ROADMAP TO MANAGING THE TRANSITION TO SUSTAINABLE FINANCE – KEY PRINCIPLES

2021

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DEFINITION OF SUSTAINABLE FINANCE

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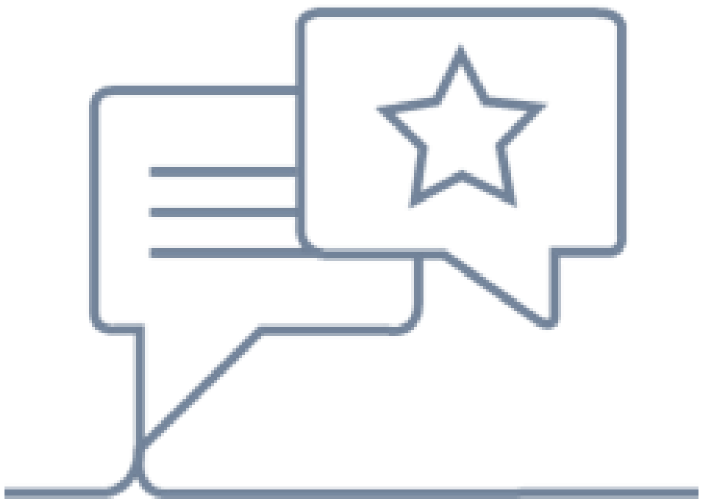
Principle 1: Sustainable finance is an umbrella term which is used to capture a wide range of activities. It is therefore important for firms to ensure that they have set, and are using, clearly defined terminology in this respect which is understood and used consistently across the organisation.

Firms will need to consider what "sustainable finance" means to them, as this will depend on their business model, risk appetite and other broader considerations. Relying on an external definition is unlikely in itself to be sufficient although firms must be mindful that a number of new EU regulations include terminology in relation to sustainable finance which must be embedded within a firm's framework for specific product types and applied consistently against the firm's own objectives (e.g. Taxonomy Regulation, Disclosure Regulation, MiFID II, Low Carbon Benchmarks Regulation).



In this context firms may wish to consider:

- Which aspects of the sustainable finance agenda are relevant to your firm and how do you categorise and define these, in particular, taking into account the evolving definitions contained within changes in EU Regulation.
- How do you ensure that your process allows for the definitions of sustainable finance to adapt over time as regulation evolves.
- What steps have you taken to ensure that your clients and stakeholders have a clear understanding of sustainable finance related terminology used in your literature.
- What action have you taken to ensure that staff have a consistent understanding of these terms and the wider corporate purpose that they feed into.

CORPORATE PURPOSE AND BUSINESS STRATEGY

Principle 2: A "one firm" approach, based on a central corporate purpose and business strategy, will ensure that sustainable finance is implemented, embedded and forms part of ongoing business as usual processes in a consistent and sustainable manner.

A strong and well embedded corporate purpose and business strategy is also essential to avoid conflicts across a firm in relation to its approach to sustainable finance, particularly for large organisations with multiple business divisions.

A firm's corporate purpose and business strategy should be mindful to take into account the numerous data points which articulate its performance in the context of a sustainability transition and which the firm's performance will often be judged on by both regulators and third parties utilising the innovative due diligence tools[1] available in the market. Such data points include:

Strong leadership around corporate purpose.

- Group business strategy – parent & subsidiary management.
- Carbon footprint analysis.
- Culture & governance analysis.
- Systemic risk management.
- Diversity & gender pay analysis.
- Non-financial misconduct & whistleblowing profile.
- AML & financial crime status.
- Anti-bribery & corruption status.
- Data & cyber resilience profile.
- Tax transparency profile.
- Supply chain due diligence.
- Compensation & benefits practices.
- Selling practices & product labelling.

