers and operations

Revised FRC UK Stewardship Code (effective from 1 January 2020)

- **Stewardship** as *"the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, which leads to sustainable benefits for the economy, the environment and society"*
- **Principle 7** - consider material ESG issues, including climate change, as part of their investment, monitoring, engagement and voting activities



REGULATORY AND POLICY DEVELOPMENTS

FRENCH DEVELOPMENTS - THE « FAMOUS » ARTICLE 173



French regulation is ahead of the European regulation

Start of French regulatory initiatives before COP21

Article 173 of the French energy transition law, codified as Article L.533-22-1 of the French *Code monétaire et financier*

In the course of being modified by the French energy and climate law, which has been adopted by Parliament and whose publication at the official journal is pending



Reporting obligation as the driver for sustainable finance

Aims at imposing on institutional investors, in particular insurance companies, pension institutions, portfolio management companies, reporting obligations

Reporting as to how institutional investors take into account ESG criteria in their investment policies

« Comply or explain » approach

Has been a key driver for the French green bond market



Changes made by the energy and climate law

Inclusion of part of the provisions of the Disclosure Regulation

Changes to the scope of institution investors

Reporting on risks related to climate change and biodiversity

Entry into force of the changes only upon entry into force of the Disclosure Regulation

REGULATORY AND POLICY DEVELOPMENTS

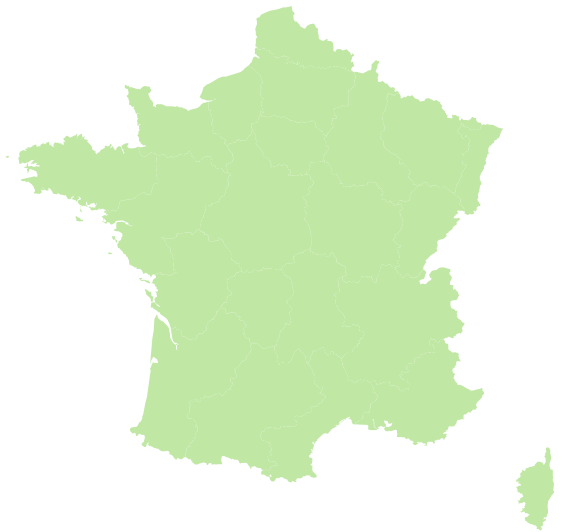
FRENCH DEVELOPMENTS – NEW LEGISLATION AND REGULATORY STATEMENTS

Other Legislative Developments

- **Law no. 2019-486 of 22 May 2019 in relation to the growth and transformation of companies (PACTE Law)** - powers to AMF to monitor the quality of information provided by portfolio management companies regarding their investment strategy and the management of risks related to the effects of climate change
- **Law no.2019-1147 of 8 November 2019 relating to energy and climate** - amended the framework regarding the application of ESG criteria by portfolio management companies

Other Regulatory and Supervisory Reports

- **AMF guide on carbon offsetting by collective investment schemes (March 2019)**
- **AMF progress report with respect to European works relating to sustainable finance (July 2019)** – re Benchmark and Disclosure regulations
- **AMF synthesis of the thematic inspections (*Supervision des Pratiques Opérationnelle et Thématique* – SPOT controls) (July 2019)** – assessment of portfolio management companies' arrangements for social responsibility investment and the integration of ESG criteria.
- **AMF report regarding the assessment of the application of the ESG criteria by among others portfolio management companies (July 2019)**
- **AMF publication of two studies on responsible finance (September 2019)** - second study aimed at evaluating the readability / appropriateness of commercial and regulatory documents published by social responsible investment funds
- **Launch by AMF and ACPR of a new mechanism to monitor and independently assess the climate-related commitments taken by Paris financial centre entities (October 2019)** - creation of commissions, publication of annual report, supervision



REGULATORY AND POLICY DEVELOPMENTS

GERMAN DEVELOPMENTS

Creation of the Sustainable Finance Committee by the German Government (June 2019)

- The Committee's purpose is to advise the German government as it drafts and implements a sustainable finance strategy, as well as to pool existing expertise and foster dialogue between the relevant players
- The Committee is made up of representatives from business, civil society and academia, as well as representatives from a number of federal ministries



