APPENDIX 4.5:
STREAM A5 ASSESSMENT REPORT

# FOCUS ON FINANCIAL INSTITUTIONS

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European Reporting Lab @EFRAG

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## DISCLAIMER

This appendix forms part of a series of seven documents, comprising the report and its appendices prepared by the European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards (PTF-NFRS), for submission to the European Commission in response to a mandate including a request for technical advice dated 25 June 2020.

The contents of the PTF-NFRS report and its appendices are the sole responsibility of the PTF-NFRS. The European Lab Steering Group Chair has assessed that appropriate quality control and due process had been observed to the extent possible within the context of the relevant mandate and the timeframe allowed, and has approved the publication of the PTF-NFRS report and its appendices. The PTF-NFRS report and its appendices do not represent the official views of EFRAG and are not subject to approval by the EFRAG governance bodies: EFRAG General Assembly and the EFRAG Board; or the European Lab Steering Group.

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- the PTF-NFRS report taken as a whole reflects a very large consensus;
- it is understood that members of the PTF-NFRS are not expected to endorse each and every one of the 54 detailed proposals in the PTF-NFRS report and may have different views on some of them;
- in addition the views expressed may not reflect the views of the organisations or entities to which individual PTF-NFRS members may belong;
- the assessment work for the different project focus areas, presented in Appendices 4.1 to 4.6 to the PTF-NFRS report, was the result of separate sub-groups of the PTF-NFRS, for which only peer review within the PTF-NFRS was performed.

Links are included in the PTF-NFRS report and its appendices to facilitate readers accessing the reference or source material mentioned. All such links were active and functioning at the time of publication.

Questions about the European Lab and its projects can be submitted to EuropeanLab@efrag.org.

# EXECUTIVE SUMMARY

## STREAM OBJECTIVES

1 The present report has been produced by workstream A5 (also called 'Stream A5' in this report) of the PTF. Its objective is to analyse existing and upcoming non-financial reporting requirements applicable to Financial Institutions (referred to as 'FIs', i.e. banks, asset managers/owners and insurance undertakings), and to identify critical issues (called 'salient points') that could be addressed by the standard setter in developing a new reporting standard.

## SYNTHESIS OF WORK CARRIED OUT

2 This assessment report results from an assessment process composed of several steps.

3 **First step:** a group of experts (called stream members) was set up. The members of the working group in charge of producing this assessment report come from the banking, insurance and asset management sectors. All of them are confronted with ESG issues in their respective activities.

4 **Second step:** the second step of the assessment process consisted of identifying important sources of information, classified into three main categories:

- EU regulatory context (e.g. NFRD, SFDR, EU Taxonomy, EBA regulations etc.)
- National regulations (e.g. French Article 173-VI)
- Private initiatives (e.g. private standards, guiding principles, disclosure practices of financial institutions)

5 **Third step:** these sources of information were reviewed using a common reading grid, focusing in particular on the following criteria: objective of the standard/regulation/principle, recipient of the information published using the regulation/standard/principle, geographical scope of application, financial institutions concerned, topics concerned (E, S, G or other), qualitative or quantitative information, existence or not of indicators.

6 For standards/regulations/principles requiring the publication of indicators, a review of indicators was carried out on the basis of the following criteria: double materiality approach (outside – inside, and inside – outside), type of indicator (absolute value, ratio etc.), unit AND existence (or not) of a calculation methodology in the regulation/standard/principle. A qualitative assessment of the indicators was then provided by the stream members: relevance of the indicator, comparability, availability of information, areas of improvement.

7 **Fourth step:** based on these analyses, the stream members produced a summary of their analyses and preliminary conclusions that were then discussed with the secretariat of the PTF.

8 **Fifth step:** these conclusions were brought together in this assessment report, which has been reviewed by a panel of reviewers, made up of members of other streams of the PTF.

## SYNTHESIS OF THE ASSESSMENT REPORT

9 The analysis and synthesis work provided by the stream members resulted in the formulation of four major conclusions, referred to as salient points. These salient points are as follows:

a) **Salient point #1:** The broad variety of financial institutions, products and services is not reflected/addressed in the NFRD, which needs to be very precise and coherent to allow effective and relevant implementation by financial institutions.

- The terminology financial institutions covers several types of activities, which do not form a homogeneous group. The three sub-segments of this group (banks, insurance undertakings, asset managers/owners) face some common issues, but also have some differences. It seems that a single NFI framework referring to FIs in general cannot address the specificities of lending, investing and insuring risk; each of these activities need to be addressed in detail.

- Existing thresholds for inclusion/exclusion of FIs in reporting requirements do not take into account the specificities of FIs which may have limited internal teams and yet have significant volumes of assets under management/loan books which directly correlate with extra-financial indirect impact (i.e. an FI may have significant assets under management/loan books while being below the 500 employees' threshold for companies to be included in the non-financial reporting requirements, as defined by NFRD and SFDR – NB: NFRD applies to listed only, although some member states have included unlisted countries too-).

b) **Salient point #2:** Some regulations overlap, thereby decreasing clarity for FIs. Contents are piling up, leading to a variety of data produced, and do not provide for coherence and efficient compliance, thus also reducing the potential effectiveness of the regulations in contributing to sustainable growth. Decentralised policymaking in key areas of the sustainable finance agenda, relying on several parallel processes and fora (e.g. Technical Expert Group, EFRAG, EBA, ESMA, EIOPA, and Platform on Sustainable finance) generates potential overlaps, inconsistencies, coordination challenges in filling in the existing gaps, whilst decreasing transparency for corporates.

c) **Salient point #3:** Financial institutions work on indirect impacts by using data from third parties. Access and processing of reliable, material and comparable data is key but particularly challenging as of today. Key issues include the following items:

- accessing data can be costly;
- material non-financial data is not always disclosed;
- varying transpositions of NFRD across countries lead to uneven NFI requirements in the EU;
- narratives disclosed are not always supported by relevant and transparent quantitative indicators (i.e. key performance indicators, KPIs);
- NFI is not harmonised enough to allow comparability;
- calculation methodologies of KPIs differ;
- data is rarely audited by an external reviewer.

d) **Salient point #4:** Key methodological aspects are not addressed by the EU Regulation (first and foremost NFRD and SFDR), such as:

- Minimal detention threshold for equity products to be reported (e.g. the share of equity owner by the investor over the total equity of the investee).
- Minimal invested/lent amounts for reporting.
- Asset types (e.g. how should a guarantee product be reported vs. a loan? How should the FIs' own money/treasury operations be reported?). It should be noted that depending on the product/service provided, the client relationship profile varies, and FIs are more or less able to collect information from the client.
- Asset size (which typically determines the ability of the investee/borrower to disclose non-financial information).
- Timing of investment/loan (e.g. should the FI report on assets or loans held on December 31st? or should the FI report on investments/loans that have been in the portfolio during the year? If so, should they take into account the duration during which the investment/loan was in the portfolio?).

- Regulation does not systematically specify what information is requested at each relevant level (i.e. whether disclosure should take place at entity level, at product level, or for each underlying asset/counterpart).
- FIs' indirect impact is not solely linked to large EU-based corporates (which have been the focus of the existing NFRD). Some major counterparts are not taken into account, which can lead to important gaps in the reporting.
  - o Many FIs have substantial exposure outside of the EU (for instance, some big European asset managers have more than 50% assets under management outside the EU), which leaves a major gap in FI's NFI reporting.
  - o Sovereign entities can also be FI counterparts (they can be borrowers, or investees if FIs invest in sovereign bonds). NFI for sovereign is still a nascent topic and can also represent a gap in FI's NFI reporting.
- NFRD requests FIs to report in the same timing as other corporates. Consequently, timing can be very tight for FIs to report on their indirect impact, as the information they need to report is often published by corporates at the same time.

e) **Salient point #5:** Climate disclosure requirements are more advanced than other E and S and G requirements in the present and forthcoming EU regulations.

- Given the climate emergency, upcoming regulations do make a clear focus to date on climate topics, compared to other environmental topics, but also compared to social and governance topics. This is in line with the European Parliament declarations on November 2019, and this makes sense for FIs as they play a key role in the transition to a low-carbon and climate-resilient economy.
- However, this climate prioritisation in policy making and reporting global context has a downside: social and governance dimensions of sustainability are being left behind. Examples of exclusively climate-related regulations or initiatives are Taxonomy Regulation (2020) (taxonomy includes all main environmental vectors and minimum safeguards on social issues but Delegated Acts are prioritising Climate-change related issues), Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019), the Task-Force on Climate-related Financial Disclosures initiative of the Financial Stability Board (2016), Carbon Disclosure Project (CDP), the EBA Pilot sensitivity exercise on climate risk (2020), amongst others.

f) **Salient point #6:** Forward looking disclosure is mainly tackled from a qualitative information point of view though quantitative comparable information is key for financial institutions to reorient capital flows towards sustainable activities.

- Forward-looking analysis is a necessary component of non-financial information to disclose, in order to foster transparency on transition targets, commitments fulfilment and to perform scenario analysis. The Taskforce on Climate-related Financial Disclosure, the Central Banks and supervisors Network for Greening the Financial System, the European Commission sustainable finance strategy, to name a few of the best known, propose adopting a forward-looking disclosure, to align capital flows with the Paris agreement objective.
- In this respect, a long-term horizon is emerging from regulators and supervisors' expectations (see for instance the ECB guide on climate-related and environmental risk published in November 2020 that require FIs for a long term of more than 5 years). However, these guidelines rarely go beyond qualitative information. There is no existing disclosure standard to comply with in order to measure forward-looking performance, as existing regulations rather focus on quantitative information on current performance. NB: It must be noted that this forward-looking disclosure is not specific to FIs and will be dealt with mainly by other workstreams.

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# INTRODUCTION AND OBJECTIVES

10 Based on the workplan that was presented and adopted by the PTF-NFRS during its kick-off meeting on September 11, 2020 Stream A5 (Focus on FIs) focused on the following objectives:

a) conduct a comprehensive analysis of all non-financial reporting requirements applicable to Financial Institutions (link to be made with A1);

b) assess whether direct impacts are material for asset managers/owners, banks and insurance undertakings, and require specific non-financial reporting provisions;

c) identify specific indirect impacts of lending/financing activities, asset management and insurance and the related non-financial reporting challenges currently faced by financial institutions;

d) assess necessary steps to give sustainable finance appropriate data.

# COMMENTS ON METHODOLOGY

11 Below are a few remarks regarding key methodological elements of this report:

a) **Indirect impact:** the wording 'indirect impact' in this report refers to NFI (non-financial information) of FI counterparts (investees, borrowers and other clients). In other words, indirect impact refers to NFI regarding the portfolio of FIs, both the environment/social materiality aspects (impacts of lending/investing/insuring on the environment and society), and the financial materiality (impact of lending/investing/insuring on the FI). Whilst, the report focuses on indirect impact data for reporting purposes due to its mandate, it is acknowledged that NFI data is (and should be) also used for decision-making in FI operations, and not only for reporting purposes.

b) **Indirect impact vs direct impact:** the PTF was given the mandate to assess whether direct impacts are material for FIs. Due to time constraints, it was decided that Stream A5 would focus on indirect impact, instead of working on comparing direct impact and indirect impact. It was directly postulated that the indirect impacts (regardless of the calculation principles) were much greater than the direct impacts. The direct impacts of FIs are dealt with by other work streams of the PTF, in the same way as any other types of companies.

c) **FI sub-segments:** Financial institutions is not a homogeneous group. The present report states that the terminology 'financial institutions' covers at least three main segments: banking; asset management; insurance. An even finer distinction can surely be made, but it appeared to the Stream A5 that this typology constituted a good working basis for a future non-financial standard.

# DETAILED ANALYSIS OF THE CURRENT STATE OF PLAY

## FIs HAVE SPECIFIC BUSINESS MODELS AND CHALLENGES

12 The financial sector has certain specific characteristics that deserve to be highlighted. These characteristics should be kept in mind when developing a non-financial reporting standard.

13 Financial institutions are intermediaries that reallocate capital flows and are at the heart of the financing of the economy. This has been recognised by the European Commission who intends to mobilise the financing power of financial institutions via its 2018 'Action Plan: Financing Sustainable Growth'.

14 Financial institutions are not a homogeneous group. The terminology 'financial institutions' covers at least three main segments: banking; asset management; insurance. For each sub-segment, the section below presents an overview of specificities (overview of the business model, main products and services, examples of ESG challenges for disclosure). Each of these sub-segments specificities and require specific disclosure requirements that are detailed further below in the document.

15 Financial institutions are highly regulated to ensure financial stability and protect clients. This document contains matrices which attempt to summarise the regulations applicable to the activities of banks, asset managers and insurers.

16 The main impact of financial institutions comes from their financing activities, i.e. the actual economic activities permitted by their financing. Their indirect impact is therefore considered more important than the impact directly produced by the organisations themselves. Direct impacts are dealt with by other PTF Streams. This assessment report therefore focuses exclusively on indirect impacts. In order to be able to report on indirect impact (i.e. activities financed), financial institutions therefore need high-quality, consistent and transparent information on the clients and projects financed.

## BUSINESS MODEL DESCRIPTION FOR EACH SEGMENT

### *Banking: overview of banking business model*

17 EU banks' business models are multifaceted, going from financing, saving, private banking, capital market activities up until debt origination and advisory services. However, to make it simple, a commercial bank has broadly two types of customers: one who deposits money with the bank and one who borrows money from the bank. Banks act as intermediaries between depositors and borrowers. Depositors and borrowers can be segmented into retail/individual, corporate, public institution and financial institution customers.