In this context firms may wish to consider:

- Whether the firm has a documented corporate business strategy in relation to sustainable finance which includes a clear corporate purpose to achieve that transition.
- How expectations among stakeholders will be actively identified in relation to sustainable finance.
- Where responsibility for defining the firm's corporate purpose and business strategy in relation to sustainable finance will sit (see "Oversight" below).
- What the specific sustainability objectives identified for the firm are and how the firm should prioritise between them.
- How the impact of sustainability related risks on the business environment in which the firm operates are assessed and factored into strategic and business decisions on an ongoing basis.
- How the firm communicates its purpose and strategy in relation to sustainability both internally and externally (including to regulators in particular where regulatory business plans are adapting).
- How alignment will be achieved at the strategic level between different business areas and divisions in order to manage potential conflicts in the approach to sustainability within the firm[2] (noting that the independence of the different business areas needs to be maintained).
- The frequency and audience for the sharing of management information on the performance of the firm in light of its corporate purpose.

[1] For example, Risk Horizon, Sustainalytics and Eco Vadis.
[2] For example, an investment bank with an asset management arm may wish to consider how it will ensure that the activities of the investment bank do not conflict with the principles set out in the stewardship policy for the asset management business.

OVERSIGHT

Principle 3: The overarching strategy will be overseen by senior management (typically the board). A number of teams in banks (e.g. compliance, legal, conduct, business management, finance, risk, first line business areas, stakeholder management) will be responsible for ensuring that there is effective oversight of the transition and it is therefore important for firms to ensure that there is a clear allocation of roles and responsibilities in this respect.

Clear and well-defined lines of oversight are central to ensure that a firm's corporate purpose and objectives in relation to sustainable finance are consistently embedded throughout the organisation.

In this context firms may wish to consider:

- Whether the board has clear roles and responsibilities within itself and its relevant sub-committees in managing the risks and opportunities from sustainable finance.
- How to ensure that the board understands and is able to assess the requirements, risks and opportunities arising from sustainable finance transition that affect the firm.
- Where adequately taking into account sustainable finance considerations in making decisions may be a fiduciary obligation of a board director, an institutional investor and/or a pension fund trustee.[3]
- Whether a new board sub-committee or task force is required in relation to sustainable finance.
- How the board will ensure adequate sharing of information between committees.
- How to demonstrate an understanding of the need for a sufficiently long-term view of the risks that can arise beyond standard business planning horizons, together with the application of adequate resource to exercise effective oversight.
- The relevant internal governance committees impacted by sustainable finance initiatives.
- How responsibility for the management of sustainable finance related risks will be assigned in line with the firm's organisational structure and the three lines of defence model.[4]
- Use of a responsibilities map and statements of responsibility for each function to clearly define the roles and responsibilities in relation to the transition to sustainable finance and to ensure that these are clearly allocated and the relevant reporting lines mapped across all three lines of defence.

[3] See, for example, the joint final report between the UN PFI and UN PRI "Fiduciary Duty in the 21st Century", https://www.unepfi.org/wordpress/wp-content/uploads/2019/10/Fiduciary-duty-21st-century-final-report.pdf.

[4] Consider whether your firm is in scope of UK rules requiring firms to identify and allocate responsibility for identifying and managing risks from sustainable finance to the relevant existing Senior Management Function (SMF) most appropriate within the firm's organisational structure and risk profile, and ensure that these responsibilities are included in the SMF's Statement of Responsibilities. See PRA Policy Statement 11/19 "Enhancing banks' and insurers' approaches to managing the financial risks from climate change", https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2019/ps1119.pdf?la=en&hash=CD95D958ECD437140A4C7CF94337DAFD8AD962DE.This requirement applied to banks and insurers from 15 October 2019. Note that the UK Climate Financial Risk Forum recommend that a maximum of two SMFs perform this function.

EXTERNAL ENGAGEMENT

Principle 4: Firms must be prepared for an increasingly activist approach amongst their shareholders and clients (in addition to the media) as well as increasing engagement from regulators which will necessitate appropriate resource being applied to collecting information on the progress towards sustainable finance and coordinating disclosures across the global group (see further **Principle 8** – *Disclosure Risk* below).