SOFT LAW INITIATIVES

UN Principles for Responsible Investment

- ❑ The world's largest corporate sustainability initiative with 7,000 corporate signatories in 135 countries
- ❑ Signatories required to report on responsible investment activities annually
- ❑ In 2018, UN PRI incorporated TCFD-aligned indicators into its reporting framework. So far these climate indicators have been voluntary although many signatories have chosen to complete them.
- ❑ From 2020, all UN PRI signatories will be required to report certain climate indicators focused on strategy and governance.
- ❑ Note that **reporting** is mandatory but **public disclosure** is still voluntary and the answers will not be assessed. Signatories can choose whether their responses are public or private.
- ❑ The remainder of the climate indicators remain voluntary.
- ❑ Relevant sections are:
 - ❑ SG 1: Identification of climate-related risk and opportunities and how they are factored into investment strategies and products
 - ❑ SG 7: Roles in organisation that have oversight, accountability and/or manage responsibilities for climate-related issues
 - ❑ SG 13: Scenario analysis and modelling

SOFT LAW INITIATIVES

UN SUSTAINABLE DEVELOPMENT GOALS



- ❑ \$5 to \$7 trillion a year needed until 2030
- ❑ Seen as creating a common language
- ❑ 67% of respondents to PwC's 2019 responsible investment survey identified and prioritised SDGs that are relevant to their investments in 2019.
- ❑ And 43% adopted a proactive approach to monitoring and reporting portfolio performance against SDGs
- ❑ Opportunities across a range of asset classes although sense that some SDGs are more “investable” than others
- ❑ Concerns about “SDG-washing”

INVESTOR REQUIREMENTS

- ❑ Due diligence questionnaires
- ❑ Manager-level ESG
- ❑ Sophistication of side letter requests
- ❑ Remedies for investors following poor ESG practices
- ❑ ESG reporting to investors

SPEAKERS

AIMA

Adam Jacobs-Dean, Managing Director,
Global Head of Markets, Governance and Innovation
E: ajacobs-dean@aima.org

Clifford Chance LLP

Owen Lysak, Partner
T: +44 20 7006 2904
E: owen.lysak@cliffordchance.com

Lily Marcel, Senior Associate
T: +44 20 7006 4158
E: lily.marcel@cliffordchance.com

Peter Pears, Senior Associate
T: +44 20 7006 8968
E: peter.pears@cliffordchance.com

Paula Caamaño Sambade, Lawyer
T: +44 20 7006 2529
E: paula.caamanosambade@cliffordchance.com

Amy Watt, Senior Associate Knowledge Lawyer
T: +44 207006 1987
E: amy.watt@cliffordchance.com

INSIGHTS FOR ASSET MANAGERS

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Insights for Asset Managers

'Insights for Asset Managers and Funds', a series of calls offering a practical overview of the issues faced by the asset management and funds sector in today's international legal, regulatory and commercial environment. Each call lasts for around 30 minutes and focuses on a specific topic, with participants able to submit questions in real time via Webex during the call.

Online recordings of these calls are available below.

Issues discussed in the Insights for Asset Managers calls include:

- Deal-contingent hedging
- Sustainable investing – a wrap up of the latest ESG developments for asset managers
- The impact of LIBOR transition on asset managers
- OTC Derivative initial margin for buy-side firms
- Marketing investment funds post Brexit: assessing the impact on managers
- Sustainable finance
- The Securitisation Regulation
- ERISA Refresher
- The European Money Market Funds Regulation: the practical implications for EU and non-EU markets
- Making the complex simple: trends and issues for complex listed funds
- MIFID2: Research Unbundling
- Brexit and the sell-side – its impact on Asset Managers
- The GDPR – What Asset Managers Need To Know
- MIFID2 Issues for Asset Manager Broker and Distributor Documentation
- The Criminal Finances Act 2017
- The FCA market study on the asset management sector
- Developments in the derivatives markets
- Variation Margin – lessons learned and next steps
- Repapering MIFID2 – facing up to the challenge
- Implementing the Senior Managers and Certification Regime: Issues arising
- Marketing funds in the US
- Addressing structural vulnerabilities from asset management: what next?
- Developments in Business and Human Rights

Contacts:



Simon Crown
Partner, (London)
T: +44 20 7006 2944
E: simon.crown@cliffordchance.com



Owen Lysak
Partner, (London)
T: +44 20 7006 2904
E: owen.lysak@cliffordchance.com



Monica Sah
Partner, (London)
T: +44 20 7006 1103
E: monica.sah@cliffordchance.com



Will Winterford
Partner, (London)
T: +44 20 7006 4386
E: will.winterford@cliffordchance.com

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The Financial Markets Toolkit is compatible with devices such as blackberrys, smart phones and tablets and a web based App is available, making access even easier.

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