18 Banks offer different value propositions to different customer segments and use multiple channels to reach out to their customers: branches, ATMs, online banking, telebanking, mobile banking while increasingly looking for automation.

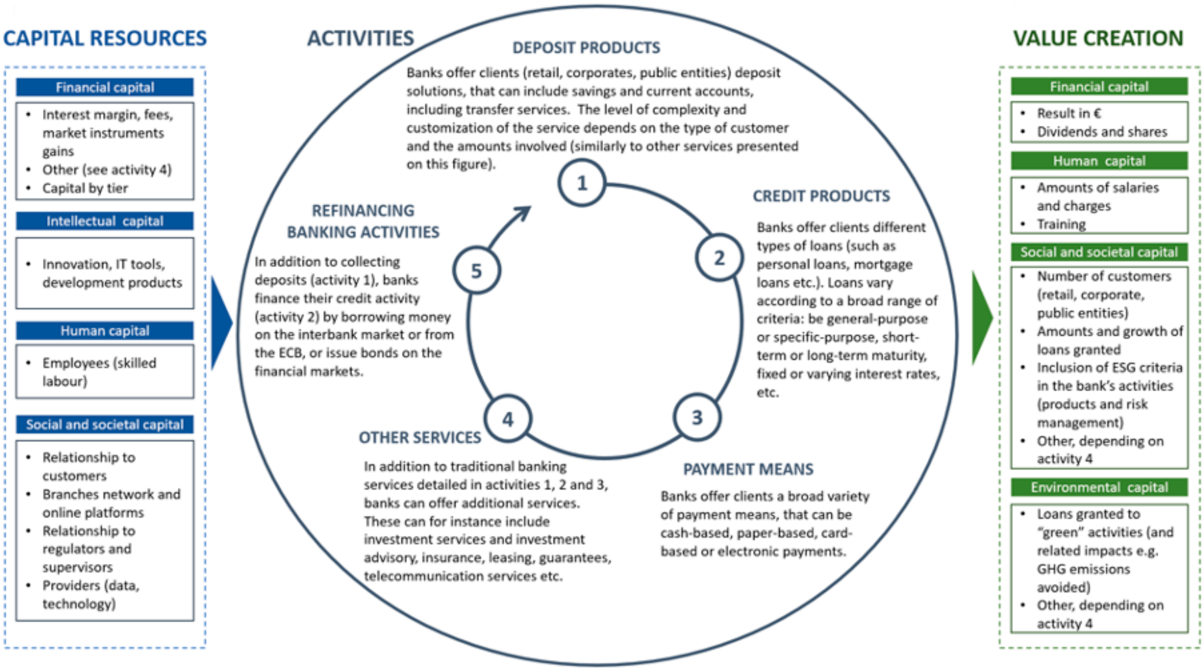
19 The economic model of banks can vary greatly with regard to the scope of the business portfolio. In recent decades, many large banks have embarked on diversification strategies in order to increase sources of income. Broadly speaking, the income (net banking income) of a bank comes from different sources:

a) Interest margin: calculated by the difference between the interest received and the interest paid. This demonstrates the effectiveness of the credit policy with regard to the rates charged and the cost of refinancing the funds loaned. The distribution of credits and the search for funds to ensure this distribution lie at the heart of a bank's activity.

b) Fees: a bank is also remunerated by fixed fees/commissions. These fees are diverse and range from the price invoiced to the customer for making a transfer, to the fees invoiced for a merger or acquisition.

c) Gains or losses on market instruments: part of a bank's operations take place on the financial market, or over the counter. They carry out these transactions for their own account or to limit their exposure to risks taken on behalf of their clients.

d) Other activities: banks sometimes extend their activity more widely, to offer services such as insurance, leasing, factoring, telecommunications etc. These activities have their own business models and contribute in a variety of ways to the bank's income.




*Banking: main products and services*

20 As explained in the introduction, banks offer a variety of products and services, which make it difficult to provide a common definition of banking activities. Nevertheless, a few activities can be identified as the minimum common denominator for most banks:

a) Deposit services: savings and current accounts, including transfer services to own accounts or third parties.

b) Lending: different types of loans for corporate or retail customers, mortgage, investment loans, treasury loans, leasing etc.)

c) Payment services: credit and debit cards, and other prepaid cards, cash management.

d) Investment services & products

e) Other services for clients: trading, factoring, custody, guarantees insurance, advisory, telecommunication, real estate services etc.

f) Other activities for own risk hedging: liquid assets portfolio, hedging derivatives for market or foreign exchange risk, funding debt issuance.

*Banking: example of challenges for ESG disclosure*

21 ESG factors can present both challenges and opportunities for a bank's assessment of its asset quality, capital strength, profitability, liquidity and funding:

a) Challenges: ESG factors are usually perceived as aggravating risk factors for banks (as opposed to new types of risks) as described by the ECB guide on climate-related an environmental risks published on 27 November 2020 – "physical and transition risks are drivers of prudential risk, in particular credit risk, operational risk, market risk and liquidity risk". For instance, climate risks (i.e. transition and physical risks) may undermine the repayment capacity of borrowers in vulnerable sectors, reducing both banks' asset quality and profitability. Hence, banks are starting to develop risk management strategies to deal with these emerging risks and to adjust their business models accordingly.

b) Opportunities: ESG factors can also provide business opportunities for banks, as they allow tapping new services, new clients, and new markets: this may lead to a shift in the business model of banks.

22 Challenges for banks exist across all ESG dimensions (as well as across the potential interrelation between the three dimensions):

a) Corporate Governance: Poor risk governance frameworks within banks' clients can lead to severe deterioration in asset quality in banks' portfolio (e.g. governance risk can materially affect client creditworthiness via fines or regulatory sanctions because of governance breaches). This is particularly true in emerging markets, which are populated by numerically more companies with poor governance, hence exposing banks more heavily when evaluating risks of that type. To manage governance risk exposure through financed activities, banks' credit analysis can for instance include a qualitative adjustment for corporate behaviour that directly measures governance risk.

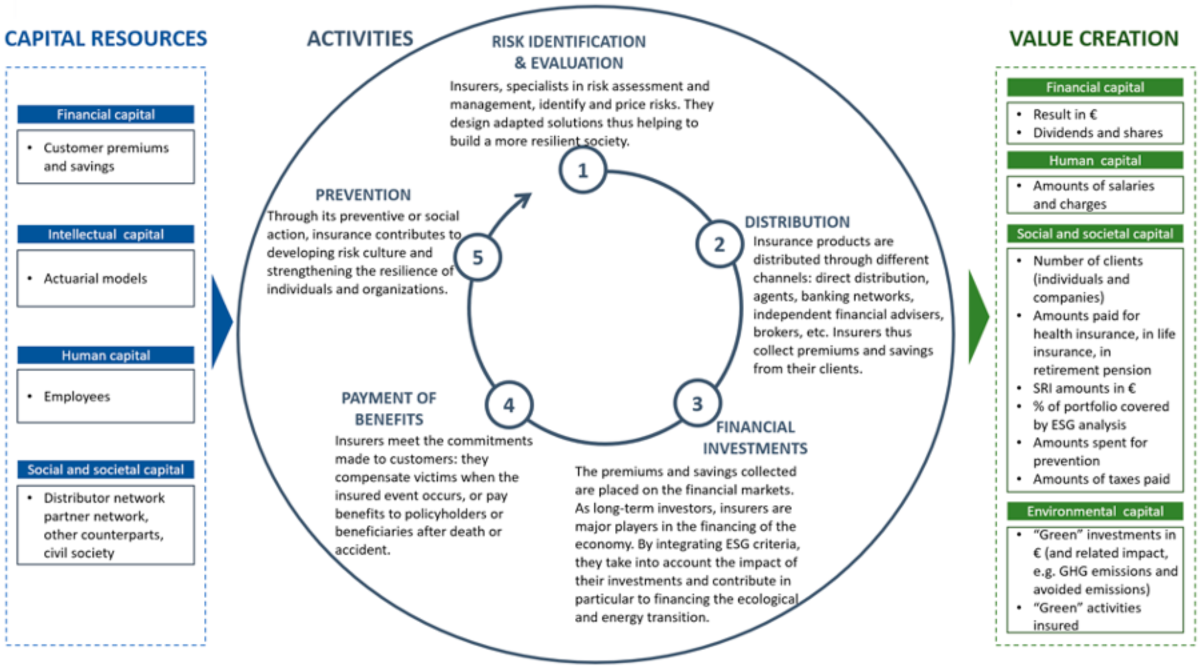
b) Social: This typically affects credit quality through litigation, as well as reputational, operational channels. Loans to companies or sovereign entities associated with insufficient social practices can lead to opposition from civil society or regulators, which can in turn lead to repayment delays and tarnish the client and the bank's image. This also relates to the issue of the Just Transition (see PRI Guide, for instance). One systemic concern raised by the just transition is that failing to take account of the social dimension will give rise to pressures to delay, dilute or abandon climate policy – therefore taking into consideration the "S" component is a way for FIs to address systemic threats to long-term stability and value creation.

c) Environment: It is expected that environmental factors, mainly climate change and biodiversity loss, will become more significant for banks in the future, particularly as the transition to a low carbon economy accelerates, the physical effects of climate change increase, and climate policy and biodiversity policy changes the regulatory environment. Assessing the risks from climate change and environmental degradation is challenging, because their effects develop over long- or uncertain-time horizons and are subject to a variety of potential policy measures and economic growth scenarios. Uncertainty related to climate dynamics (the high uncertainties of IPCC warming scenarios and the likely underestimation of actual impacts; the non-linearity of climate change and threshold effects due to "tipping points") and economic impacts (the difficulties of quantifying the costs of extreme events; the consequences of crossing "global boundaries" on economic structural variables such as ecosystem services, labour productivity and well-being) indeed make risks from climate change a considerable regulatory and supervisory challenge. There is increasing evidence that such risks can pose material challenges to the banking sector, resulting in a wide range of potential credit outcomes for affected companies, increasing credit risk volatility in banks' investment portfolios, and expose banks to stranded assets. Some banks whose business models rely on serving particular economic sectors can be more materially exposed to environmental risks.

*Insurance: overview of insurance business model*

23 The core business of insurance is to insure risk. To do this, insurers use statistical tools to assess the probability of occurrence of a risk related to goods or people. Associated with this probability, the actuary evaluates the amount of the loss that the customer may suffer in order to anticipate the probable cost for the insurer. This is the principle of actuarial science. If the actuary is not mistaken, the premiums collected make it possible to ensure the constitution of technical provisions and to cover the reimbursement of customer claims. Premiums are the main income of an insurance company.

24 The second source of income consists of income from investments in the financial markets and capital gains or losses realised on the disposal of certain assets. This additional income makes it possible to ensure that operating expenses are covered.




*Source: Business model prepared by the FFA (French Federation of Insurance)*

*Insurance: main products and services*

25 Main products and services offered by insurers include:

a) Property insurance (car, home)

b) Personal insurance (travel, general liability)

c) Life insurance and critical illness

d) Savings and investments

e) Pensions and retirement planning

f) Other products

26 Clients benefiting from these services can be individuals, corporates or public entities.

*Insurance: example of challenges for ESG disclosure*

27 On the insurance cover/underwriting side, ESG challenges include:

a) Promote sustainable insurance solutions and offer inclusive services to clients. This includes for instance adapting offers to encourage sustainable behaviours (e.g. decrease insurance premiums for car drivers with low fuel consumptions or decreasing tariffs to make services more accessible).

b) Update the risk identification and management to better reflect emerging risks embedded in the activity insured (in particular to include climate risks in the actuarial science framework, but other environment and social emerging risks ca be considered as well).

28 On the investment side, the following issues emerge among priorities for insurers:

a) Contribute to financing a fair transition towards a low-carbon economy, while reducing investments in high-emitting energy production sources, such as thermal coal; the same dynamics apply to other ESG topics, here insurers can reduce investments based on criteria such as child labour, controversial weapons etc, whilst increasing investments aiming at reducing social inequalities and whilst keeping return on investment on point.

b) Assess and manage ESG risks, and in particular climate risks in investment portfolios

c) Support the transformation of ESG practices of issuers, through voting and engagement

d) Offer savings, insurance and pension products managed with ESG characteristics to policyholders

29 To manage its assets, an insurer can choose to manage the assets itself, or entrust them to one or more asset managers. In these cases, the insurer can provide ESG guidelines (or a more detailed policy) to the asset manager.

30 Challenges for ESG practices and disclosure exist on both sides of the balance sheet, they key challenge being accessing quality and harmonised data on risks covered and on investments made.