In this context firms may wish to consider:

- The risks and opportunities of engaging with certain clients and sectors and how these are assessed in relation to the transactions that are entered into with both existing and new clients.
- The approach to and benefits of supporting clients with their own transition to sustainable finance and how this can be achieved consistently across the firm and its client base.
- A regulatory engagement policy in relation to the transition to sustainable finance, including active engagement with regulators and how regulatory requests for information will be dealt with in a timely and consistent way across jurisdictions.
- How to ensure that the investor relations team is fully connected with the relevant information flows on the sustainability strategy and progress against targets.

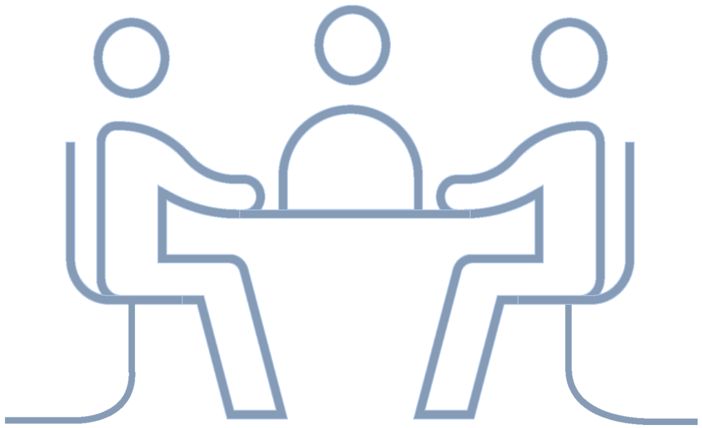
TRAINING

Principle 5: Training should cover the firm's corporate purpose and objectives in relation to sustainable finance, the emerging legal and operational risks and opportunities associated with the transition and the changes impacting the activities of each business line.

Training is a central element of the embedding process and therefore firms should consider how sustainable finance considerations will be built into training on an ongoing basis as well as an initial awareness raising exercise.

In this context firms may wish to consider:

- The initial and ongoing training requirements across the firm in relation to sustainable finance.
- Which staff populations are impacted by the transition to sustainable finance and their specific training needs in this context.
- How consistency of messaging will be ensured across all training materials.
- How ongoing learnings from the transition to sustainable finance will be consistently communicated to staff.



ENTERPRISE RISK MANAGEMENT FRAMEWORK

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Principle 6: Enterprise risk management frameworks will need to capture the risks emerging as a result of the transition to sustainable finance.

Sustainable finance risks should be considered and documented within existing enterprise risk management frameworks, alongside other risks[5].

In this context firms may wish to consider:

- How to ensure that the board or management body consider sustainability related risks when developing the firm's overall risk management framework.
- How to identify, prioritise, measure, monitor, manage, and report on exposure to these risks in a manner proportionate to your business (including what external input, if any, may be required).
- How this risk management process will be evidenced in written risk management policies, management information, and board risk reports.
- How sustainability related risks will be embedded within or linked to established risk categories.
- Introducing a risk appetite statement embedding sustainability related risks, including metrics to be used in monitoring the risk levels. Consider including the risk exposure limits and thresholds for the risks that the firm is willing to bear, taking into account factors such as: (i) the short- and long-term interests of the firm, and how decisions today affect future risks; (ii) results of stress and scenario testing, for shorter (e.g. 0 – 10 years) and longer (e.g. 10 – 30 years) time horizons; (iii) the fact that ongoing risks may continue to materialise and crystallise; and (iv) sensitivity of the balance sheet to changes in key risk drivers and external conditions.
- How the risk tolerance and management will be aligned with the firm's overall sustainability strategy and how risk performance metrics will drive changes in strategy.
- Channels of engagement between risk functions and internal and external stakeholders to understand emerging sustainable finance trends.
- Distinguishing between macro group level risks and subsidiary risks.
- How sustainability related risks could have an adverse impact on business continuity.

[5] Given the unique impacts and dependencies of sustainable finance-related risks, COSO and WBCSD have partnered to develop guidance to help entities better understand the full spectrum of these risks and to manage and disclose them effectively: https://www.wbcsd.org/Programs/Redefining-Value/Business-Decision-Making/Enterprise-Risk-Management/Resources/Applying-Enterprise-Risk-Management-to-Environmental-Social-and-Governance-related-Risks

FINANCIAL RISK

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Principle 7: Firms must be strategic in considering the far-reaching breadth and magnitude of the financial risks associated with sustainable finance transition, relevant to multiple lines of business, sectors, and geographies.

