

EU Strategy on Sustainable Finance

*EU Taxonomy, SFDR Regulation and NFRD
Regulation*

February 2021

Associazione Italiana Investor Relations (AIR)



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The business of sustainability



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Introducing the Presenters



***Onur
Durmus***

*Partner
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Aquaro***

*Partner
ERM Italy*

ERM: Trusted advisor to leading corporate & financial clients



History & credibility to stakeholders

Nearly 50 years of working with leading organisations including 50% of Fortune 500 companies in the last 5 years



People

Unique blend of staff i.e. technical, strategy, legal, and in-house private markets and banking experience



Experience

Delivers ESG support to over 100 GPs, LPs and lenders across the globe. Engaged by PRI PE advisory group to create LP-GP monitoring and reporting guidance



Integrated Solutions

ERM brings multiple disciplines together with a deep understanding of financial and operational impacts for improved business performance across the fund lifecycle



Independent assurance

ERM Certification and Verification Services (ERM CVS) is a wholly owned subsidiary of the ERM Group, a global market leader in sustainability services. Operating in more than 50 countries, we deliver independent, performance-driving certification and verification to our clients.

Global Footprint



160

Offices in 40 countries

5,000+

Professional staff

150+

Countries with projects completed

Established relationships with relevant organizations and thought leaders



We extend our network and work through memberships that closely align with our values and mission. Here is a sample of ERM's relationships with key thought leaders.

World Business Council for Sustainable Development



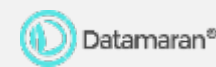
ERM is a founding member of WBCSD, a global, CEO-led organization of over 200 leading businesses working together to accelerate the transition to a sustainable world. ERM CEO Keryn James is currently serving as an Executive Committee member of the WBCSD.

UN Global Compact Signatory



We are a signatory of the United Nations Global Compact and members of the UK Local Network. ERM's mission is aligned with the 10 principles, and we actively support and participate in UNGC engagements.

Datamaran



ERM has a unique partnership with Datamaran, a powerful cloud-based data analytics platform that identifies and monitors material ESG topics using cutting-edge technology, through which we offer comprehensive, data-driven analysis utilizing Datamaran's unique software platform.

World Benchmarking Alliance Ally



Progress against the SDGs isn't happening fast enough. Together with diverse Allies, the WBA is developing transformative benchmarks to measure companies' progress against the global challenges we all face.

GRI GOLD Community Member



We support the Global Reporting Initiative by sharing insights and trends in sustainability and reporting and supporting the global community of practice and knowledge sharing.

Institute of Corporate Responsibility & Sustainability (ICRS)



We have been members of this professional body since its creation in 2014, supporting events and webinars as speakers, facilitators and participants.

Task Force on Climate-Related Financial Disclosure



ERM was the sole consulting firm engaged by the G20 Financial Stability Board (FSB) Task Force on Climate-Related Financial Disclosures (TCFD).

Future-Fit Business Benchmark



We are accredited partners to help organisations apply the benchmark. Future-Fit has translated systems science into practical free-to-use tools designed to help business leaders and stakeholder respond to today's biggest challenges.

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2. CONTEXT

Towards an improved legislative landscape



On 28 November 2018, the Commission presented its strategic long-term vision **“The Green Deal”** for a prosperous, modern, competitive and climate-neutral economy by 2050.

To reach the target, **three main actions** have been identified:



1. EU Budget

at least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework



2. Blended Finance

InvestEU & European Fund for Sustainable Development (EFSD)



3. Private Finance

Commission Action Plan on financing Sustainable Growth



Commission Action Plan

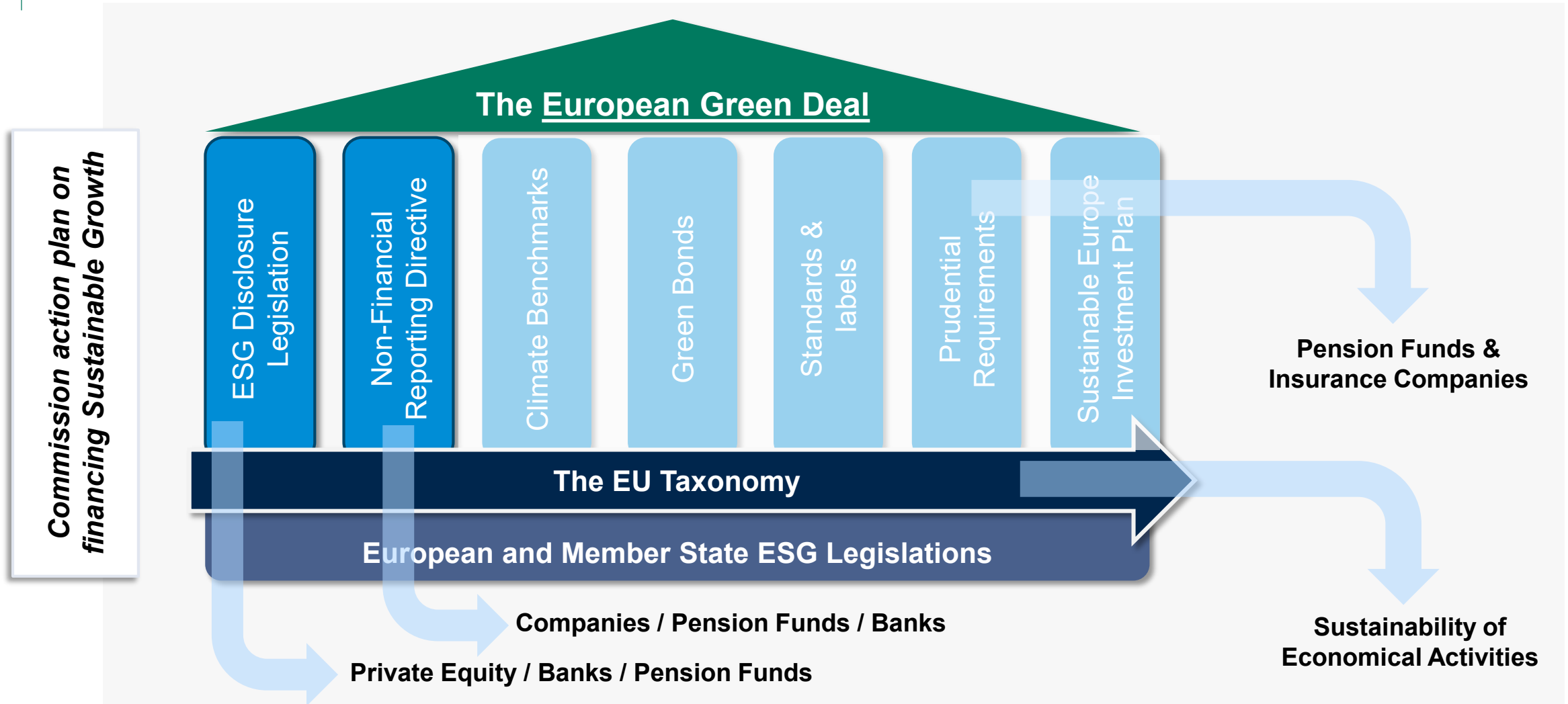
Reorient capital flow towards more sustainable investments