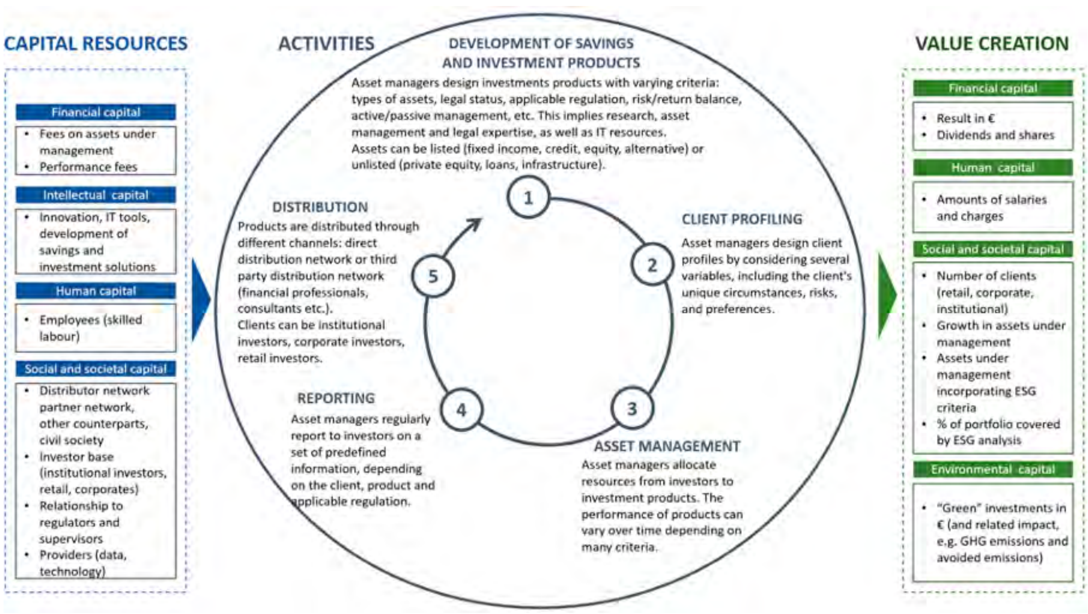
*Asset management: overview of asset management business model*

31 The asset management industry transforms savings into financial investments by allocating capital flows from their clients (individuals and institutions) to the financial markets. To do so, asset managers invest in securities (shares, bonds – be it from sovereign or private issuers-, and other securities) and other assets (such as real estate) in order to meet specified investment goals for the benefit of the investors. Because asset managers manage investments on behalf of other parties, they face a dual mandate: appreciation of a client's assets over time while mitigating risk. Investors may be individuals (via investment contracts or via collective investment schemes) or institutions (insurance companies, pension funds, corporations etc.).

32 Investing and managing portfolios for their clients define their own operations. Asset managers therefore have a unique and a specific business model among FIs: they do not use their balance sheet.

33 Asset management is regulated in the EU through regulations such as MiFID 2, UCITS and AIFM – that apply either at the entity level or the product level.

34 Since the 2008 financial crisis, the main trends of the industry have mostly been its concentration, higher fee compression, the development of passive strategies and rising innovation in an environment of low interest rates.



*Asset management: main products and services*

35 The industry develops a large variety of products and services and generates revenues by charging fees based on the volume of assets they manage. Services offered to clients include investments in different types of products:

a) Listed equities: the manager invests in equities listed on stock exchanges.

b) Fixed income: the manager invests mainly in bond and money market products.

c) Diversified assets: the manager invests in different asset classes, in different business sectors and in different geographic areas. The manager can invest beyond financial assets, and operate on currencies, commodities, real estate, etc.

d) Unlisted assets: private equity, private debt (loans), infrastructure.

e) Alternative assets: and hedge funds.

36 In several of these asset categories, management can be active (i.e. the objective is to outperform the market in comparison to a specific benchmark) or passive (i.e. tracking a market-weighted index or portfolio in order to achieve similar results).

*Asset management: examples of challenges for ESG disclosure*

37 In this context, ESG products have experienced strong development but also important challenges:

a) A large variety of ESG funds have been launched, based on different approaches: this can be considered as innovation in a non-mature market, but it can also be seen as a brake to the market's development due to the incomprehensible offer for customers and due to the green washing aspect of some products that may generate customers' lack of trust. In other words, the fact that a large variety of ESG funds have been launched using many incomparable approaches is a characteristic of an immature market, and can be seen as an opportunity thanks to a significant innovation process; but it can also be seen as a risk to increase savers' misunderstanding and green washing.

b) While the asset management industry is developing a global strategy, the lack of standardisation of non-financial information from companies leads to the use of external providers. This has two major consequences:

(i) The oligopoly of data providers and the concentration of non-financial rating agencies increase the dependence of asset managers on access to non-financial information in terms of content and prices.

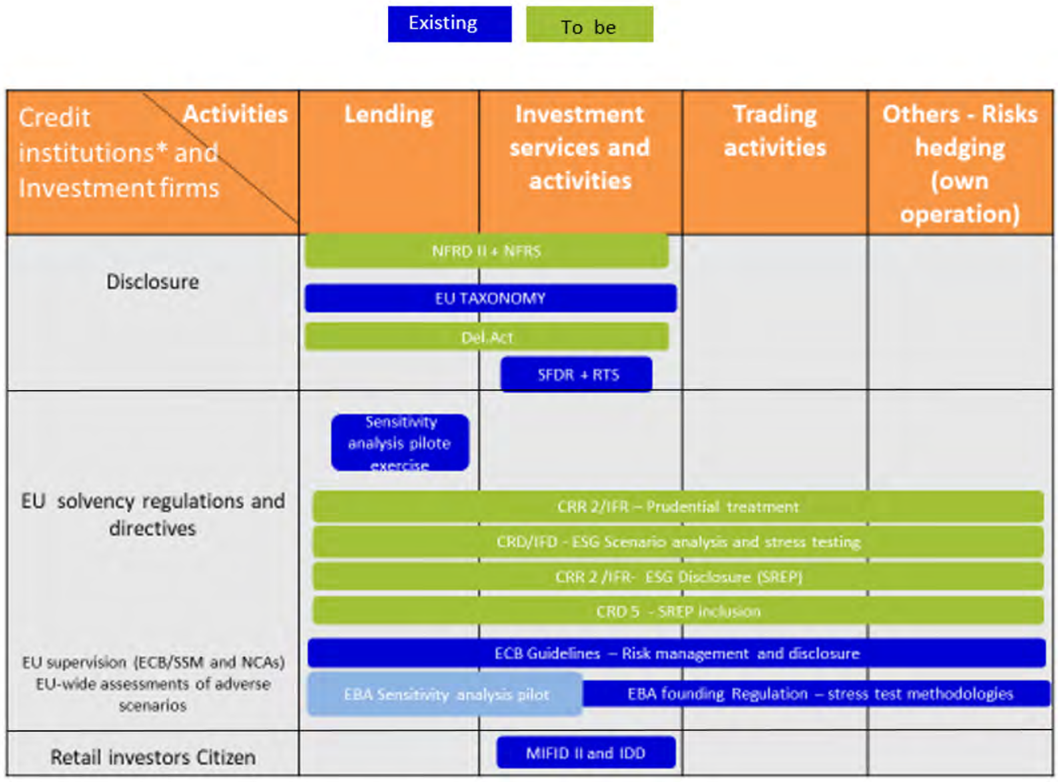
(ii) Because each data provider has a specific methodology based on ratings, it is not possible to respond to EU regulations that are based on specific indicators (SFDR and in particular assessing the 'principle adverse impacts' (PAI).

c) As evidenced further in this report, EU regulations have been concentrated on investment products (see matrices below) but because of a different timeline and contents, there is a lack of convergence. This lack of convergence is mentioned throughout the report, and means the lack of common timelines, definitions, methodologies, reporting formats etc.

## MATRICES OF ACTIVITIES AND ASSOCIATED APPLICABLE CURRENT AND UPCOMING REGULATIONS

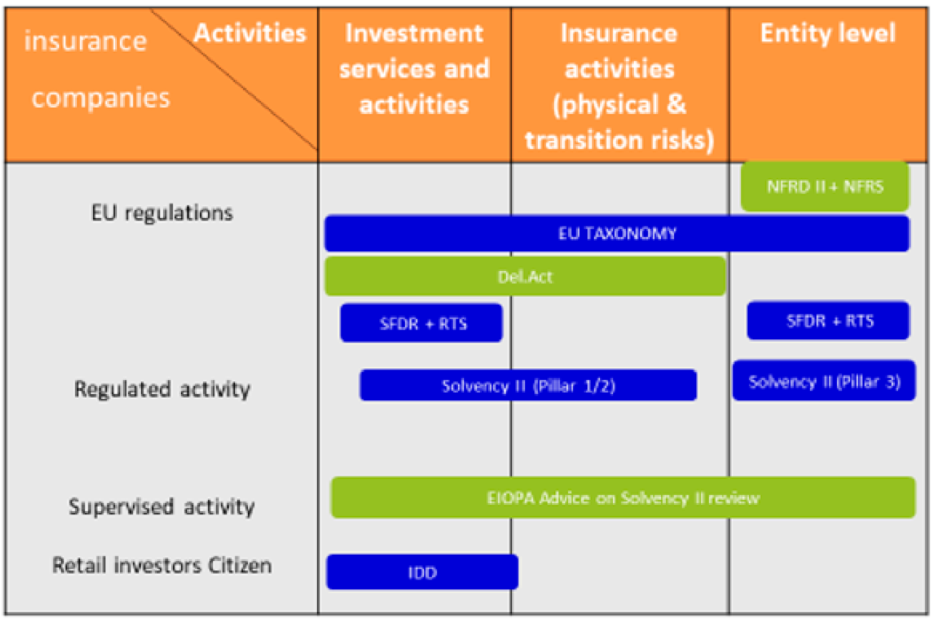
38 The matrices below provide an overview of applicable existing (in blue) and upcoming (in green) regulations by activities from each sub segments.

a) Banking:

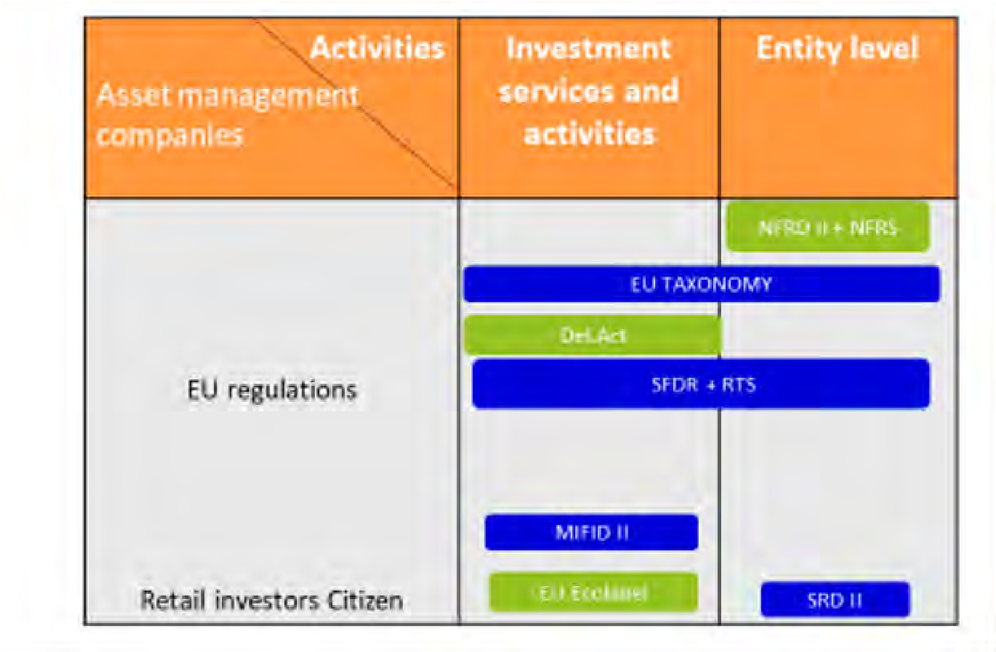



*(excluding Insurance and asset management subsidiaries)

b) Insurance:



c) Asset management:




39 Some conclusions can be drawn from these matrices:

a) The three types of sub-segments are subject to several regulatory requirements (already existing or currently under development) relating to sustainable finance. These include EU legislative texts such as the NFRD, the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR), as well as non-legislative requirements set by supervisors and regulators.

b) The majority of regulatory requirements imposed by EU law are mandatory. Within the limits set by EU law, supervisory initiatives may add additional reporting requirements on a case-by-case basis.

c) Not all activities are covered by European regulations, in particular as regards banks and insurance companies. Examples of areas not yet covered by ESG regulation include:

(i) Activities insured by insurers: while asset management activities are partly addressed via SFDR, property and casualty insurance activities are not specifically addressed by current or upcoming regulation. Some information on this topic can nevertheless be disclosed by insurers through NFRD, if insurers identify important risks linked to the activities insured.

(ii) Activities financed by banks: similarly, banks can choose to disclose information on risks associated to financed activities, if they identify that important risks stem from these activities (as per NFRD). An appendix of the ‘Guidelines on non-financial reporting: Supplement on reporting climate-related information’ is dedicated to banks, but these guidelines are voluntary, and do not specify how they should be implemented (products concerned, calculation methodologies etc.). As explained further in this report, the EBA is considering addressing this issue, and published a discussion paper ‘on management and supervision of ESG risks for credit institutions and investment firms’ (October 2020). This discussion paper is articulated around four pillars: (i) Common definitions of ESG factors, ESG risks and their transmission channel (ii) Quantitative and qualitative indicators, metrics and methods to assess ESG risks (iii) Management of ESG risks by institutions (iv) ESG factors and ESG risks in supervision.

d) The regulatory landscape is complex due to many different concepts and imprecise definitions (PAI, DNSH, ESG preferences, Article 8 and 9, …), highlighting the lack of synergies / links between the different regulations. This raises the question of convergence in terms of timing and requirements.

## KEY TAKE-AWAYS OF FIs BUSINESS MODELS

40 The terminology 'financial institutions' covers several types of activities, which do not form a homogeneous group. The sub-segments of this group (banks, insurance undertakings, asset managers/owners) face some common issues, but also have some differences:

a) Common issues: some products and services are offered by all three sub-segments (e.g. some banks carry out investment activities, similarly to insurers or asset managers); dependency to indirect data from counterparts; aggregation of a broad dataset (due to a large number of counterparts); relationship to different types of counterparts with different abilities to disclose NFI (corporates, sovereigns, retail, data providers); activities already partly covered by NFI regulation (e.g. SFDR).

b) Differences: products and services differ (lending vs investing vs insuring risk). These three activities imply very different processes for integrating ESG considerations in operations and reporting. Consequently, if EU regulation wants to ensure the correct implementation of requirements by all three sub-segments, it will need to consider these specificities. For instance, whilst SFDR tries to address asset managers/owners' specificities by distinguishing between entity and product-level reporting, NFI regulation has not done the same yet for banks or insurers.