Firms should consider how they will demonstrate that they understand the financial risks relevant to sustainable finance transition and how these will affect their business model. Firms may consider using scenario analysis and stress testing to inform the risk identification process and understand the short- and long-term financial risks to their business model.

In this context firms may wish to consider:

- How to measure, monitor, manage and mitigate the financial risks relevant to sustainable finance in line with the firm's risk appetite statement. This may need to be done across asset type, business line and sector.
- Inclusion as part of the Internal Capital Adequacy Assessment Process (ICAAP) or Own Risk and Solvency Assessment (ORSA) of: (i) all material exposures relating to the financial risks from climate change; and (ii) an assessment of how firms have determined the material exposure(s) in the context of their business.
- Financial risks from climate change arise in the form of "physical"[6] and "transition"[7] risk. These manifest, for example, as increasing underwriting, reserving, credit, operational or market risk for firms. In this context firms may wish to consider how scenario analysis may be used to address a range of outcomes relating to different transition paths, and a path where no transition occurs. Firms may consider using these scenarios to understand the impact of the financial risks associated with the transition to sustainable finance on their solvency and liquidity. Where a firm relies on management actions to mitigate the financial risks from a scenario, it should consider whether these are realistic, credible, consistent with regulatory expectations, and achievable.
- How the results of financial risk scenarios need to be mapped to other sustainable finance work streams, including: performance against business plan; disclosures in relation to corporate strategy and services; the firm's market positions; regulatory capital assessments; product approval processes; and investment activities.

[6] Physical risks from climate change arise from a number of factors, and relate to specific weather events (such as heatwaves, floods, wildfires and storms) and longer-term shifts in the climate (such as changes in precipitation, extreme weather variability, sea level rise, and rising mean temperatures). Increasing frequency and severity or volatility of extreme weather events including flooding leading to physical damage to the value of financial assets or collateral held by banks, leading to increased credit risk.
[7] Transition risks can arise from the process of adjustment towards a low-carbon economy. A range of factors influence this adjustment, including: climate-related developments in policy and regulation, the emergence of disruptive technology or business models, shifting sentiment and societal preferences, or evolving evidence, frameworks and legal interpretations.

DISCLOSURE RISK

Principle 8: Firms are required to make ESG related disclosures both in relation to their corporate purpose and across their regulated activities, services and product types. Firms should ensure that their reporting on their progress against or compliance with sustainable objectives is grounded in the voluntary codes or new laws and regulations governing such disclosures.

In this context firms may wish to consider:

- Mapping all required disclosures relevant to the group and the entities sitting within it.
- Identify areas where industry standard template disclosures are available and appropriate for use.
- Consider the frequency of updates needed in relation to disclosures and embed a process for refreshing disclosures within the control framework.
- Identifying areas where they may be at risk of conflicting disclosures and develop heightened monitoring around such areas.
- Identifying areas where the firm is exposed due to available data or uncertainty in disclosure standards and consider ways to ensure that the language of disclosures makes any related statements on accuracy.
- Consider whether a phased implementation approach to disclosures may be appropriate – for example, to align with the progress of a firm's broader strategy on the transition to sustainable finance and the integrity of data available during certain time periods.
- The tools available to the firm to validate the accuracy of the information disclosed. To the extent such tools are relied upon, consider the control framework in place to ensure the initial and ongoing integrity of the tool.
- Consider whether independent auditing of ESG disclosures may be relevant (treating this information like financial disclosures) (see also **Principle 15** – *Effective Impact Measurement*).
- Engaging legal and litigation functions to track emerging trends in misstatement litigation. How the independence of the individual corporate entities within the group will be maintained in light of the potential liability of the parent company for the implementation and management of ESG matters across the whole group.[8]
- How to acknowledge and address the needs of different audiences and different disclosure types and methods.