Mainstreaming sustainability in risk management

Foster transparency & long-termism

- 1 Establish a **Taxonomy** of environmentally sustainability activities
- 2 Create **standards and labels** for green financial products
- 3 Foster investment in sustainable projects
- 4 Incorporate **sustainability** in providing investment **advice**
- 5 Develop sustainability **benchmarks**
- 6 Better integrate sustainability in ratings and market research
- 7 Clarify institutional **investors'** and asset managers' **duties**
- 8 Incorporate sustainability in **prudential requirements**
- 9 Strengthen corporate **sustainability disclosure**
- 10 ↑sustainable **corporate governance** and ↓ short-termism

Action Plan on financing Sustainable Growth



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3. SUSTAINABLE FINANCE DISCLOSURE REGULATION (SFDR)

The SFDR: General overview



The **EU's Regulation (Regulation (EU) 2019/2088) on sustainability-related disclosures in the financial services sector** aims to harmonize the sustainability-related disclosures at European level i) to enable clients and investors to make informed investment decisions, also from the point of view of the impact on sustainability, and ii) to move capital and private savings towards activities that are sustainable.

Scope

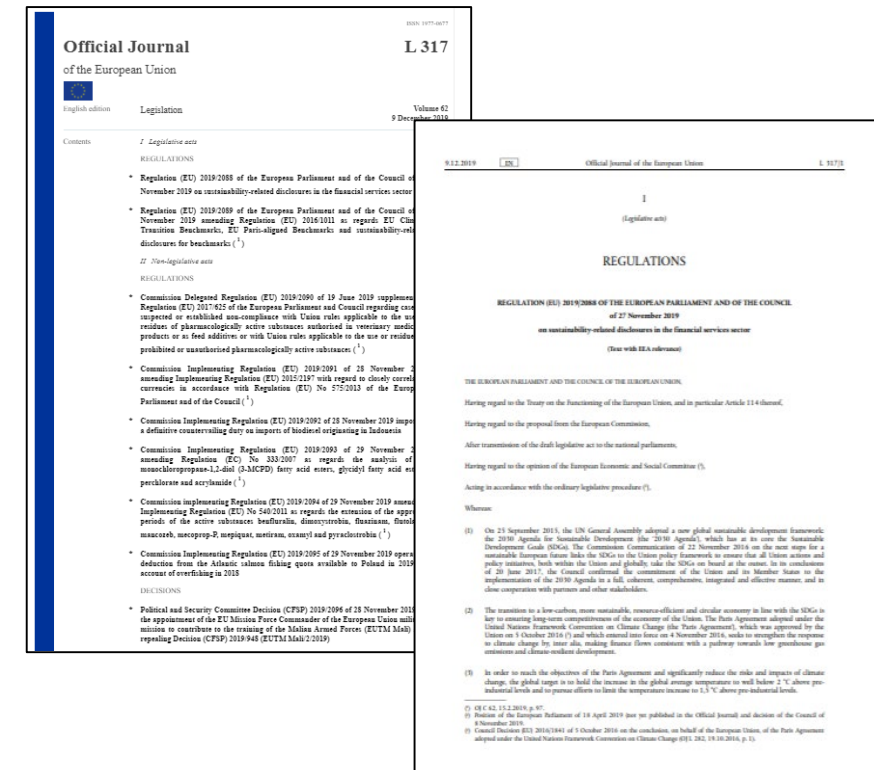
The SFDR applies to “**financial market participants**”, a term that includes MiFID investment firms that provide portfolio management, alternative investment fund managers (AIFMs), and UCITS (or their management companies).

The regulations set out requirements relating to “**financial products**” made available by financial market participants. The term “financial products” includes portfolios managed by MiFID managers and alternative investment funds (AIFs) managed by AIFMs.

Requirements levels

The disclosures required under the SFDR consist of:

- *Entity-level disclosures (e.g. AIFM); and*
- *Product-level disclosures (e.g. portfolio).*



Entity level requirements



ENTITY LEVEL REQUIREMENTS			
Obligations		Type of disclosure	Deadline
[Art. 3] The asset manager must formulate a policy on the integration of sustainability risks in its investment decision-making process.		Website	10 March 2021
		Pre-contractual disclosure (product-level disclosure of the manager's policy)	10 March 2021
[Art. 4] An asset manager must make a business decision to either (NOT COMPLETELY ASSESSABLE - Regulatory Technical Standards (RTS) still under definition)			
COMPLY	2.a Implement a due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors, at the level of the manager as an entity; or	Website	10 March 2021 (To be re-defined according with RTS publication)
EXPLAIN	2.b Publish the reasons for not considering the adverse impact of investment decisions on sustainability factors	Website	10 March 2021 (To be re-defined according with RTS publication)
[Art. 5] Update existing remuneration policy to include information on how the policy is consistent with the integration of sustainability risks		Website	10 March 2021

Product level requirements



FINANCIAL PRODUCTS REQUIREMENTS			
Obligations		Type of disclosure	Deadline
[Art. 6] An asset manager must decide, for each financial product that it “makes available”, whether to either:			
COMPLY	Publish the results of the assessment of the likely impact of sustainability risks on the return of the financial product	Pre-contractual disclosure	10 March 2021
EXPLAIN	Publish clear and concise reasons why sustainability risks are not relevant for returns of the financial product		10 March 2021
[Art. 7] If the asset manager has implemented a sustainability DD policy (NOT COMPLETELY ASSESSABLE - Regulatory Technical Standards (RTS) still under definition)			
COMPLY	[Art. 7.1] Disclose whether and how each financial product considers the principal adverse impacts on sustainability factors.	<ul style="list-style-type: none">• Pre-contractual disclosure• Periodic disclosure	30 December 2022 (To be re-defined according with RTS publication)
EXPLAIN	[Art. 7.2] If not implementing a sustainability DD policy, disclose for each financial product an express negative statement that the asset manager does not consider adverse impacts, and the reasons for not doing so.	Pre-contractual disclosure	10 March 2021 (To be re-defined according with RTS publication)
[Art. 13] The asset manager must review of all its marketing materials for all in-scope products and services, to ensure that those marketing documents do not contradict any information disclosed under the SFDR.		All marketing materials	10 March 2021 (and ongoing)

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4. NON-FINANCIAL REPORTING DIRECTIVE (NFRD)

The NFRD: European Directive 2014/95/EU

The European Parliament and the Council of the European Union approved the Directive 2014/95/EU, the “*Barnier Directive*”, on the 22nd of October 2014.