41 In order to produce NFI on indirect impacts (i.e. impacts from FIs' portfolio, as explained in the 'comments on methodology' section: investments, risks insured, credits granted etc.) financial institutions must be able to access information provided by counterparts (such as clients / borrowers / investors etc.). This information must be sufficiently high-quality, consistent, timely, comparable and transparent.

42 The sector is heavily regulated, especially by Solvency II disclosure and risk measure requirements, Insurance Distribution Directive as well as the current NFDR. Part of the regulation concerns non-financial information. However, not all activities / services are covered. The application schedule as for all stakeholders is not aligned (not the same deadlines for SFDR, IDD, EU taxonomy and others) and so are disclosure requirements.

43 The reporting burden on EU financial institutions is already elevated, which raises issues of level playing field vis-à-vis non-EU competitors subject to different regulatory frameworks.

# IS THE INFORMATION REQUIRED FROM FIs BY THE DIFFERENT REGULATIONS CONSISTENT WITH THEIR SPECIFICITIES?

## NFRD AND ITS NON-BINDING GUIDELINES: EXISTING NON-FINANCIAL GUIDELINES ARE A GOOD BASIS FOR FI NON-FINANCIAL DISCLOSURE, IN PARTICULAR WHEN THEY HAVE BEEN ADAPTED TO FIs

*Strengths / positive aspects of NFRD and its non-binding guidelines*

44 NFRD and its non-binding guidelines are double materiality oriented (both sustainable materiality and financial materiality), which is very relevant for FIs considering the leverage effect of the financial system which nurtures both types of materiality: the double materiality approach offers relevant information to FIs who need to know about the impacts of their third parties in order to better understand and measure the impacts of their investment portfolios and activities, for the assessment and the integration of both external impacts (for example, costs of managing environmental risks like droughts or floods) and externalities derived from impacts caused by financed companies both positive impacts and principal adverse impacts (for example, injury rates).

45 NFRD and its non-binding guidelines are process and risk management oriented (identification of main risks, disclosure of policies and associated action plans to prevent or mitigate these risks, related Key Performance Indicators): the notion of risk is key for FIs, as having available information from third parties is essential to assessing their own risks and integrate this factor in the decision making process (for example, in an investment of a new factory, information on the use of energy or the location, if it is near a protected area for instance, could be key for the decision making process).

46 Regarding reporting climate-related information, the Supplement on reporting climate-related information of the Guidelines on non-financial reporting (2019) goes beyond: on the one hand it proposes information and KPI disclosures with a great level of detail, enhancing previously mentioned homogeneity, and on the other hand it includes further guidance for banks and insurance companies focused mainly on indirect impacts and with detailed climate related KPIs. Providing accurate KPIs is very valuable to ensure all FIs disclose the same information in a comparable and homogenous way. This guidance for banks and insurance companies proposes different KPIs for banks and insurance, taking into consideration the differences between both activities. Nevertheless, KPI objectives (what is meant by this indicator? What does it show? How should it be understood?) and underlying methodologies are not always clearly stated, as shown in the below table.

### KPIS non binding guideline analysis

| Indicator name | What is the objective of the indicator? | Double materiality: Outside -> inside or inside -> outside impact measurement | Unit - %, kWh, $kCO_2e$ etc. | Is a calculation methodology prevalent for the KPI? |
|---|---|---|---|---|
| Amount or percentage of carbon-related assets in each portfolio in MEUR or as a percentage of the current portfolio value | Impact metric?<br>Show awareness of the exposure of portfolio to sectors affected to varying degrees by climate-related risks and opportunities. | Inside -> outside | M in reporting currency / percentage | No<br>Aligned with TCFD |
| Weighted average carbon intensity of each portfolio, where data are available or can be reasonably estimated | Impact metric?<br>Show awareness of the exposure of portfolio to sectors affected to varying degrees by climate-related risks and opportunities. | Inside -> outside | $tCO_2e$/M revenues in reporting currency | GHG Protocol methodology or the ISO 14064-1:2018 standard (since this is Scope 3 of portfolio)<br>Aligned with TCFD. |
| Volume of exposures by sector of counterparty. | Transition risk metric?<br>Show the concentration of exposures towards high-carbon and low-carbon sectors. | Outside -> inside | Reporting currency | Not specified but rather clear |
| Credit risk exposures and volumes of collateral by geography/country of location of the activity or collateral, with an indication of those countries/ geographies highly exposed to physical risk. | Physical risk metric?<br>Show the concentration of exposures and collateral in countries and geographies highly exposed to physical risks. | Inside -> outside | Reporting currency | Not specified especially chich reference should be used to dentify highly exposed region |
| Volume of collaterals related to assets or activities in climate change mitigating sectors. | Show the volume of green collaterals, e.g. with lower carbon exposure. | Inside -> outside | % of the total volume of collaterals | Not specified |
| Volume of financial assets funding sustainable economic activities contributing substantially to climate mitigation and/or adaptation (absolute figures and compared to total exposures) according to the EU taxonomy. | Show the concentrations of green investments and their resilience to climate change. | Inside -> outside | % of the total risk exposure or reporting currency | Based on Taxonomy: to be defined in the coming regulation |
| Total amount of the fixed income portfolios invested in green bond certified according to a potential EU Green Bond Standard if and when such a standard is approved, or according to any other broadly recognised green bond framework (at year-end) divided by (a 5-year rolling average of) total amount of holdings in fixed income portfolios. | Commitment metric?<br>This indicator demonstrates commitment to green finance and the investor's strategy and transition path towards alignment with a well below 2 °C scenario.<br>It helps demonstrate track-record and forward-looking data can underpin the investor's transition strategy with a robust key-performance indicator. | Inside -> outside | % and total amount in reporting currency | Not specified and not linked with financial indicators (HFT or AFS...) |
| Breakdown of underwriting exposure by lines of business to economic sectors (life / non-life / reinsurance). | Demonstrate awareness of current economic exposure and concentration (if any) in industries that are impacted by climate change in varying degrees. | Outside -> inside | Reporting currency and % (e.g. of net premiums written and of technical provisions as in Directive 2009/138/ EC deriving from infrastructure insurance from policyholders in the energy sector) | Aligned with SASB and Solvency II |
| Percentage of products incorporating climate-related risks into the underwriting process for individual contracts (life / non-life / reinsurance). | Demonstrate product portfolio resilience to climate change. | Inside -> outside | % | Aligned with SASB |

| Indicator name | What is the objective of the indicator? | Double materiality: Outside -> inside or inside -> outside impact measurement | Unit - %, kWh, $kCO_2e$ etc. | Is a calculation methodology prevalent for the KPI? |
|---|---|---|---|---|
| Number and value of climate-related underwriting products offered (Non-life / reinsurance). (The company has developed a specific offering for geographic areas particularly exposed to extreme weather events) | Demonstrate ability to capture opportunities deriving from climate change mitigation and adaptation. | Inside -> outside | Reporting currency | - |
| Maximum Expected Loss from natural catastrophes caused by climate change (life / non-life / reinsurance). | Demonstrate risk management maturity and business resilience to adverse conditions. | Outside -> inside | Reporting currency | Aligned with SASB |
| Total losses attributable to insurance payouts from (1) expected natural catastrophes and (2) non-expected natural catastrophes, by type of event and geographic segment (net and gross of reinsurance). | Demonstrate risk management maturity and business resilience to adverse conditions. | Outside -> inside | Reporting currency | Aligned with SASB |
| Breakdown of assets under management by business sector across asset classes (equity / bonds / infrastructure / real estate / structured products / MBS / derivatives) (8). | Report the net asset value in equity broken down by industry. | Inside -> outside | Reporting currency | Aligned with SASB |

47 In addition to defining recommended disclosures and further guidance, the Supplement on reporting climate-related information of the Guidelines on non-financial reporting (2019) indicates the alignment with other reporting frameworks and makes references to other EU policies or initiatives. This is very useful for FIs as it facilitates the identification of related information requirements in other regulations and initiatives and it prevents different calculations for the same data, KPIs or information.

| KPI | UNIT OF MESURE | EXAMPLE | RATIONALE | ALIGNMENT WITH ORDER REPORTING FRAMEWORKS | EU POLICY REFERENCE |
|---|---|---|---|---|---|
| Breakdown of underwriting exposure by lines of business to economic sectors (life/non life/reinsurance) | Reporting currency | Amount and % of net premiums written and of technical provisions as in Directive 2009/138/EC deriving from infrastructure insurance from policyholders in the energy sector | Demonstrate awareness of current economic exposure and concentration (if any) in industries that are impacted by climate change in varying degrees | EU Toxonomy<br>SASB<br>Directive 2009/138 EC (Solvency II) | 2030 climate and energy framework |
| Percentage of products incorporating climate-related risks into the underwriting process for individual contacts (life/non life/ reinsurance) | 0-100% | Product could be related to a specific type risk or to a segment of the clientele with a particular exposure to climate risks | Demonstrate product portfolio resilience to climate change | SASB | 2030 climate and energy framework |

*Source: European Commission, Supplement on reporting climate-related information of the Guidelines on non-financial reporting (2019), pages 33-34*

48 The existence of an assurance requirement within the NFRD in some countries is very relevant when it comes to data reliability and comparability (although it should be noted that the majority of EU countries have chosen not to require an external audit on NFRD-data disclosed by corporates).

*Limitations*

49 NFRD implementation varies from one country to another: the transposition of NFRD throughout states members has different levels of ambition to date and leave room for flexibility, which is probably one of the main factors that has contributed to the limitations of the European non-financial reporting and that goes together with the lack of comparability and reliability. Some of the main factors where this divergence has become more evident are the different scope of companies, the mandatory assurance or verification and the specification of KPIs to be disclosed. The report of Accountancy Europe relative to the Member State implementation of EU NFI Directive states that the latter "represents a minimum standard for non-financial reporting across the EU and, as such, allows considerable flexibility for Member States to adapt the provisions to suit their local regulatory environments" (Source: Member State Implementation of Directive 2014/95/EU; https://www.accountancyeurope.eu/publications/member-state-implementation-eu-nfi-directive). Practically all Member States have chosen to follow the high level of flexibility contained in the Directive that effectively allows the companies affected to choose their own reporting framework from the existing range of frameworks available.

50 There is no common sustainability risk mapping identification methodology, neither for FIs nor for other sectors. Therefore, material issues addressed in non-financial reporting can be very different between FIs. Main risks and opportunities selected by FIs can be identified differently depending on the risk and opportunity mapping methodology. Moreover, for a same identified risk/opportunity, the level of disclosed information may vary a lot, and especially relative to indirect impacts (ex: integration in analysis (credit & equity research) and in valuation models, screening universe, etc). As a result, disclosed ESG information is diverse, not standardised and so hardly comparable from one FI to another.

51 NFRD requirements are limited to information disclosure related to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters and do not go further by for instance imposing disclosure specific topics per sector of activity or KPIs. However, guidelines on non-financial reporting (2017) add key principles and guidance on methodology and propose examples of high level KPIs that could facilitate comparability between companies' disclosures but that remain not precise enough to achieve homogenous information and comparability. These are very useful for FIs since they need to work with homogenous information from third parties.

52 Moreover, NRFD guidance focuses on climate-related information, leaving behind other issues that could be as relevant as climate change depending on the specificities of FIs activities. For instance, social aspects are very relevant for retail banks, with potentially significant impacts (ex: evictions or repossessions, mortgages for vulnerable groups), nevertheless there is no common disclosure guidance that allows stakeholders to assess the performance of each FI on these topics and their contribution to a Just Transition. In order to properly reorient capital towards sustainable investments, FIs also need quality information on Social and Governance aspects. Unlike climate-related impacts (cf. the Supplement on reporting climate-related information of the Guidelines on non-financial reporting (2019)), there is a lack of a clear list of Social and Governance indicators for FIs that captures the particularities of the sector and allows comparability.

53 Ultimately, although the Supplement on reporting climate-related information of the Guidelines on non-financial reporting (2019) provide relevant and well-defined KPIs, this remains non-binding guidance, with no obligation of monitoring and disclosure.

54 Last but not least, as well highlighted in the report of Accountancy Europe relative to the Member State implementation of EU NFI Directive, *"Regarding assurance, the majority of Member States have chosen the minimum standard contained in the Directive: the auditor shall check that the required statement is present"*. Indeed, only three Member States have chosen to require a higher level of assurance: France, Spain and Italy. This is a clear limitation for data reliability and comparability.

## SOME OF THE FIs ACTIVITIES AND PRODUCTS ARE NOT CLEARLY ADDRESSED BY THE REGULATIONS

55 As presented in detail through business models, FIs provide a wide range of products and services, that are not always clearly covered by the EU upcoming regulations, as detailed in the next paragraphs.

56 **Focus on the Taxonomy regulation:** Many questions remain open when applying the Taxonomy regulation to specific FIs' situations. For instance, when it comes to private banks, it is not easy to understand how to afford the provisions of taxonomy regulation. Allocating necessary resources, the system of classification can be designed and integrated into the bank system and be ready to classify new operations, but for portfolio of existing loans it is very difficult since data is not directly available within the bank systems. Required data is not only to classify the operation but also should demonstrate it complies with the minimum safeguards and with the Do No Significant Harm principle that is still quite unclear to date. Work towards filling these gaps and developing common methodologies to make the taxonomy usable for the banking sector is currently being carried out by both the EBA (in the context of its response to the Commission's call for advice on the Taxonomy disclosure), as well as by the Platform on sustainable finance, and notably its subgroup on data and usability, which has a dedicated team working on usability issues for banks.