[8] For example, the UK Supreme Court has indicated that transnational class action litigation claims may be made against parent companies in respect of ESG-related complaints, where those parent companies assume responsibility for the management of ESG matters. The Court upheld jurisdiction over a UK domiciled parent company in litigation brought by those living in the vicinity of the overseas mining operations of a joint venture subsidiary. Jurisdiction was based in large part on the parent's active role in the overseas investment, as confirmed by statements in its public ESG-related statements, sustainability literature, and the ESG arrangements the parent company had in place with certain subsidiaries (Vedanta Resources v. Lungowe & Ors 2019 UKSC 20). It is expected that a similar case will be heard at the Supreme Court later this year.

CONDUCT RISK

Principle 9: The critical nature of global firms achieving a sustainable transition for their own economic performance combined with increasingly urgent client demand for sustainable investment types raises enhanced conduct risks in the context of individual behaviour within firms, including where the achievement of sustainable objectives are embedded within remuneration policies, which need to be identified and managed.

A key part of firms' implementation and embedding strategy should include the incorporation of ESG considerations within their conduct risk framework. Firms may wish to incorporate within this process a consideration of the key performance indicators, management information and other data that they require to effectively manage and monitor these risks on an ongoing basis as part of their wider governance processes.

Whilst the conduct risks relevant to the transition to sustainable finance will vary between firms, there are a number of key cross-cutting themes that firms may find useful to keep in mind when embedding ESG within their conduct risk framework:

- *Incentive risk:* As firms embed the achievement of sustainability targets within their remuneration frameworks, individuals will naturally be incentivised to achieve the formal metrics. It will be important to manage any risk of associated poor behaviour that may arise.

- *Information asymmetries:* Information asymmetries are seen by regulators as a central driver of poor outcomes for end investors. The quality of publicly available data pertaining to sustainable finance is evolving. Firms must be mindful of the heightened risk of inconsistent disclosure levels and access to data resulting in inequalities in the market which have the potential to disadvantage investors. Firms should therefore ensure that potential information asymmetries in the sustainable finance space are identified as a conduct risk to ensure that these are mapped and addressed consistently across the entire business taking into account the different roles that the firm may play in the lifecycle of a particular product or service.

- *Inconsistent, unreliable or insufficient sustainable finance related disclosures by third parties:* Each firm should consider the extent to which its own sustainability transition is reliant on consuming information and services from third-party service providers (for example, in the context of investment research or reliance on third-party benchmarks). Inconsistent, unreliable or insufficient sustainable finance related disclosures may result in assets being mispriced because the market is unable to determine their true value, or may result in consumers taking decisions based on misleading information.

- *Greenwashing:* Whilst common definitions and standards are being developed, during the transition to a uniform taxonomy it is not always clear what firms or consumers mean by or expect from "green" or "sustainable" products and services. This creates that risk that consumers suffer harm from "greenwashing" – marketing that portrays an organisation's products, activities or policies as producing positive environmental outcomes when this is not the case. If investors and end consumers do not receive the appropriate information and advice to understand whether a product they are offered is genuinely green or sustainable, there is a risk that they purchase unsuitable products. In addition, any misleading communications also create a potential mis-selling risk. Accordingly, firms need to consider this as part of their wider conduct risk framework to ensure that a clear standard is being maintained on a uniform basis across the organisation. (See also **Principle 1** – *Definition of Sustainable Finance*).

CONDUCT RISK (CONTINUED)

Principle 9: The critical nature of global firms achieving a sustainable transition for their own economic performance combined with increasingly urgent client demand for sustainable investment types raises enhanced conduct risks in the context of individual behaviour within firms, including where the achievement of sustainable objectives are embedded within remuneration policies, which need to be identified and managed.

Firms may wish to consider the following voluntary indications of good practice in this context:

- What proactive steps do you take as a firm to identify the conduct risks inherent within the transition to sustainability.
- How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the transition to sustainable finance.
- What support (broadly defined) does the firm put in place to enable those who work for it to meet the sustainability objectives set.
- How do the board and executive committee (or appropriate senior management) gain oversight of the conduct of the transition within their organisation, and equally importantly, how do they consider the conduct implications of the strategic decisions that they make.
- Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to transition to sustainable finance.
- Consider a framework to allow for the effective and consistent initial and ongoing diligence of third-party information sources.