This Directive requires to large entities of public interest to provide a **non-financial disclosure** including at least information regarding the **environment, social, personnel, human rights, actions against active and passive corruption** and a description of the **diversity and inclusion policy** applied in relation to the board of directors, management and control bodies composition of the company.

The **EU Directive** aims to:



1

Improve the **uniformity and comparability of non-financial information disclosed** in the European Union

2

Facilitate the investors' access to non-financial information

3

Map and monitor the main sustainability risks associated with company activities

Italian Legislative Decree 254/2016

The **Italian Legislative Decree 254/2016** transposes the EU Directive 2014/95/EU on non financial information disclosure, also known as “Barnier Directive” into the Italian law and the **Non-Financial Disclosure (NFD)** represents the response to such reporting obligation introduced by directive. Companies can also choose to publish a **more extensive NFD**, which also includes typical elements of the Sustainability Report, or publish **two separate documents**. In addition, a **third independent party must** provide a statement of compliance with the information provided in the NFD.

MAIN CONTENTS AND ELEMENTS

➤ To the extent necessary to ensure an understanding of the company's business, its performance, results and impact, the *individual non-financial statement covers the issues:*



➤ At least, the understanding of business' activity could be guaranteed *by describing the following elements:*



main risks, generated or suffered, linked to socio-environmental issues and which derive from business activities or from products and services provided



organizational and management model of the company



Policies implemented by the organization

Who has to report?

Italian Legislative Decree 254/2016

WHO HAS TO REPORT?

ENTITIES OF PUBLIC INTEREST*

- **Issuers** whose securities are admitted to trading on a regulated market of an EU country
- **Banks**
- **Insurance companies**

&

LARGE SIZE FIRMS

- At least **500 employees** on average employed during the current FY
- **Total balance sheet** greater than **20,000,000 €**
- or
- **Net revenues** on sales **greater than 40,000,000 €**

* Entities as reported in the art. 16, c. 1, of Legislative Decree n. 39 of January 27, 2010

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5. EU TAXONOMY

General overview



WHY?

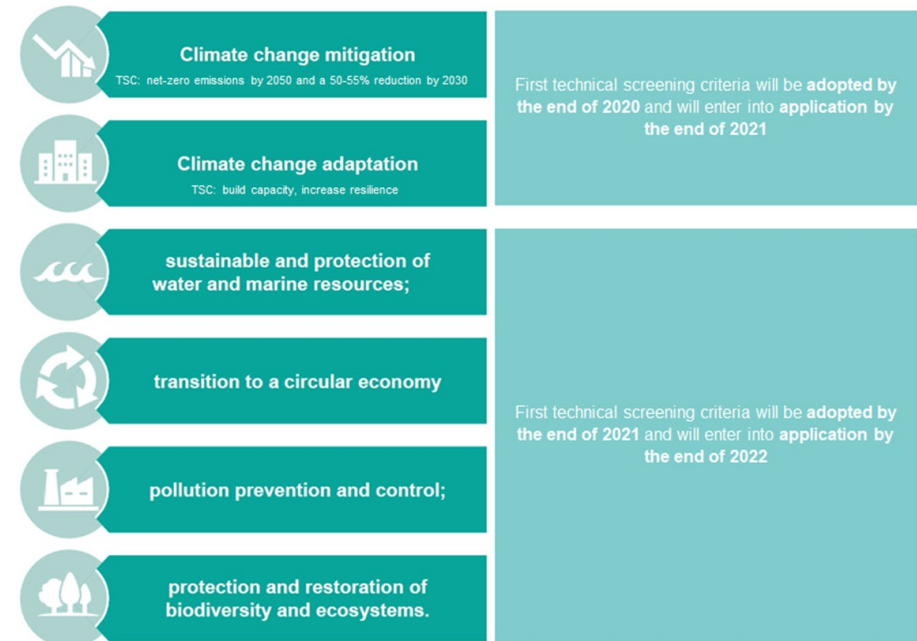
With rapidly growing sustainability policies and strategies, **confusion** emerged around **what can be considered sustainable and green**.

In this context, the **EU Taxonomy aims to answer to the “What is green?”** question, setting the technical basis for a **common understanding** of what is “Environmentally sustainable”.

HOW?

The EU Taxonomy defines a **list of environmentally sustainable activities** by defining **technical screening criteria** for selected environmental objectives to help investors, companies, issuers and project promoters navigate the **transition to a low-carbon**, resilient and resource-efficient economy.

WHAT?



Who will be impacted by this Taxonomy?



Large companies who are already required to provide a non-financial statement under the **Non-Financial Reporting Directive**. They will be required to **complete their first set of disclosures against the Taxonomy**, covering activities that substantially contribute to climate change mitigation and/or adaptation, **in the course of 2022**.



Financial market participants offering financial products in the EU, including occupational pension providers. They will be required to **complete their first set of disclosures against the Taxonomy**, covering activities that substantially contribute to climate change mitigation and/or adaptation, by the **end of December, 2021**.



The **EU and Member States** when setting public measures, standards or labels for **green financial products** or green (corporate) bonds.

The following sectors are covered by the Taxonomy (based on NACE, *Nomenclature des Activités Economiques dans la Communauté Européen*):

	Agriculture and forestry
	Manufacturing
	Electricity, gas, steam and air conditioning supply
	Water, sewerage, waste and remediation
	Transport
	Information and Communication Technologies (ICT)
	Buildings

The following sectors are currently excluded by the Taxonomy (based on NACE Rev.):

- 1) Mining and quarrying;
- 2) Construction;
- 3) Professional, scientific and technical activities.

How does it work in a nutshell?