57 **Focus on project financing:** for project financing as well, there are also relevant gaps of understanding among FIs to be able to properly apply some upcoming regulations. For instance, from a taxonomy perspective, there is lack of information of how a project finance should be categorised and how to assess the minimum safeguards and the Do No Significant Harm principle.

58 **Focus on insurance:** speaking about insurance, insurance products are definitely under the umbrella of the SFDR regulation. On the other hand, the Insurance Distribution Directive requests the insurance seller to ask its potential clients about his ESG preferences. However, it is not obvious that this will apply to all sorts of insurance services. Would travel insurance be concerned? What about unemployment insurance for outstanding loans? What about corporate and public institutions seeking insurance coverage? The coverage of insurance products by the upcoming regulation remains unclear for insurers (SFDR, IDD, Solvency II, EU taxonomy…).

## REGULATION DOES NOT ADDRESS IMPORTANT TECHNICAL AND METHODOLOGICAL QUESTIONS, THAT WOULD FACILITATE DISCLOSURE BY FIs AND HARMONISE PRACTICES

*Main comments on existing EU regulations*

59 Required data by the existing regulations is topic centric only, as there are no KPIs with defined calculation methodology, so it lacks precision and comparability to allow transparency and benchmark for financial institutions and their customers about non-financial material impacts and risks. As an example, in the NFRD French transposition, article 2.A. 1. b. requires absenteeism data to be disclosed, yet there is no KPI definition or calculation methodology provided. In such circumstances, the company is likely to disclose an absenteeism rate, however the numerator can be a total of hours, or a total of days (within the number of working hours may vary from one country to another), and the denominator may be the total of employees, or the total full time employees, or solely the total of full time long term contract employees… Another example could be article 2. A. 2. a., which requires information on environmental policy and the means allocated to the fight against pollution: these means can be a number of FTE or can be a dedicated budget or can be the sum of both FTEs and budget allocated to the fight against pollution… there are no precise KPIs, means of calculation to create transparency and ability to benchmark disclosed data.

60 A list of defined KPIs does exist within the RTS project, however their calculation methodologies are not specified. For instance, KPI 1 is 'defined' (i.e. 'Carbon emissions (broken down by scope 1, 2 and 3 carbon emissions – including agriculture, forestry and other land use (AFOLU) emissions – and in total)'), however scope 3 calculation methodology varies a lot from one company to another. Let's take another example with KPI 26 ('Share of the investments in investee companies exposed to operations and suppliers at significant risk of incidents of child labour exposed to hazardous work in terms of geographic areas or type of operation' and 'Share of investee companies exposed to operations and suppliers at significant risk for incidents of child labour exposed to hazardous work in terms of geographic areas or type

of operation'): there is no guidance in the RTS project to conduct the calculation of child labour risk exposure: what are the criteria to be used (geographical locations, policies in place, ratings ?) ? What referential(s) to be used?

61 This topic centric approach for disclosure results in a potential coverage of a wide array of KPIs which remain at the choosing of the FIs (e.g. working conditions is a topic – underlying KPIs such as accident rates, turnover rates, etc. are indicative and detailed scope and calculation means are not provided). That is why building the required data is a complex, costly process for both FIs and the underlying assets (as an example, Eurazeo provides information on average 130 KPIs to fulfil current requirements. This example is aligned with the major part of companies under NFRD regulations in the EU, as a benchmark on around 40 EU companies (scope: France) shows that they disclose more than 100 KPIs).

62 Beyond a lack of a harmonised methodology for KPI calculation, indicators also lack standardisation in terms of guidance on underlying data sources to use (e.g. GHG emission factors, physical risk maps, etc.). Data sources remain at the choosing of the FIs.

63 Similarly, there is no guidance on the use of statistical based data versus real data calculation. Choosing to provide KPIs based on real data or statistical data remains at the choosing of the FIs when it could be adapted depending on the sector and or size of the underlying asset (e.g. calculating direct carbon emission or water consumption has a very different materiality for a service company compared to a manufacturing company direct activity; using statistical based data may be a facilitator when starting an non-financial reporting for smaller companies).

64 Current discrepancy and lack of standards lead us to formulate the following observations:

a) Data and KPIs production are not harmonised, hence quality is lacking;

b) Data production is not efficient and is costly for all;

c) Transparency and comparability are insufficient and allow limited possibilities of measuring progress;

d) Proliferation of soft law and private initiatives which generates heavy, costly administrative work for companies and creates confusion for customers and other stakeholders.

65 Decentralised policy-making in key areas of the sustainable finance agenda, relying on several parallel processes and fora (e.g. Technical Expert Group, EFRAG, EBA, ESMA, EIOPA, Platform on sustainable finance), which generates potential overlaps, inconsistencies, coordination challenges in filling the existing gaps, further limiting transparency and capacity building in the private sector.

66 SFDR and NFRD regulations do not provide guidance on the scope of product and services for which non-financial disclosure is required. Consequently, FIs can decide the scope on which they want to use to disclose information. The following topics are not precisely addressed:

a) Minimal detention threshold for equity products (e.g. the share of equity owner by the investor over the total equity of the investee).

b) Minimal invested/lent amounts for reporting.

c) Asset types (e.g. how should a guarantee product be reported vs. a loan? How should the FIs' own money/treasury operations be reported?). It should be noted that depending on the product/service provided, the client relationship profile varies, and FIs are more or less able to collect information from the client.

d) Asset size (which typically determines the ability of the investee/borrower to disclosure non-financial information).

e) Timing of investment/loan (e.g. should the FI report on assets or loans held on December 31st? or should the FI report on investments/loans that have been in the portfolio during the year? If so, should they take into account the duration during which the investment/loan has been in the portfolio?).

67 NFRD requests FIs to report in the same timing as other corporates. Consequently, timing can be very tight for FIs to report on their indirect impact, as the information they need to report is often published by corporates at the same time

(e.g. when an FI discloses its Universal Registration Document in March, it can be very difficult to incorporate information that is disclosed by corporates in their own URD that is also issued in March).

*Main comments on EU upcoming regulations*

68 The major part of upcoming regulations requires data with complex calculations and analysis that are not fully defined in the regulation itself or in Delegated Acts (DAs), so FIs are in a situation of uncertainty. For example, SFDR does not specify how to communicate on adverse impacts of financial products and services.

69 The temporal scope of KPIs defined by regulations or DAs (including RTS) is sometimes missing: KPIs relative to FIs can be reported for and in the current year, life portfolio or other scopes, and this can be aligned or not aligned with the reporting of their peers.

## REGULATION DOES NOT SYSTEMATICALLY SPECIFY WHETHER DISCLOSURE SHOULD TAKE PLACE AT ENTITY LEVEL, AT PRODUCT LEVEL, OR FOR EACH UNDERLYING ASSET/COUNTERPART

70 Current NFRD regulation does not provide guidance for product and services non-financial impacts disclosure. Financial institutions are compliant with the NFRD regulation when providing consolidated non-financial data. There is no requirement to provide data at product / service line (e.g. total credit products, total private equity products) nor at product / service level (e.g. fund level, loan level, ). Similarly, Article 8 of the Taxonomy Regulation will require banks and insurers to disclose the share of the balance sheet (asset and liabilities for insurers) aligned with the Taxonomy, at entity level.

71 The consultation on the SFDR launched by the ESAs the summer of 2020 has highlighted the difficulties here mentioned: the sector has answered quite unanimously about the complexity and the need for a clear reading of the regulation with regards to entity versus product disclosure.

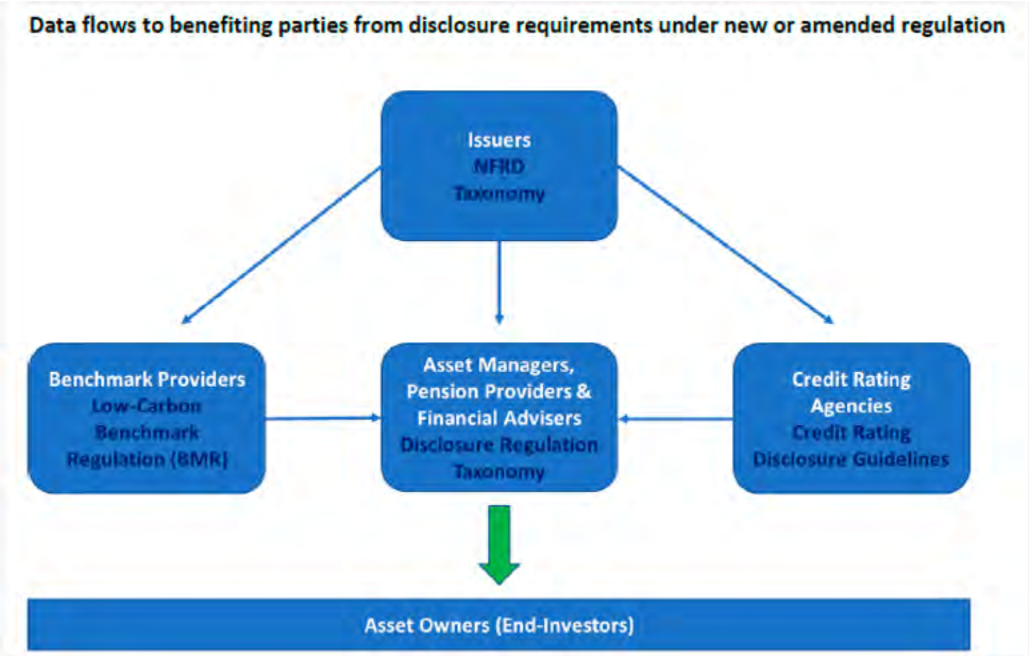
72 Article 4 of the SFDR *'transparency of adverse sustainability impacts at entity level'* and the elements presented on page 14 of the consultation *'in order to promote comparable disclosures at entity level, the ESAs have proposed a reporting template…'* do suggest that data requested on the table proposed by the ESAs should be represented per entity (i.e. at asset manager/owner level) and not per product. Consequently, once the RTS will be delivered, data should be reported at entity level (i.e. aggregated data for all the financial products provided by the same entity), which may not provide quality information to the end investor relative to financial product he is buying (as would be the case if data was disclosed at product level, or even more at individual asset level within the product).

73 Moreover, disclosing aggregated amounts to all investors might lead to confusion and misunderstanding for external readers and investors, for asset managers but also for other FIs. That is why it can be necessary to combine disclosure at an aggregated level (i.e. at entity level) and disclosure at a granular level (product or even at underlying asset level). For instance, a bank could disclose information on three disclosure levels: i) As an entity, a bank can disclose its total scope 1,2,3 GHG emissions (including its indirect impacts on counterparties with regard to scope 3 GHG emissions), as an aggregate number that qualifies the whole company. ii) The bank can also disclose information at product level (e.g. aggregation of GHG emissions of all project finance loans, or aggregation by geographical scope). iii) The bank can even disclose at a more granular level (e.g. GHG emissions of each project financed, anonymised if need be). This combined disclosure very strongly enhances transparency and somehow goes in the same direction as the upcoming SFDR which might shortly clarify that it will be meaningful to properly disclose at product level (although not at asset level) for the sake of good investing choices by all types of investors.

## SOME REGULATIONS OVERLAP, THEREBY DECREASING CLARITY FOR FIs. CONTENTS ARE TO PRODUCE ARE PILING UP, AND DO NOT PROVIDE FOR COHERENCE AND EFFICIENT COMPLIANCE, THUS ALSO REDUCING THE POTENTIAL EFFECTIVENESS OF THE REGULATIONS IN CONTRIBUTING TO SUSTAINABLE GROWTH. IS CONVERGENCE AND SIMPLIFICATION NEEDED?

74 The EC action plan on sustainable finance has introduced decisive sustainability and ESG disclosure requirements, which will have an impact on all FIs in the EU.

75 In addition to the current NFRD – and its associated non-binding guidelines of June 2017 and June 2019, a series of texts have been issued with some overlapping requirement, underlined by ICMA (International Capital Market Association) in a report dedicated to the sustainability disclosure regime published in April 2020 (cf. diagram below).




*Source: ICMA – Update on the EU's Sustainability Disclosure Regime (Avril 2020)*

76 The European regulatory architecture described in the matrix (see paragraph 30) reveals some overlapping requirements and a silo operating construction that compromise synergies. The non-financial disclosure framework for FIs is being built adding layers on existing regulations – NFRD. The lack of coordination and harmonisation among EU standards results in a complex framework, with unnecessary operational burden for FIs to analyse potential discrepancies or overlapping requirements, and the data availability from their clients or counterparts.

77 The table hereafter illustrates the numerous KPIs required from climate carbon issues from different layers of regulation showing poor rationalisation of requested information (vertical alignment). The information requested is redundant, aiming at the same target but required in different regulation layers and in different formats. The lack of alignment/ coherence between regulations on KPI requirements is also shown in appendix 2, which compares KPIs expected by NFRD, SFDR and Taxonomy Regulation (requirements from the EBA and from the Climate Benchmark Regulation are not shown here, but also require specific indicators on climate that add up to the ones shown below).