MIS-SELLING RISKS

Principle 10: A key risk of the increasing investor demand for sustainable investments is the risk of products being labelled as "sustainable" without adequate due diligence on the underlying objective of the product or the client. Firms should manage the risk of misrepresenting the sustainability outcomes of investment products and services, or failing to align these outcomes with the objectives of their clients.

In this context firms may wish to consider the controls that they have in place to manage:

- The articulation of the firm's intention behind key sustainability terms and definitions used in client communications.
- Ensuring that staff at all levels of the product development and distribution lifecycle (including third-party distributors) are trained in the concept of sustainable investments.
- The mis-selling risks that may arise if a sustainable finance consideration takes precedence over a client's personal investment objective and the necessary differentiation between investment objectives on the one hand and sustainable finance preferences on the other hand.
- The mis-selling risks that arise if clients receive misleading communications or information (including "greenwashing") which leads them to purchase unsuitable products or services.
- Incentives to staff which could result in a potential mis-selling risk (for example, by selling own-products or more costly ones, by generating unnecessary churning of clients' portfolios or by firms misrepresenting products or strategies as fulfilling ESG preferences where they do not).

ANTITRUST RISK

Principle 11: Firms should keep under review a growing policy consensus that antitrust could be a powerful, complementary legal tool to promote improved sustainability practice. In particular, firms should track regulatory developments and cases linking greenwashing allegations to an abuse of dominance, as well as tracking horizontal cooperation guidance.[9]

In this context firms may wish to consider the controls that they have in place to:

- Manage and monitor developments in global antitrust agency practice and guidance closely in order to track opportunities for progressive commercial policies that could arise as the legal framework evolves.
- Manage transition plans which embed antitrust considerations.
- Identify and manage the conflicts inherent within the transition to sustainable finance including where compliance with public policy and market standards may lead to potential discrimination against certain companies, industries or sectors or may negatively impact emerging market development. In particular, firms may wish to consider alignment with evolving guidance on horizontal cooperation and the importance of transparency in managing risk in this area.

[9] For example, the Italian antitrust agency recently characterised alleged "greenwashing" practices as an abuse of dominance within the meaning of national antitrust rules on the basis that greenwashing can significantly impact the choices made by consumers. The European Commission is examining whether established guidance on horizontal cooperation agreements should be updated to facilitate business cooperation on sustainable business practices and collective bargaining by (independent) "gig economy" workers.

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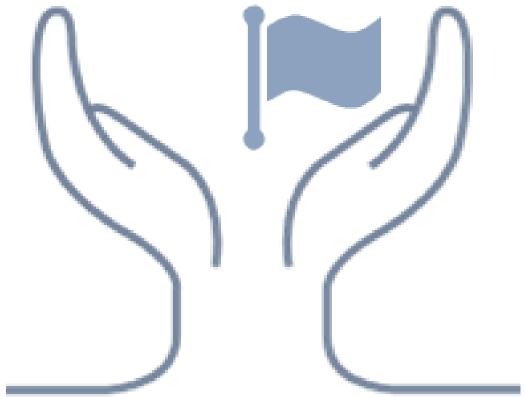
COUNTERPARTY RISK

Principle 12: Firms need to be cognisant of the potential risks resulting from the transition to sustainable finance by their counterparties as well as their third-party service providers.

In this context firms may wish to consider:

- Mapping the areas where the transition to sustainable finance by counterparties and/or third-party service providers has potential to impact the firm's own progress positively and negatively.
- Embedding sustainability and ESG due diligence within all external vendor / service provider / wider supply chains in on-boarding/review programmes.
- Regulatory developments concerning a firm's obligations with respect to its supply chain such as the Modern Slavery Act 2015 in the UK, the French Law on the Duty of Vigilance for Parent and Sub-Contracting Companies, and the Swiss Responsible Business Initiative.
- Enhanced KPIs from relevant stakeholders whose own sustainability status impact the achievement of the firm's own objectives and whether there may be any concentration risk.
- Data credibility where data from third-party data providers is relied upon, including appropriate due diligence when labelling activities as sustainable in such circumstances due to the potential for investors to rely on such statements when making their investment decisions.