The Taxonomy sets **performance thresholds** and **minimum social safeguards** (referred to as '*technical screening criteria*') for economic activities, which:



The performance thresholds will help companies, project promoters and issuers:

- **access green financing to improve their environmental performance;**
- **identify which activities are already environmentally friendly;**
- **grow low-carbon sectors and decarbonize high-carbon ones.**

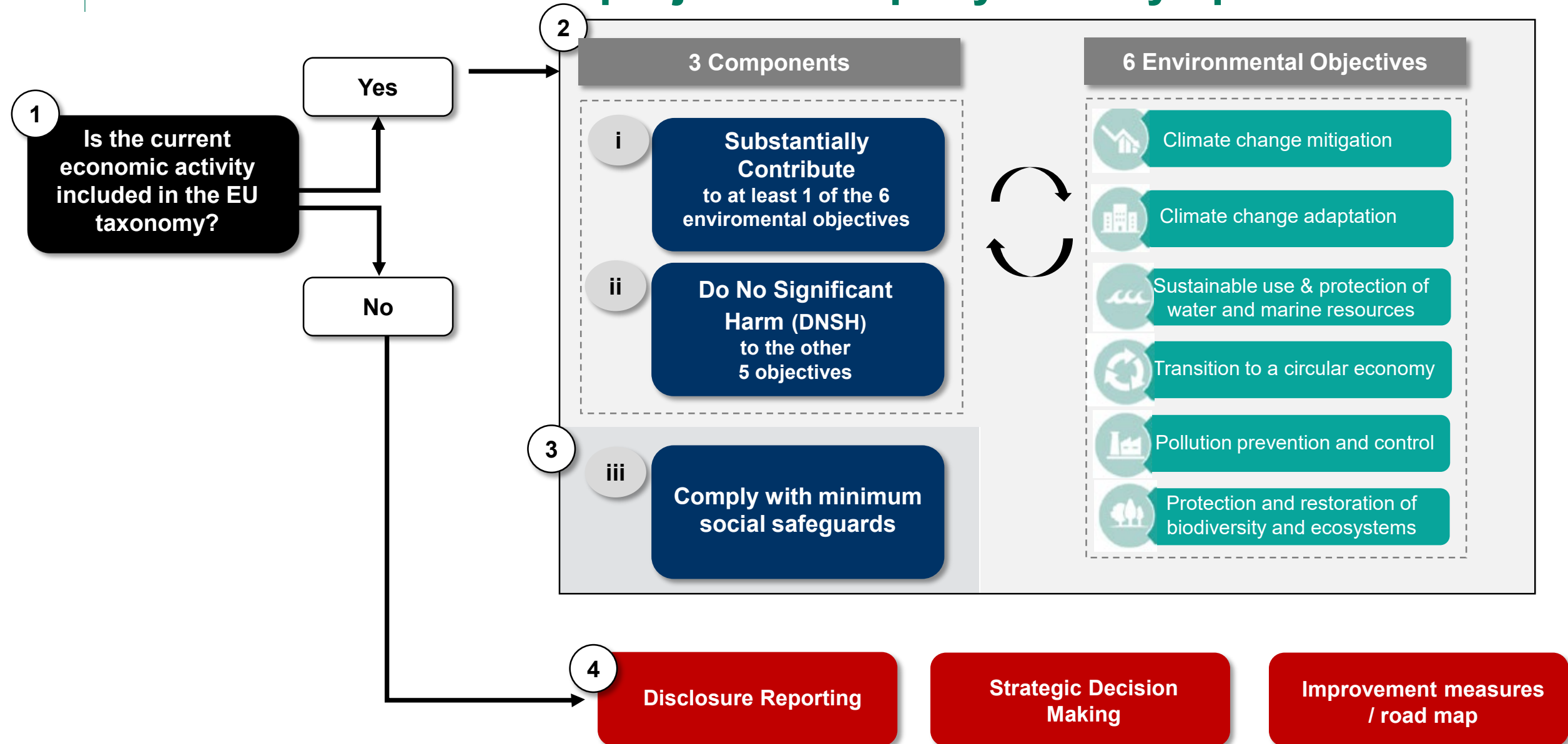
Companies are:

- **therefore required to give company-level disclosures on the proportion of turnover** aligned with the Taxonomy as well as on **capital expenditure (CapEx)** and, if relevant, **operational expenditure (OpEx)** aligned with the Taxonomy
- **expected to have conducted thorough due diligence** on the operations related to those activities that they wish to qualify as Taxonomy-aligned

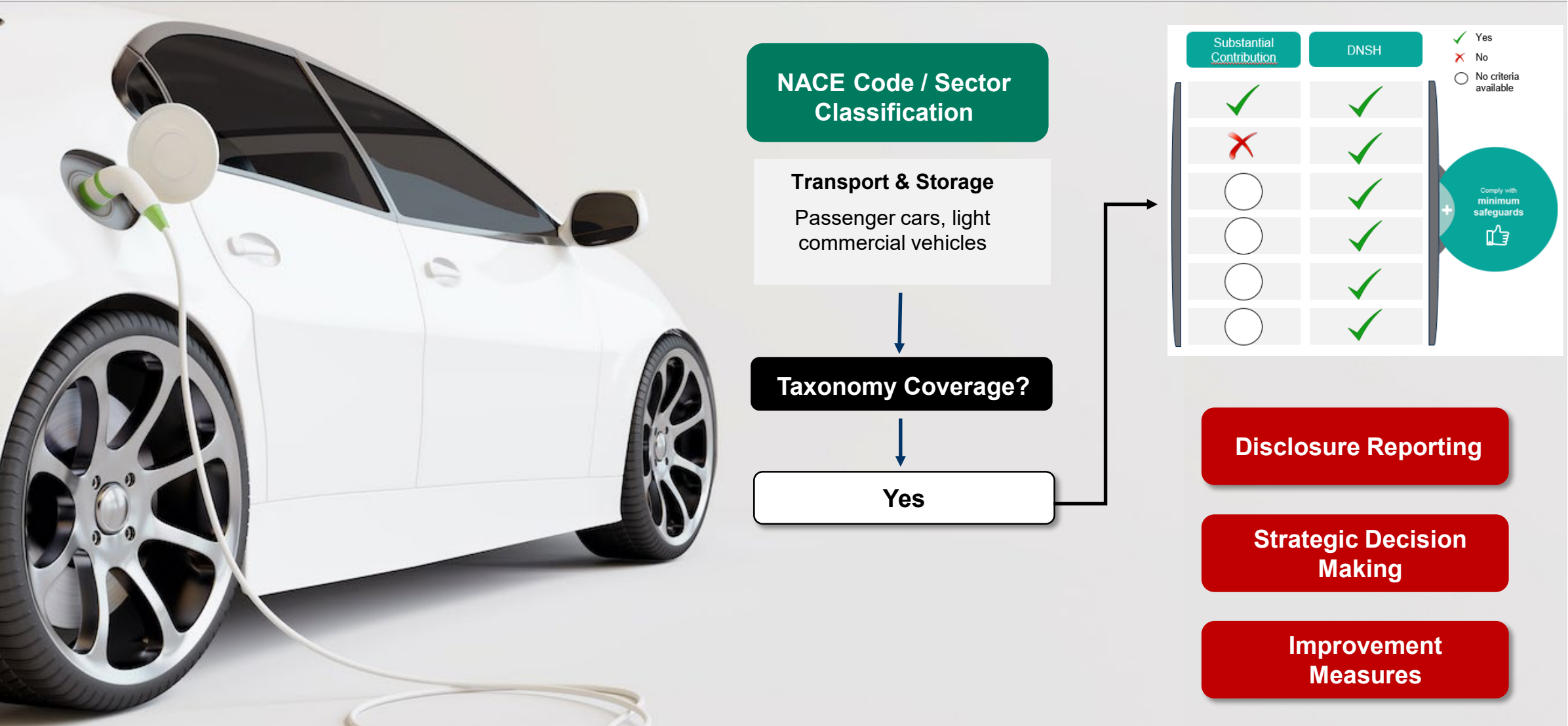
Further Considerations:

- *The disclosure should be made as **part of the non-financial statement**, which may be located in annual reporting or in a dedicated sustainability report.*
- *It is recommended that companies complete the Taxonomy calculation **separately for each of the environmental objectives** for which substantial contribution technical screening criteria have been developed **and social safeguards**. This means that it should be completed separately for climate change mitigation and adaptation from 2021 and for all six environmental objectives for 2022.*
- *This is to provide **transparency** around which environmental objectives are being pursued.*
- *The Taxonomy disclosure obligations encourage the **reporting of progress towards meeting the screening criteria** as well as **reporting on their achievement**.*
- *The Taxonomy Regulation **does not explicitly require any formal verification of Taxonomy-related disclosures**, but does consider it **good practice** to seek **external assurance** on their Taxonomy-related disclosures.*

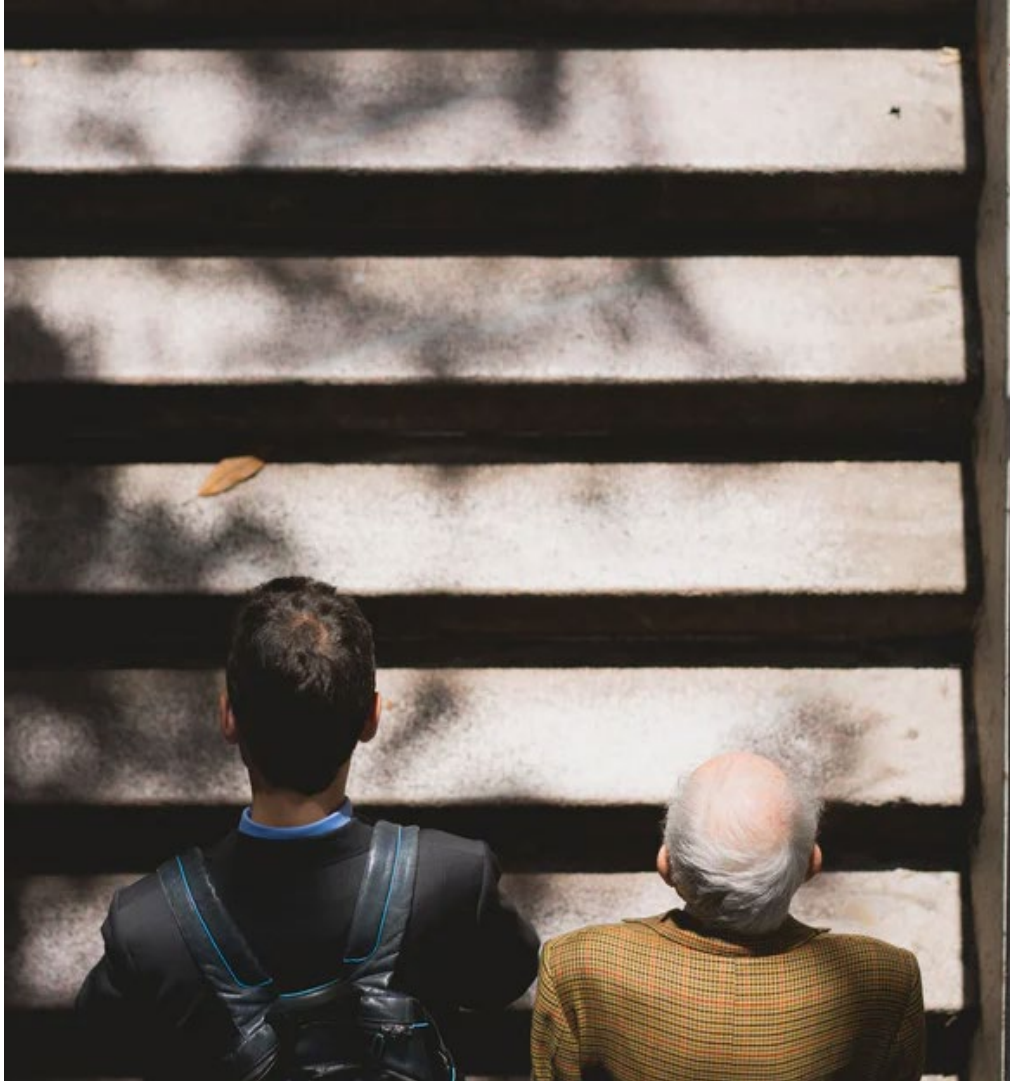
How do we evaluate a project / company activity / portfolio?



Case Study: Vehicle Manufacturer (20% of revenue from electric car production)



What are others doing?