## KPIS analysis on climate and carbone issue

| Name of the standard | Indicator name | Category of indicator | What is the objective of the indicator? |
|---|---|---|---|
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Amount or percentage of carbon-related assets in each portfolio in MEUR or as a percentage of the current portfolio value | Carbon | Show awareness of the exposure of portfolio to sectors affected to varying degrees by climate-related risks and opportunities. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Weighted average carbon intensity of each portfolio, where data are available or can be reasonably estimated | Carbon | Show awareness of the exposure of portfolio to sectors affected to varying degrees by climate-related risks and opportunities. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Volume of exposures by sector of counterparty. | Carbon | Show the concentration of exposures towards high-carbon and low-carbon sectors. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Credit risk exposures and volumes of collateral by geography/country of location of the activity or collateral, with an indication of those countries/geographies highly exposed to physical risk. | Carbon | Show the concentration of exposures and collateral in countries and geographies highly exposed to physical risks. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Volume of collaterals related to assets or activities in climate change mitigating sectors. | Carbon | Show the volume of green collaterals, e.g. with lower carbon exposure. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Volume of financial assets funding sustainable economic activities contributing substantially to climate mitigation and/or adaptation (absolute figures and compared to total exposures) according to the EU taxonomy. | Carbon | Show the concentrations of green investments and their resilience to climate change. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Total amount of the fixed income portfolios invested in green bond certified according to a potential EU Green Bond Standard if and when such a standard is approved, or according to any other broadly recognised green bond framework (at year-end) divided by (a 5-year rolling average of) total amount of holdings in fixed income portfolios. | Carbon | This indicator demonstrates commitment to green finance and the investor's strategy and transition path towards alignment with a well below 2 °C scenario.<br>It helps demonstrate track-record and forward-looking data can underpin the investor's transition strategy with a robust key-performance indicator. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Breakdown of underwriting exposure by lines of business to economic sectors (life / non-life / reinsurance). | Carbon | Demonstrate awareness of current economic exposure and concentration (if any) in industries that are impacted by climate change in varying degrees. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Percentage of products incorporating climate-related risks into the underwriting process for individual contracts (life / non-life / reinsurance). | Carbon | Demonstrate product portfolio resilience to climate change. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Number and value of climate-related underwriting products offered (Non-life / reinsurance).<br>(The company has developed a specific offering for geographic areas particularly exposed to extreme weather events) | Carbon | Demonstrate ability to capture opportunities deriving from climate change mitigation and adaptation. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Maximum Expected Loss from natural catastrophes caused by climate change (life / non-life / reinsurance). | Carbon | Demonstrate risk management maturity and business resilience to adverse conditions. |
| NBGS: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies | Total losses attributable to insurance payouts from (1) expected natural catastrophes and (2) non-expected natural catastrophes, by type of event and geographic segment (net and gross of reinsurance). | Carbon | Demonstrate risk management maturity and business resilience to adverse conditions. |

| Name of the standard | Indicator name | Category of indicator | What is the objective of the indicator? |
|---|---|---|---|
| SFDR RTS | 1. Carbon emissions (broken down by scope 1, 2 and 3 carbon emissions - including agriculture, forestry and other land use (AFOLU) emissions - and in total) | Carbon | Total carbon emission |
| SFDR RTS | 2. Carbon footprint | Carbon | |
| SFDR RTS | 3. Weighted average carbon intensity | Carbon | |
| SFDR RTS | 4. Solid fossil fuel sector exposure | Carbon | Share of investments in solid fossil fuel sectors |
| SFDR RTS | 1. Emissions of inorganic pollutants | Carbon | tonnes of inorganic pollutants equivalent per million EUR invested |
| SFDR RTS | 2. Emissions of air pollutants | Carbon | tonnes of air pollutants equivalent per million EUR invested |
| SFDR RTS | 3. Emissions of ozone depletion substances | Carbon | tonnes of ozone depletion substances equivalent per million EUR invested |
| SFDR RTS | 4. Investing in companies without carbon emission reduction initiatives | Carbon | 1. Share of investments in investee companies without carbon emission reduction initiatives |
| SFDR RTS | | Carbon | 2. Share of investee companies without carbon emission reduction initiatives |
| EBA Action plan on sustainable finance | Carbon related exposures | Carbon | Institution risk profile |
| EBA Action plan on sustainable finance | Volume of Financial Assets funding sustainable economic activitties contributing substantially to climate mitigation and/or adaptation (green asset ratio) | Climate (mitigation & adaptation) | Transparency on how climate change related risks are embedded into business targets/strategies/decision making processes/risk management |
| EBA Action plan on sustainable finance | Volume of collaterals related to assets or activities in climate change mitigating sectors | Climate (mitigation & adaptation) | Transparency on how climate change related risks are embedded into business targets/strategies/decision making processes/risk management |
| EBA Action plan on sustainable finance | Total amount of the fixed income portfolios invested in green bonds | Climate (mitigation & adaptation) | Transparency on how climate change related risks are embedded into business targets/strategies/decision making processes/risk management |

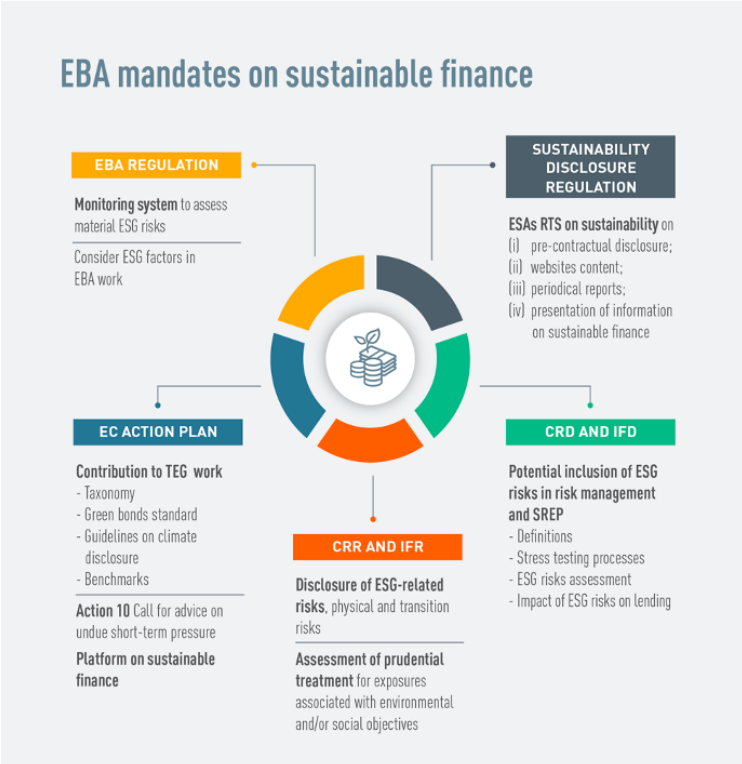
78 The lack of harmonisation is also revealed by some overlapping concepts that can be found in regulation layers. For example, existing regulations introduce two similar concepts with the ‘principal adverse impacts’ definition and the ‘do no significant harm’ (DNSH) screening criteria without specifying their interlinkage. The SFDR regulation introduced the principal adverse impacts: negative, material or likely to be material effects on sustainability factors that are caused, compounded by, or directly linked to, investment decisions and advice performed by the legal entity. In addition, in the Taxonomy technical report detailed criteria are defined to assess the DNSH principle for each activity with no reference to the measurement of principal adverse impacts.

79 Another example is the risk of divergences in the definition of what is considered as ESG. Several existing or upcoming regulations refer to ESG, without necessarily being aligned on what ESG means (or defining ESG precisely). For instance, MiFID 2 (on product governance and suitability assessment) mentions the ESG preferences of a client, while SFDR refers to products promoting environmental characteristics (article 8) and sustainable investments (article 9) -whilst also referring to the Taxonomy Regulation. This raises the question of the definition of ESG, and how it is used by different regulations. The different layers of regulations could generate a risk of fragmentation, and decrease clarity around ESG for FIs and clients.

INFORMATION REQUIRED FROM FIs CAN BE DISCLOSED TO TWO DIFFERENT AUDIENCES: SUPERVISORS OR THE BROADER PUBLIC. THE LINE SHOULD BE DRAWN CLEARLY BETWEEN WHAT IS REQUIRED BY THE NFRD (AUDIENCE: BROADER PUBLIC) AND BY SUPERVISORS. NB: IT SHOULD ALSO BE NOTED THAT THAT REQUESTS FROM THE SUPERVISOR TOWARDS FIs MAY GENERATE REQUESTS FROM FIs TOWARDS COUNTERPARTS (CLIENTS/INVESTEES ETC.).

80 FIs are regulated companies with specific financial risks stemming from their various activities as shown in the business models.

81 Here are the mandates of EBA to state prudential requirements on sustainable finance:




*Source: EBA Action plan for sustainable Finance*

82 In its Action plan for sustainable Finance (December 2019) the EBA clarifies its mandate on prudential disclosure: EBA shall develop a technical standard implementing the disclosure requirements included in part 8 of the CRR2 including article 449a on ESG Risks. Following this mandate, EBA will specify which ESG risks *'disclosures as part of the comprehensive technical standard on Pillar 3'*. The disclosure of ESG related risks (physical and transition) shall complete ESAs RTS requirements on sustainability.

83 EBA states that the ESG related disclosure will build on existing work such as Guidelines on non-Financial Reporting, TCFD and EU Taxonomy which is key for vertical alignment of requirements. Nevertheless, the existing initiatives (survey, consultation and pilot exercise) do not draw a clear line between what information should be disclosed from a risk management perspective to regulators and supervisors in addition to what has already been defined by ESAs RTS on sustainability. To this extent the example of the 'Green Asset ratio' based on EU taxonomy application for banks is quite interesting. Consequently, it should be kept in mind that:

a) Some information could be disclosed to the supervisors for supervision purposes, whilst other information could be disclosed to a broader audience (in particular information on environmental and social materiality).

b) Information required from FIs by the supervisor will necessarily results in cascading requirements from FIs towards their clients/investees (i.e. FIs will require their clients/investees to disclose information that will allow FIs to report to the supervisor). Consequently, both reporting formats (to the supervisor and to a broader audience) are linked.

84 The use of the EU taxonomy to disclose the value or ratio of a bank portfolio which is aligned with EU taxonomy technical criteria is commonly shared by all regulation layers: non-binding guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies, SFDR, ECB draft guide on climate related and environmental risk. The EC in its call for advice asks EBA to clarify the KPIs and methodology to be used for disclosure of EU taxonomy aligned assets (Article 8).

85 The scheme shows on the one hand a great coordination to adapt sustainability disclosure on FIs specificities but also on the other hand a use of a single information to answer different disclosure objectives. As noticed by ECB in its reply to EC public consultation on the renewed sustainable finance strategy and the revision of the NFRD: *'the taxonomy is defined in terms of making a substantial contribution to the EU climate and environmental objectives, the taxonomy only provides clear definition of what is 'sustainable' from a 'normative' perspective – aimed at assessing the alignment of a given economic activity with defined sustainability goals – and not from a risk management perspective, which is aimed at minimising exposures to climate and environmental risks. Although these two perspectives sometimes overlap, they reflect distinct considerations'*.

## SCOPE OF FIs COVERED BY DISCLOSURE REQUIREMENTS: RELEVANT CRITERIA / THRESHOLDS FOR INCLUSION OF FIs IN THE REPORTING REGULATIONS DO NOT ALWAYS REFLECT FI SPECIFICITIES

86 SFDR and NFRD regulations set a 500 employees' threshold for companies to be included in the non-financial reporting requirements (if not listed). This threshold does not take into account the specificities of FIs which may have limited internal teams and yet significant amounts of assets under management/loan books which directly correlate with non-financial indirect impact. E.g., an asset manager with high volumes of assets under management (and hence potentially important non-financial impacts) but with less than 500 employees is not required to report through the current NFRD. This represents a lack in the reporting requirements in the EU, as a high volume of financial flows/investments activities are not covered yet, although this issue will be partly addressed by SFDR.

# DATA IS KEY – WHICH INFORMATION FROM THIRD PARTIES IS NEEDED?

87 Because FI disclosure is linked to their products and services, FIs are users of information disclosed by third parties (clients, investee companies, etc.). Therefore, it is key to find coherence between a reporting of direct impacts of FIs' clients and investees companies and a reporting of indirect impacts of FIs.

## THERE IS A HUGE HETEROGENEITY OF DATA QUALITY COLLECTED BY FIs. THIS IS DUE TO THE DIVERSITY AND LACK OF MANDATORY DISCLOSURE FROM BOTH REGULATIONS, GUIDING PRINCIPLES AND STANDARDS

88 Based on the assessment, numerous reporting regulations, framework and standards have been identified:

a) The first consequence of this is that each corporate can choose the framework and standard that it prefers: by using different way of reporting, it is impossible for FIs to compare different companies and to make reliable investment decision-making;

b) Secondly, data is accessible through publications in heterogeneous formats;

c) This fragmentation means there is a clear lack of consistency and comparability and then, there is a need for convergence of standards transparency.

89 Current and upcoming regulations and standards focus mostly on disclosure, rather than performance measurement or impact:

a) The information available is most often narrative: a company discloses the actions implemented but the objectives to be achieved are not always very well described and clear. That information can be of little or no use to some data users like FIs because they do not tell enough about their impact, hence its performance. Two examples are provided below for illustration purposes:

(i) Purchasing / relations with suppliers and sub-contractors: as per NFRD, companies need to state whether they integrate social and environmental topics within their purchasing activities and their relationship with suppliers and sub-contractors. The way disclosure is required enables many different ways to answer and does not provide any means of comparison for external users, such as FIs. Standard indicators such as the ratio of suppliers / sub-contractors who have signed a responsible purchasing agreement, the ratio of CSR audited suppliers, with detailed scope and methodology could allow for comparison. Comparison could be even more possible if sectoral benchmarks were provided.