COMPLIANCE FRAMEWORK

Principle 13: The transition to sustainable finance will impact firms' existing compliance framework in a number of ways. This is driven, for the most part, by the range of reforms that impact the regulated activities that firms perform.

In this context, firms may wish to consider:

- *Conflicts of interest:* Conflicts of interest may stem from the manufacture and distribution of sustainable investments. Such conflicts could arise where the risk appetite of the firm is not aligned with that of its clients, or the firm is incentivised by certain categories of sustainable investment and not others. Firms may wish to mitigate such conflicts by ensuring that appropriate controls are in place in product design, distribution and remuneration structures. Firms should also consider updates to conflicts maps and conflicts policies on how these risks are identified and managed. In this regard, firms must be particularly mindful of global fragmentation risk.

- *Product governance:* Proposed changes to integrate sustainability risks and factors within the MiFID II framework will impact firms' existing governance processes by requiring them to consider ESG preferences when specifying the types of clients for whose needs, characteristics and objectives the financial instrument is compatible and assigning a target market (something which many firms already do currently).

  The ESG preferences that an investment/product fulfils should be specified with enough granularity to allow them to be meaningfully tracked through the product governance lifestyle. As part of this, distributors should consider the plausibility checks that they are able to undertake to verify whether a product fulfils ESG preferences.

  The general expectation is that a negative target market will not be required in relation to ESG considerations such that firms are not expected to identify products that have a negative impact on these objectives. Generally speaking, this will result in two types of target market: target markets in which certain ESG characteristics are specified and target markets without any reference to ESG characteristics.

  Firms might also consider introducing product level ESG Key Performance Indicators (KPIs). ESG KPIs will need to be: relevant, specific and complete; clear, balanced and understandable; consistent over time; comparable; and reliable, verifiable and objective. ESG KPIs will become increasingly relevant in benchmarking, positioning and valuation.

- *Suitability and appropriateness assessments:* Proposed changes to the MiFID II regime require firms to take sustainability issues into account when advising clients. Firms will have to consider how to incorporate ESG preferences into their suitability assessments (including updating their client questionnaires and when selecting the products to be offered) and explain, in ex-post information disclosures, how the recommendation to the client meets the client's ESG preferences.

- *Client on-boarding/off-boarding:* Firms will need to gather information on their clients' ESG preferences in order to comply with many of the aforementioned obligations. Firms should consider the need to collect ESG preference information from clients at the on-boarding stage. Separately, over time, firms may need to consider whether their sustainability transition and objectives remained aligned with the objectives of their clients.

COMPLIANCE FRAMEWORK (CONTINUED)

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Principle 13: The transition to sustainable finance will impact firms' existing compliance framework in a number of ways. This is driven, for the most part, by the range of reforms that impact the regulated activities that firms perform.

- *Client disclosures:* Firms should anticipate a need for disclosures on how they are operationalising the transition to sustainable finance and the impact that this will have on their client disclosures. In particular, firms may consider disclosures to clients in relation to: (i) how their ESG preferences for each financial instrument are taken into consideration in the selection process used by the firm to recommend financial products/services, and (ii) product-level disclosures on the extent to which ESG objectives are being tracked (e.g. as required under the Benchmark Regulation or Disclosure Regulation for certain types of products).

- *Complaints handling:* As ESG factors receive greater consumer focus this will filter through to the nature and type of complaints that firms receive. In this context, firms may wish to consider whether the complaints handling function is trained and equipped with adequate expertise to manage these complaints but also to identify compliance issues around the firm's sustainability strategy and obligations.

On a broader level, firms may wish to consider the following when monitoring and managing the risks associated with the transition to sustainable finance:

- Consider the key areas (including policies and procedures) impacted and how they should be updated to incorporate sustainable finance factors.