4

Develop Strategic Response(s)

3

Identify Opportunities

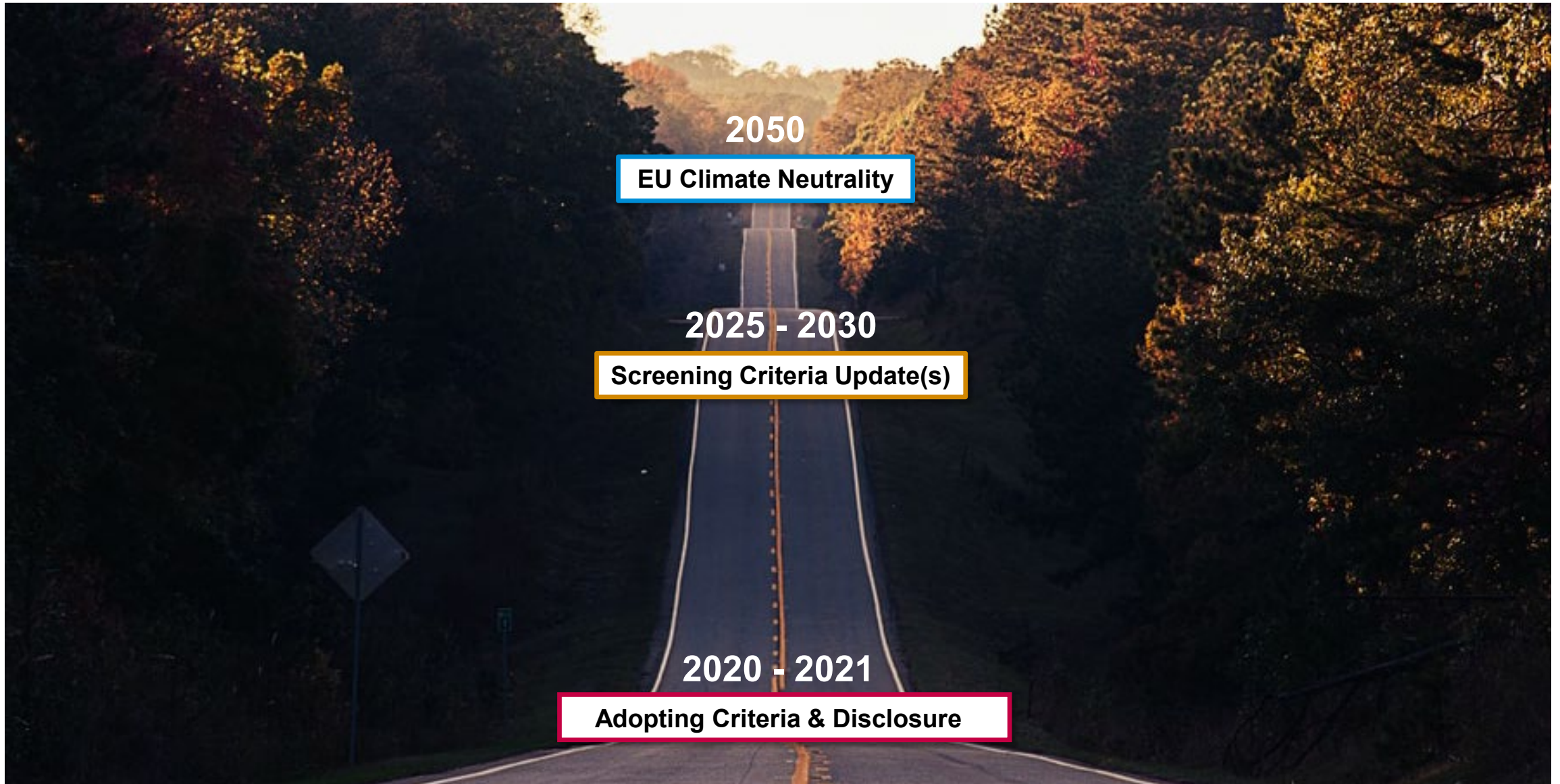
2

Manage Risks

1

Analyse

Future outlook



In Summary:

Key considerations when factoring ESG disclosures in your business

- It is complex, start sooner than later
- There is risk of non-compliance and liability
- All disclosure schemes are looking at similar areas, build on your previous efforts

It is important to:

- Continuously improve transparency and reporting
- Simplify: set-up easy to implement processes
- Work on data consistency across your industry
- Take action and improve performance





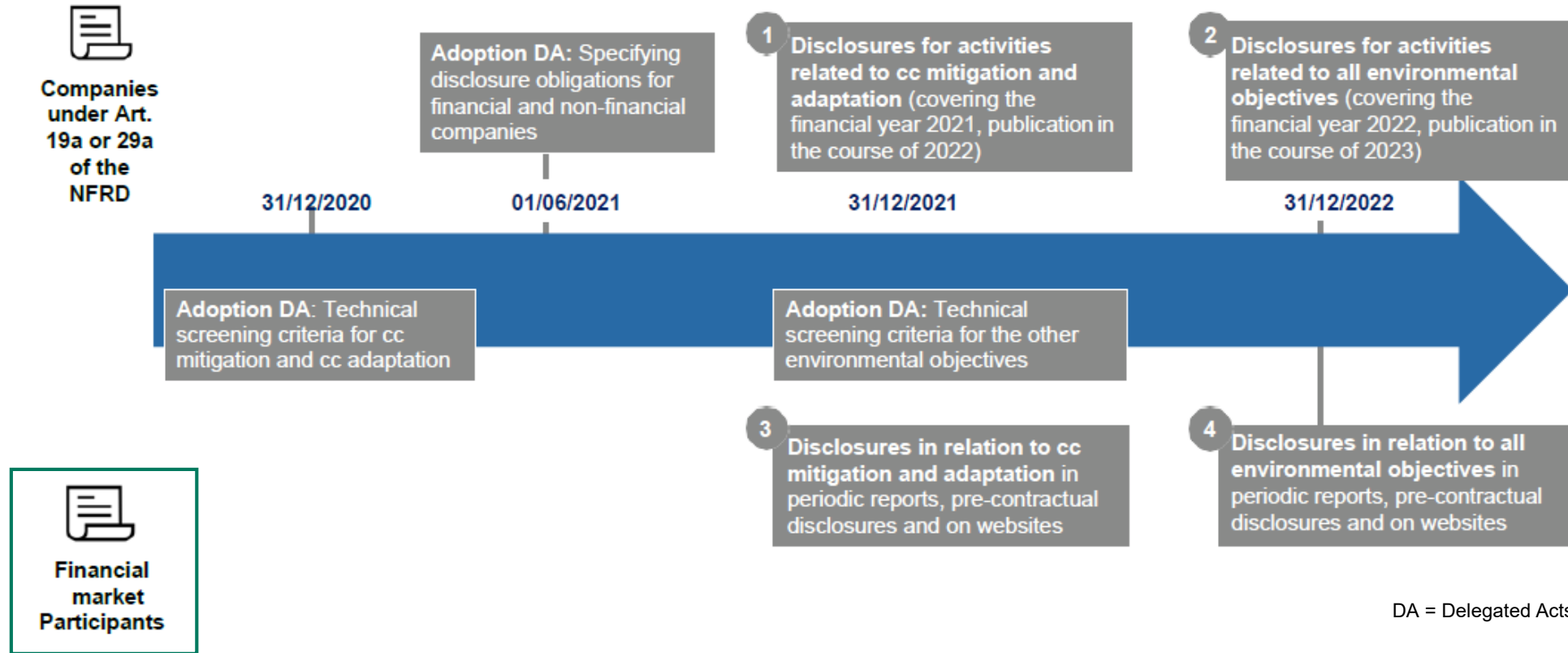
Q & A

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ANNEX

EU Taxonomy Timing



Financial products with Taxonomy disclosure obligations:

- Pensions and Asset Management: UCITS funds (equity funds, exchange-traded funds / ETFs, bond funds); Alternative Investment Funds / AIFs (fund of funds, real estate funds, private equity of SME loan funds, venture capital funds, infrastructure funds); Portfolio management under Article 4.1 of MiFID II; Pensions (pension products, pension schemes defined with reference to IORP II, pan-European personal pension products)
- Insurance-based investment products (IBIPs)
- Corporate and Investment Banking: Securitization funds, venture capital and private equity funds, portfolio management, index funds

The EU Taxonomy is one of the main emerging initiatives

The International Platform on Sustainable Finance

USA

(SEC) Securities and Exchange Commission

European Union

The EU Taxonomy

United Kingdom

- Green Finance Strategy
- Financial Conduct Climate Financial Risk Forum

China

- China's Green Bond Endorsed Project Catalogue
- Green Industry Guiding Catalogue

Singapore

Green Finance Initiative

Australia

Sustainable Finance Initiative

Other Global Initiatives:

- Principles for Responsible Investing (PRI)
- Task Force on Climate-related Financial Disclosures (TCFD)
- United Nations Environment Programme Finance Initiative (UNEP FI)
- Sustainable Banking Network
- The Network for Greening the Financial System

Project: development of an EU Taxonomy alignment evaluation tool

The Brief: We supported a leading Italian bank by developing an **EU Taxonomy Guidance alignment evaluation tool** to screen non-SME corporate exposures and evaluate their alignment with respect the EU Taxonomy.

Client's needs: evaluation of the alignment to the EU Taxonomy criteria for approximately 5,000 non-SME corporate clients.

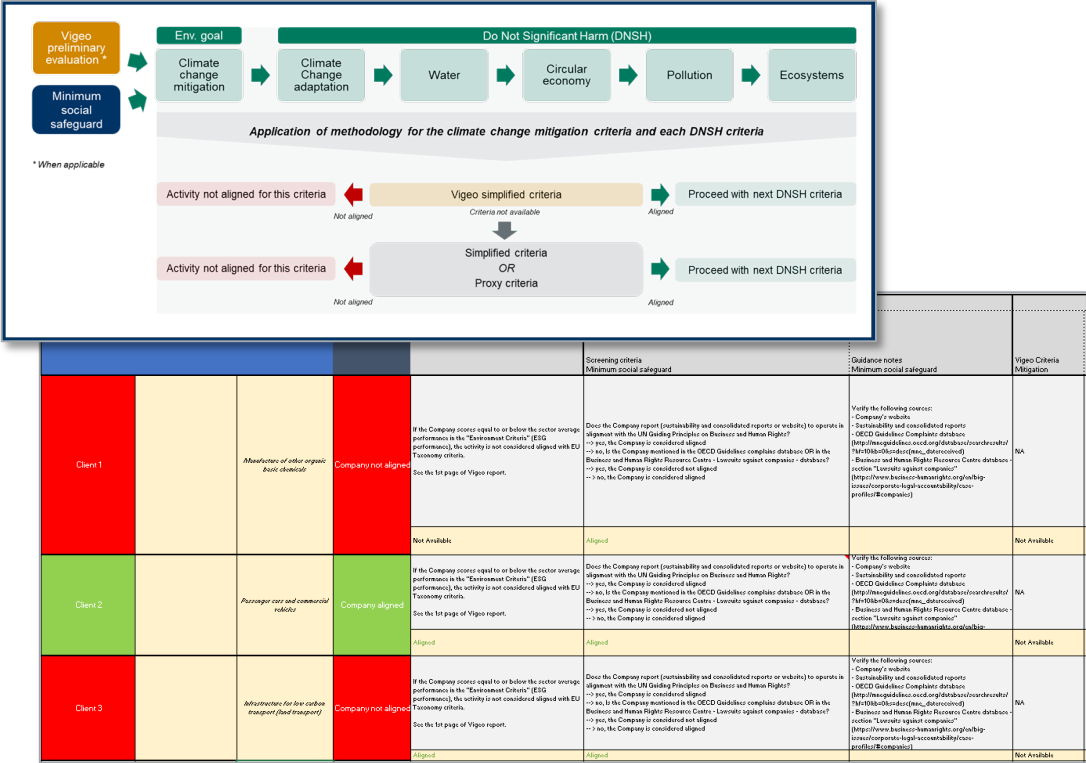
Services delivered:

- **Diagnosis phase:** Development of an approach to adapt the EU Taxonomy Criteria to available information, taking into consideration the large portfolio to be screened and the client's resources availability.
- **Implementation phase:** Development of a methodology and a tool aligned to the EU Taxonomy, consisting in an excel file that provides, for each Taxonomy activity and criteria (mitigation and DNSH) simplified and proxy criteria to be verified based on easy to access information.

Outcomes:

- Simple, while consistent, approach and tool to verify the alignment of a large portfolio (thousands of companies) to the criteria of the EU Taxonomy.

Bank (confidential)



Project: EU Taxonomy Awareness Workshop & Assessment Methodology

The Brief: We supported the Client in increasing the investment team familiarity with the EU Taxonomy and with the potential implications this may have on investments.