(ii) Child labour: As per articles 26, 27, 28 of RTS project under A4 SFDR, it is not explained how to evaluate a ''significant risk'' for child labour. If the same disclosure pattern arises as for the aforementioned NFRD, it can be expected that the disclosure on this topic will vary from one entity to another.

b) FIs have specific objectives, in particular in the EU Action plan. For instance, to reallocate capital flows, they have to assess long term risks and scenario analysis, especially for climate change. To achieve this, qualitative data is useful but quantitative data is also needed in terms of time-horizon and content.

90 Our assessment work also highlighted that KPI mentioned in different guidelines, framework and standards are numerous and are not granular enough to provide key information to FIs:

a) Climate-related KPIs are the most mature ones in terms of definitions, scopes and methodologies. However, when it comes to social, governance or other environmental topics, KPIs are few, with sometimes unclear definitions and methodologies (ex: KPIs on biodiversity: the RTS refer to a KPI on the 'preservation practices & monitoring of pressures corresponding to indirect/direct drivers of ecosystem change', or the 'impact on IUCN Red List species and/

or national conservation list species'; KPIs on social matters: the RTS refer to the 'excessive CEO pay ratio'; KPIs on human rights matters: the RTS refer to the 'exposure to controversial weapons').

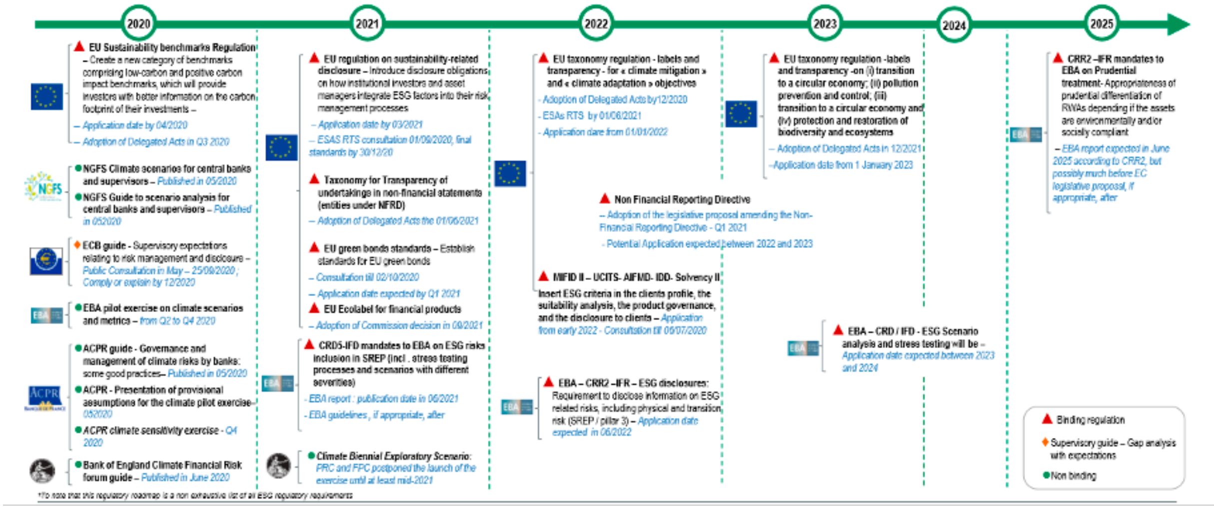
b) But even on climate-related issues, the definitions and calculation methodologies are not yet mature: many climate indicators coexist, with different calculation methodologies. In addition, the lack of transparency, frequent changes in methodologies and their complexity are a challenging issue for FIs (see chart: KPIs analysis on climate and carbon issues, on paragraph 68).

c) The comparison of ESG KPIs used by the three main EU regulations shows that there is no convergence (see Appendix 2)

91 In conclusion, data methodologies are not standardised and not transparent, information is not frequently audited, hence not comparable: nevertheless, high quality, comparable and verifiable disclosure is a prerequisite to enable FIs to correctly assess the risks and opportunities in their investment decision-making process and to respond correctly to current and upcoming EU regulations.

## EU REGULATION TIMELINES ARE NOT ALWAYS ALIGNED, WHICH WILL MAKE IT MORE COMPLICATED FOR FIs TO COLLECT RELEVANT DATA FROM CORPORATES

92 The ESG calendar is quite full and complex in the coming years for companies and especially FIs:




*Source: BNP Paribas, October 2020*

93 Comparing the upcoming EU regulations and the NFRD timeframes highlights two main challenges for FIs.

*Reminder on timelines*

94 NFRD: The NRFD will be reviewed early 2021 (launch of Commission's proposal). Following legislative negotiations, the changes agreed in the legislative process would need to be transposed by Member States (in case the Directive is retained) or authorities would need time to prepare for application of the new rules (in case the legislation is transformed in a Regulation). The new rules would therefore start to apply in 2024 earliest (assuming legislative agreement in 2022).

95 Taxonomy: The Taxonomy regulation (level 1) has been published in June 2020. 'The Commission shall adopt a delegated act' to establish the technical screening criteria, and 'shall consult the Platform' on sustainable Finance before doing so, as well as seek advice from the Member States Experts Group and from the Regulation. The first delegated act (level 2) – technical screening criteria for both climate mitigation and climate adaptation objectives – has to be adopted by 31 December 2020 and should then enter into application from 1 January 2022 (Article 10, 11). As disclosure at the corporate level of Taxonomy-alignment (article 8) is required as of January 2022, a second delegated act is required on article

8 by the Taxonomy Regulation (a call for advice from the European Commission to the ESAs has been launched in September 2020, and ESMA launched a consultation on this article 8 in November 2020). The third delegated act (level 2) – technical screening criteria for other four environmental objectives – has to be adopted by 31 December 2021 and should then enter into application from 1 January 2023 (Article 13, 14, 15). A fourth delegated act, outlining the concrete guidance on the Taxonomy disclosures, will be adopted by June 2021 specifying the information companies subject to the non-financial reporting directive will have to disclose on how, and to what extent, their activities align with those considered environmentally sustainable in the Taxonomy.

96 SFDR: The SFDR regulation (level 1) shall enter into application from 1 March 2021 for the first requirements. The other ones will enter into application progressively. The Regulatory Technical Standards (level 2) will be finalised by the end of January 2021 and enter into application by January 2022.

*Two main challenges for FIs relative to these different timeframes during the transition periods*

97 Disclosure of the sustainable shares of investments for investors (article 5 and 6 of the taxonomy) is required as of January 2022 (for the two climate objectives), whereas companies will publish their non-financial statement including their shares of green turnover and Capex related to year 2022 only during spring 2023. This means that sustainable share of investment portfolios published by investors will have to be based on estimated share of sustainable activities of the companies during this transition period.

98 Disclosure at the corporate level of Taxonomy-alignment (article 8) is also required as of January 2022, with the same deadline applied to both FIs and non-FIs. This creates an inconsistency, because in the absence of information on product-level Taxonomy alignment of their financial products, FIs necessarily have to rely on aggregate information on the Taxonomy alignment of the entire corporates to estimate alignment of their stock of financial assets. However, since their non-financial counterparts will only start to disclose company-level Taxonomy alignment only in 2022, FIs will not have this key information in the first year of application of the Taxonomy disclosure requirements.

99 Dates of entering into force of the Taxonomy regulation and the NFRD revision – which may require mandatory non-financial assurance and better reliability/comparability – are not consistent. Financial products marketed as environmental / sustainable based on share of sustainable activities/Capex/OpEx will be calculated with information from non-financial statements before the revision, so with limited level of reliability.

100 This non-alignment between regulations will hinder FIs from collecting and therefore disclosing relevant data during the transition periods.

## REGULATION DOES NOT ADDRESS THE POSSIBLE SCOPING / COVERAGE ISSUES IN FI PORTFOLIOS

101 FIs are characterised by a complex business model requiring specific approach when it comes to disclosing sustainability elements.

102 The current NFRD regulation does not take into account the underlying assets type or size:

a) Those assets may be some very young and/or small companies (i.e. start-ups, ETIs, SMEs), that may encounter difficulties in collecting and measuring their own non-financial data: for example, many SMEs do not have information relative to their footprint and cannot afford putting in place relevant monitoring systems. That is why, for a bank, it is not easy and often not possible to obtain relevant data and information required by the SFDR for instance. In lending activities, the ability for a bank to assess the appropriate profile of a customer often depends from the ability of the client to produce reliable and meaningful data, and in turn, that strongly depends on the size of the corporation requiring the lending. This example highlights the de-levelling effect of the regulations towards small and medium enterprises.

b) Regulatory requirements to disclose non-financial data at their own company level may not be aligned or may not exist with those required by the FIs. For instance, in France, the *"Bilan Social"* applies to company over 300 employees, so all companies below this threshold do not face any requirements of disclosing HR data. As a consequence, most of them do not have the process nor the internal tools and organisation to provide non-financial reporting.

c) It should also be noted that depending on the product/service provided by the FI, the client relationship profile varies, and FIs are more or less able to collect information from the client. For instance, a bank might be able to collect different information from a client when it finances a project (project finance) than when it finances a general-purpose corporate loan.

103 The current NFRD regulation does not take into account the geographies where the assets are located (and, to some extent, neither does the Taxonomy Regulation; the question arises as to how the TSC, the minimum social safeguards and the governance requirements can be applied outside of the EU):

a) Some companies may be partly or fully located outside the European Union (see figure below, which shows that European asset managers' funds' holding of debt securities and listed shares issued outside of the euro area is greater than inside the euro area);

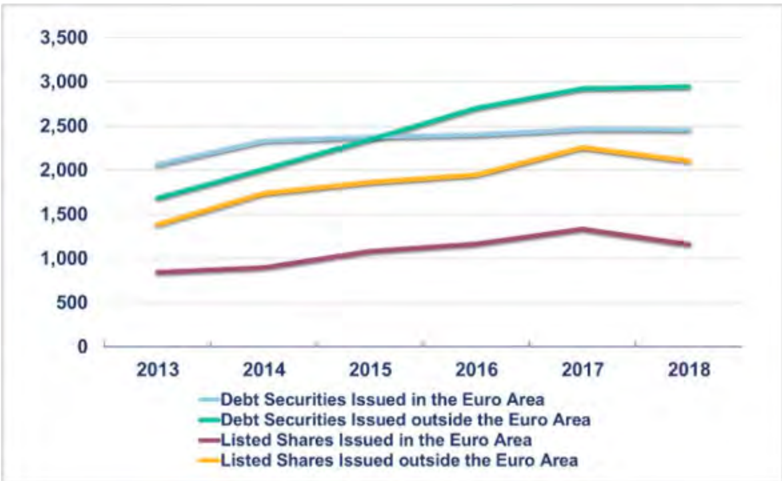
b) Outside the European Union, non-financial disclosure requirements may be existing or non-existing;

c) When existing, type of requirements may be discrepant with those in place in the European Union:

(i) For example, social data measurements in the US and in the EU are very different (diversity, absenteeism, accident, health coverage, ...), yet existing;

(ii) Environmental measurements are discrepant, apply mostly to most polluting sectors (e.g. manufacturing, energy,...). Yet, they are developing in a growing number of countries – regulatory or label-based initiatives – which should allow to require disclosure for most material impacts.

**Debt securities and listed shares held by investment funds located in the EU (in EUR billions)**




*Source: EFAMA calculations based on ECB data, in "asset management in Europe: an overview of the asset management industry", EFAMA, November 2020*

## CLIMATE DISCLOSURE REQUIREMENTS ARE MORE ADVANCED THAN OTHER E, S AND G REQUIREMENTS IN THE UPCOMING UE REGULATIONS

104 Given the climate emergency, upcoming regulations do make a clear focus so far on climate topics, compared to other environmental topics, but also compared to social and governance topics. This is perfectly in line with the European Parliament declarations on November 2019, and this makes sense for FIs as they play a key role in the transition to a low-carbon and climate-resilient economy. However, this climate prioritisation in policy making and reporting global context has a downside: social and governance dimensions of sustainability are being left behind. Examples of exclusively climate-related regulations or initiatives are Taxonomy Regulation (2020) (taxonomy includes all main environmental vectors and minimum safeguards on social issues but Delegated Acts are prioritising Climate-change related issues), Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019), the Task-Force on Climate-related Financial Disclosures initiative of the Financial Stability Board (2016), Carbon Disclosure Project (CDP), the EBA Pilot sensitivity exercise on climate risk (2020), among others. The list of KPIs in appendix 2 also reflect the predominance of climate over other E, S and G matters.

105 Similarly, the Taxonomy Regulation (2020/52) establishes criteria to determine whether an economic activity is qualified as environmentally sustainable, including main environmental vectors, even though climate objectives are being developed first and will be disclosed 1 year before the other vectors.

106 Moreover, the Delegated Regulation specifying the technical screening criteria address social and governance issues as “safeguards” only, and not as objectives in themselves, as for environmental topics.

107 This is also reflected in some CSR reports: while one can find detailed information about CO2 emissions, waste reduction and pollution of water, it’s hard to find detailed information about social and governance impacts. However, one has to be careful as the sole focus on reduction of $CO_2$ might decrease the social acceptance for it or increase social inequality.

# FORWARD LOOKING DISCLOSURE

## FORWARD LOOKING DISCLOSURE IS MAINLY TACKLED FROM A QUALITATIVE POINT OF VIEW, THOUGH QUANTITATIVE COMPARABLE INFORMATION IS KEY FOR FIs TO REORIENT CAPITAL FLOWS TOWARDS SUSTAINABLE ACTIVITIES

108 The development of numerous new initiatives highlighting the relationship between climate change and financial risk brings to light a consensus on the importance of climate risk, and it is expected from the financial sector to play a key role in financing the transition of the economy toward sustainable activities.