- Determine the key measures and metrics that will be used to monitor adherence to the firm's sustainable finance strategy.

- Consider whether adequate resources and sufficient skills and expertise are devoted to monitoring and ensuring that the transitional steps identified are being implemented and that sustainable finance risks are within the firm's risk appetite.

- Determine the management information that should be provided to the board and relevant sub-committees to enable them to perform this oversight function.

MONITORING

Principle 14: Where appropriate, firms may wish to consider a range of quantitative and qualitative tools and metrics to monitor their exposure in the context of meeting their corporate sustainability strategy as measured against their risk appetite, monitoring that the corporate and product disclosures are accurate on an ongoing basis in addition to monitoring for compliance with new regulatory obligations.

These metrics and tools will evolve and mature over time as firms gain experience.

Keeping pace with change in this area is also an important aspect of managing and embedding the transition to sustainable finance and it is therefore important for firms to ensure that they have a change management framework for tracking new developments and assessing new and emerging risks as part of this process. In turn, it is also important to ensure that roles and responsibilities have been clearly defined and allocated in this regard.

In this context firms may wish to consider:

- How regulatory development monitoring and tracking will be implemented and operationalised as part of the change management process and the allocation of roles and responsibilities in this regard.
- Updates to existing monitoring frameworks to take into account the emerging risks and compliance obligations associated with the transition to sustainable finance.
- Whether adequate resources and sufficient skills and expertise are devoted to monitoring and ensuring that the transitional steps identified are being implemented and that sustainable finance risks are within the firm's risk appetite.
- How to embed new sustainable finance risk monitoring tools within operations.
- The management information that should be provided to the board and relevant sub-committees to enable them to perform this oversight function and to take informed decisions in light of the firm's exposure to sustainability related risks.
- The indicators and targets that will be used to ensure the firm's progress against its sustainability objectives and how it will be ensured that these are specific and measurable.
- Assurance measures, particularly in relation to sustainability reports and disclosures, and how these can be used to track performance against corporate and product level disclosures.

IMPACT MEASUREMENT

Principle 15: Impact measurement is a key part of the transition to sustainable finance to enable firms to assess progress and effectiveness against their defined sustainable finance objectives. This will in turn facilitate and feed into the various sustainability-related disclosures that a firm must make as well as help identify areas for further improvement and development.

Firms will have to conduct this task across business lines and divisions as well as at a holistic level, benchmarking against internal metrics/standards as well as external ones. This process should be viewed as an ongoing one (rather than a one-off) to drive ongoing change.

Firms may wish to consider the following to ensure effective impact measurement:

- Identify internal and external benchmarks against which performance can be tracked and measured. This should include the relevance of the UN Sustainable Development Goals and the availability of data to measure performance against the UN Sustainable Development Goals and other benchmarks.
- Consider sector initiatives associated with assessing the impact of investments, such as Principles for Responsible Banking, the IFC Operating Principles for Impact Management, and Value Balancing alliance.
- The opportunities presented by ESG and sustainability matters (e.g. to strengthen supply chain resilience and identify greater efficiencies).
- Internal and external stakeholder engagement and feedback to determine the effectiveness of strategies and policies.
- Determine frequency and best methods of measuring indicators against key goals and determine whether the data indicates that the desired impact is being achieved. External audits of performance.

INDUSTRY REPORTS

ESG Disclosure Landscape for Banks and Capital Markets in Europe

Latham & Watkins has collaborated with the Association for Financial Markets in Europe (AFME) to produce: The European ESG Disclosure Landscape for Banks and Capital Markets, a new report designed to help financial institutions navigate Europe's increasingly complex ESG reporting landscape.

To access the report please click here.

Governance, conduct and compliance in the transition to sustainable finance

Latham & Watkins have partnered with AFME to develop: Governance, Conduct and Compliance in the Transition to Sustainable Finance, a helpful resource intended as a roadmap to assist readers in establishing and/or furthering their corporate purpose and objectives in relation to sustainable finance.

To access the framework please click here.

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