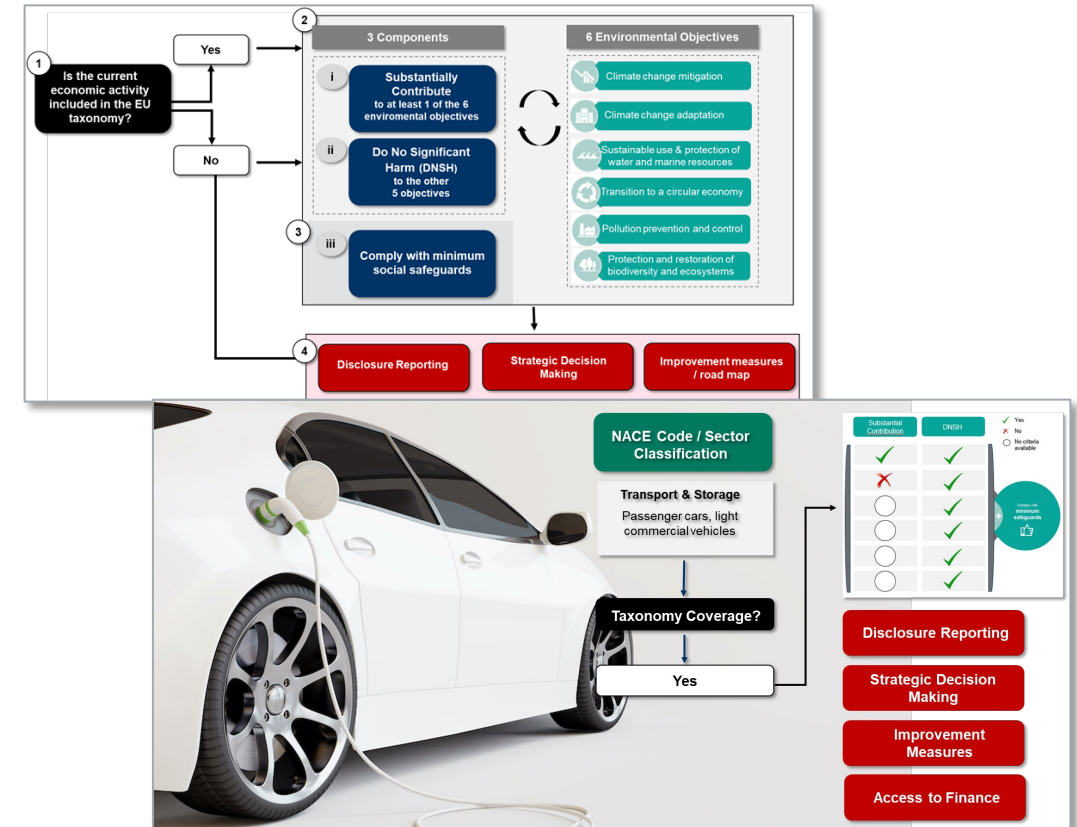
Services delivered:

- Taxonomy alignment assessment of three case studies based on three current client investments (PE, Real Estate and Infra) to showcase how the EU Taxonomy could impact the investment selection process.
- Development of a decision tree adopting the EU Taxonomy methodology for the investment team to check the relevance of the EU Taxonomy for an investment target at the early stages of the investment decision.
- Leading of an internal roundtable workshop.

Outcomes:

- Early decision-making tool to assess implication of EU Taxonomy classification on investments

Private equity (confidential)



Project: EU Taxonomy Assessment of a Private Equity (PE) portfolio

The Brief: We supported a PE fund in assessing Portfolio Companies (PCs) against the EU Taxonomy criteria.

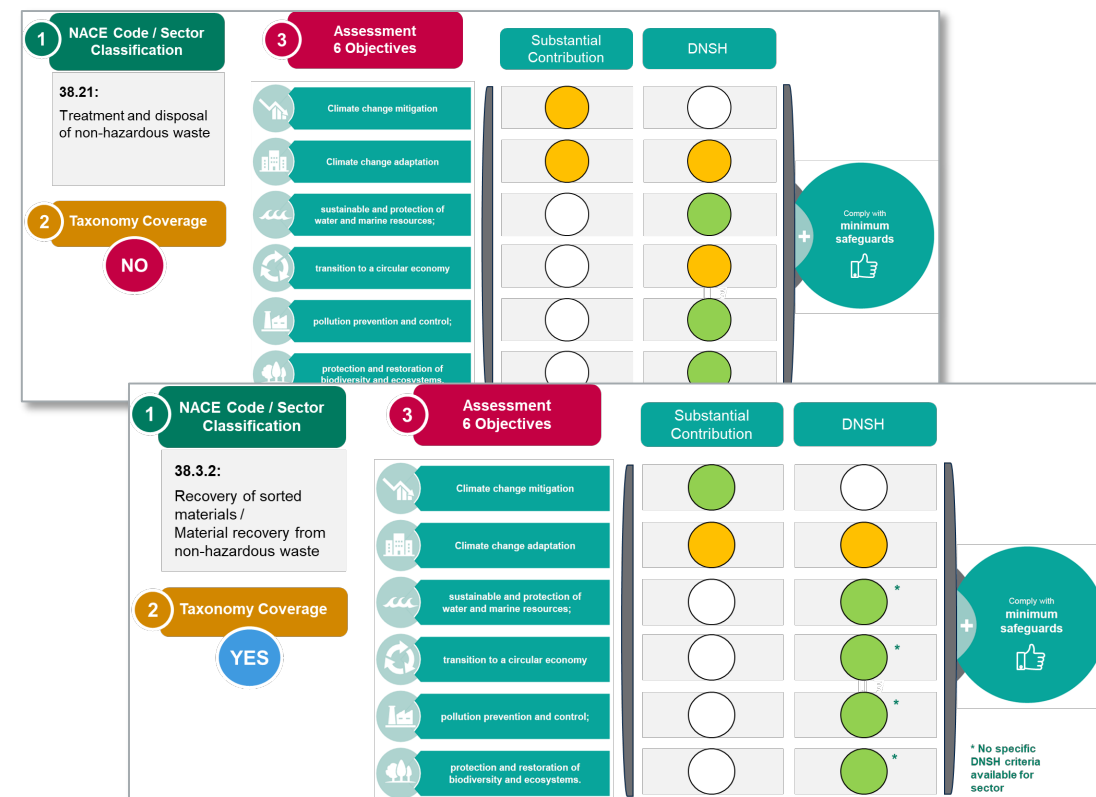
Services delivered:

- Identification of Portfolio Companies covered by the EU Taxonomy;
- Analysis of available information for each PCs (e.g. Sustainability Report, Company Website and available environmental/ESG due diligence reports) and technical assessment with respect the EU Taxonomy criteria, where applicable.
- For the PCs not covered by the EU Taxonomy, ERM performed a qualitative assessment based on industry trends and standards with respect to the six Taxonomy environmental objectives.

Outcomes:

- PCs assessment against EU Taxonomy criteria and PE fund percentage of investments eligible as “green” according with the EU Taxonomy.

Private equity (confidential)





Thank you

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