109 Forward-looking analysis is a necessary component of non-financial information to disclose, in order to foster transparency on transition targets, commitments fulfilment and to perform scenario analysis.

110 The Taskforce on Climate-related Financial Disclosure, the Central Banks and supervisors Network for Greening the Financial System, the European Commission sustainable finance strategy, to name a few of the best known, propose to adopt a forward-looking disclosure, to align capital flows with Paris agreement objective.

111 In this respect, a long-term horizon is emerging from regulators and supervisors' expectations. It is one of the main concerns of the *ECB guide on climate-related and environmental risk* published in November 2020 that requires FIs for a long term of more than 5 years: to understand the business environment in which they operate, to integrate risk materiality measurements in their strategic decision, in their capital planning, in stress testing and scenario analysis.

112 However, these guidelines rarely go beyond qualitative information. There is no existing disclosure standard to comply with in order to measure forward-looking performance, as existing regulations rather focus on quantitative information on current performance. Forward-looking performance measurement is left in the hands of private initiatives using different methodologies, which raises questions on accuracy and transparency of the information they produce.

NB: It must be noted that this forward-looking disclosure is not specific to FIs and has mainly been dealt with by other workstreams.

# SALIENT ASSESSMENT POINTS

## FIRST SALIENT POINT

113 The broad variety of financial institutions, products and services is not reflected/addressed in the NFRD, which needs to be very precise and coherent to allow effective and relevant implementation by financial institutions.

a) The terminology 'financial institutions' covers several types of activities, which do not form a homogeneous group. The three sub-segments of this group (banks, insurance undertakings, asset managers/owners) face some common issues, but also have some differences. It seems that a single NFI framework referring to 'FIs' in general cannot address the specificities of lending, investing and insuring risk; each of these activities need to be addressed in detail.

b) Existing thresholds for inclusion/exclusion of FIs in reporting requirements do not take into account the specificities of FIs which may have limited internal teams and yet have significant volumes of assets under management/loan books which directly correlate with extra-financial indirect impact (i.e. an FI may have significant assets under management/loan books while being below the 500 employees' threshold for companies to be included in the non-financial reporting requirements, as defined by NFRD and SFDR – NB: NFRD applies to listed only, although some member states have included unlisted countries too).

## SECOND SALIENT POINT

114 Some regulations overlap, thereby decreasing clarity for FIs. Contents are piling up, leading to a variety of data produced, and do not provide for coherence and efficient compliance, thus also reducing the potential effectiveness of the regulations in contributing to sustainable growth. Decentralised policymaking in key areas of the sustainable finance agenda, relying on several parallel processes and fora (e.g. Technical Expert Group, EFRAG, EBA, ESMA, EIOPA, Platform on sustainable finance) generates potential overlaps, inconsistencies, coordination challenges in filling the existing gaps, whilst decreasing transparency for corporates.

## THIRD SALIENT POINT

115 Financial institutions work on indirect impacts by using data from third parties. Access and process of reliable, material and comparable data is key but particularly challenging as of today. Key issues include the following items:

a) accessing data can be costly;

b) material non-financial data is not always disclosed;

c) varying transpositions of NFRD across countries lead to uneven NFI requirements in the EU;

d) narratives disclosed are not always supported by relevant and transparent quantitative indicators (i.e. key performance indicators, KPIs);

e) NFI is not harmonised enough to allow comparability;

f) calculation methodologies of KPIs differ;

g) data is rarely audited by an external reviewer.

## FOURTH SALIENT POINT

116 Key methodological aspects are not addressed by the EU Regulation (first and foremost NFRD and SFDR), such as:

a) Minimal detention threshold for equity products to be reported (e.g. the share of equity owner by the investor over the total equity of the investee).

b) Minimal invested/lent amounts for reporting.

c) Asset types (e.g. how should a guarantee product be reported vs. a loan? How should the FIs' own money/treasury operations be reported?). It should be noted that depending on the product/service provided, the client relationship profile varies, and FIs are more or less able to collect information from the client.

d) Asset size (which typically determines the ability of the investee/borrower to disclose non-financial information).

e) Timing of investment/loan (e.g. should the FI report on assets or loans held on December 31st? or should the FI report on investments/loans that have been in the portfolio during the year? If so, should they take into account the duration during which the investment/loan has been in the portfolio?).

f) Regulation does not systematically specify what information is requested at each relevant level (i.e. whether disclosure should take place at entity level, at product level, or for each underlying asset/counterpart).

g) FIs' indirect impact is not solely linked to large EU-based corporates (which have been the focus of the existing NFRD). Some major counterparts are not taken into account, which can lead to important gaps in the reporting:

   (i) Many FIs have substantial exposure outside of the EU (for instance, some big European asset managers have more than 50% assets under management outside the EU), which leaves a major gap in FI's NFI reporting.

   (ii) Sovereign entities can also be FI counterparts (they can be borrowers, or investees if FIs invest in sovereign bonds). NFI for sovereign is still a nascent topic and can also represent a gap in FI's NFI reporting.

h) NFRD requests FIs to report in the same timing as other corporates. Consequently, timing can be very tight for FIs to report on their indirect impact, as the information they need to report is often published by corporates at the same time.

## FIFTH SALIENT POINT

117 Climate disclosure requirements are more advanced than other E and S and G requirements in the present and forthcoming EU regulations.

a) Given the climate emergency, upcoming regulations do make a clear focus to date on climate topics, compared to other environmental topics, but also compared to social and governance topics. This is in line with the European Parliament declarations on November 2019, and this makes sense for FIs as they play a key role in the transition to a low-carbon and climate-resilient economy.

b) However, this climate prioritisation in policy making and reporting global context has a downside: social and governance dimensions of sustainability are being left behind. Examples of exclusively climate-related regulations or initiatives are Taxonomy Regulation (2020) (taxonomy includes all main environmental vectors and minimum safeguards on social issues but Delegated Acts are prioritising Climate-change related issues), Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019), the Task-Force on Climate-related Financial Disclosures initiative of the Financial Stability Board (2016), Carbon Disclosure Project (CDP), the EBA Pilot sensitivity exercise on climate risk (2020), amongst others.

## SIXTH SALIENT POINT

118 Forward looking disclosure is mainly tackled from a qualitative information point of view though quantitative comparable information is key for financial institutions to reorient capital flows towards sustainable activities.

a) Forward-looking analysis is a necessary component of non-financial information to disclose, in order to foster transparency on transition targets, commitments fulfilment and to perform scenario analysis. The Taskforce on Climate-related Financial Disclosure, the Central Banks and supervisors Network for Greening the Financial System, the European Commission sustainable finance strategy, to name a few of the best known, propose to adopt a forward-looking disclosure, to align capital flows with Paris agreement objective.

b) In this respect, a long-term horizon is emerging from regulators and supervisors' expectations (see for instance the ECB guide on climate-related and environmental risk published in November 2020 that requires FIs for a long term of more than 5 years). However, these guidelines rarely go beyond qualitative information. There is no existing disclosure standard to comply with in order to measure forward-looking performance, as existing regulations rather focus on quantitative information on current performance. NB: It must be noted that this forward-looking disclosure is not specific to FIs and will mainly be dealt with by other workstreams.

# APPENDIX 1: LIST OF THE SOURCES ANALYSED

## EUROPEAN UNION REGULATIONS AND GUIDELINES

1 Taxonomy (Regulation EU 2020/852)

2 SFDR (Regulation 2019/2088), including MifiD and IDD

3 EU Climate Benchmarks (Regulation 2019/2089)

4 Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01) Annex I Further guidance for banks and insurance companies

5 EBA Survey on Pillar 3 disclosures on ESG risks under Article 449a CRR

6 EC – guidelines to help companies disclose non-financial information

7 EBA Action plan on sustainable finance

8 ECB Guide on climate-related and environmental risks – draft version

9 EBA Pilot sensitivity exercise on climate risk

10 ECB reply to the public consultation on the NFRD

11 NFRD

## LOCAL REGULATIONS AND GUIDELINES

12 Energy law transition – Loi n°2015-992 du 17 août 2015 relative à la transition énergétique pour la croissance verte – article 173

13 Duty of Care Law (n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre)

14 AMF position/recommendation doc-2020-03 – information to be provided by collective investment schemes incorporating non-financial approaches

## STANDARDS / PRINCIPLES

15 SASB Asset Management and Custody Activities

16 SASB Commercial Banks

17 SASB Investment Banking & Brokerage

18 UN PRB (Principles for Responsible Banking)

19 UN PRI (Principles for Responsible Investment)

20 UN PSI (Principles for Sustainable Insurance)

21 UN Guiding Principles on Business and Human rights

22 OECD: Guidelines for Multinational Enterprises

## LABELS

# APPENDIX 2: COMPARISON OF KPIs REQUIRED BY NFRD, SFDR AND THE EU TAXONOMY REGULATION

| | NON-FINANCIAL REPORTING DIRECTIVE (NFRD) & 2017 GUIDELINES | DISCLOSURE REGULATION (AND RTS PROPOSAL) | EU TAXONOMY REGULATION (ARTICLE 8) |
|---|---|---|---|
| Environment | 1. Emission of other pollutants<br>2. Energy performance and improvements<br>3. Energy consumption from non-renewable sources<br>4. Energy intensity<br>5. Direct and indirect GHG emissions<br>6. Extraction of natural resources<br>7. Impacts and dependences on natural capital and biodiversity<br>8. Waste management<br>9. Transportation, use and disposal of products<br>10. Development of green products and services | **GHG**<br>1. Carbon emissions (broken down by scope 1, 2 and 3)<br>2. Carbon footprint<br>3. Weighted average carbon intensity<br>4. Solid fossil fuel exposure<br>Energy performance<br>5. Total energy consumption from non-renewable sources and share from non-renewable energy consumption<br>6. Breakdown by type of non-renewable<br>7. Energy consumption intensity<br>8. Energy consumption intensity per sector<br>**Biodiversity**<br>9. Preservation practices & monitoring of pressures corresponding to indirect/ direct drivers of ecosystem change<br>10. Impact on IUCN Red List species and/or national conservation list species<br>11. Existence of deforestation policy<br>**Water**<br>12. Water emissions<br>13. Exposure to areas of high-water stress<br>14. Untreated discharged wastewater<br>**Waste**<br>15. Hazardous waste ratio<br>16. Non-recycled waste ratio | 1. Taxonomy-aligned turnover, CapEx and OpEx<br>(mandatory indicators)<br>2. By environmental/climate objective? To be decided as part of Article 8 delegated act (by June 2021)<br>3. The classification itself also provides for GHG emissions indicators; and other climate and environmental-related indicators (optional indicators) |
| Sub-total | 10 | 16 | 3 |

| | NON-FINANCIAL REPORTING DIRECTIVE (NFRD) & 2017 GUIDELINES | DISCLOSURE REGULATION (AND RTS PROPOSAL) | EU TAXONOMY REGULATION (ARTICLE 8) |
|---|---|---|---|
| **Social** | 1. Gender diversity<br>2. Other aspects of diversity<br>3. Employees entitled to parental leave, by gender<br>4. Workers who participate in activities with a high risk of specific accidents or diseased<br>5. Number of occupational accidents<br>6. Employee turnover<br>7. Ratio of employees working under temporary contracts<br>8. Average hours of training per year, by gender<br>9. Employee consultation processes<br>10. Number of people with disabilities employed | 1. Implementation of fundamental ILO conventions<br>2. Gender pay gap<br>3. Excessive CEO pay ratio<br>4. Board gender diversity<br>5. Policies on the protection of whistle-blowers<br>6. Investments in companies w/o workplace accident prevention policies | N/A |
| Sub-total | 10 | 6 | N/A |
| **Human rights** | 1. Occurrences of severe impacts on human rights<br>2. Process for receiving and addressing complaints, and mitigation/remedies<br>3. Operations and suppliers at significant risk of human rights violations<br>4. Human trafficking<br>5. Accessibility by disabled people<br>6. Respect for freedom and association<br>7. Engagement with relevant stakeholders | 1. Human rights policy<br>2. Due diligence processes to monitor adverse human rights impacts<br>3. Processes and measures for preventing human beings trafficking<br>4. Operations and suppliers at significant risk of incidents of child labour<br>5. Operations and suppliers at significant risk of incidents of forced or compulsory labour # and nature of cases of severe HR issues<br>6. Exposure to controversial weapons | N/A |
| Sub-total | 7 | 6 | N/A |

| | NON-FINANCIAL REPORTING DIRECTIVE (NFRD) & 2017 GUIDELINES | DISCLOSURE REGULATION (AND RTS PROPOSAL) | EU TAXONOMY REGULATION (ARTICLE 8) |
|---|---|---|---|
| **Governance** | 1. Anti-corruption policies, procedures and standards<br>2. Criteria used in corruption-related risk assessments<br>3. Internal control processed and resources to preventing corruption and bribery<br>4. Appropriate anti-corruption training by employees<br>5. Use of whistleblowing mechanisms<br>6. Number of pending/completed legal actions | 1. Policies<br>2. Cases of insufficient actions taken to address breaches<br>3. Number of convictions and fines | N/A |
| Sub-total | 6 | 3 | N/A |
| **Others** | 1. Supply-chain indicators (labor practices, human trafficking, GHG emissions, water and environmental pollution, deforestation and other biodiversity-related risks)<br>2. Conflict minerals | N/A<br>i.e. optional indicators provided in the RTS consultation paper | N/A |
| **Total (per regulation)** | **33 + 2 others** | **32** | **3** |

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