ESG Disclosure Landscape for Banks and Capital Markets in Europe

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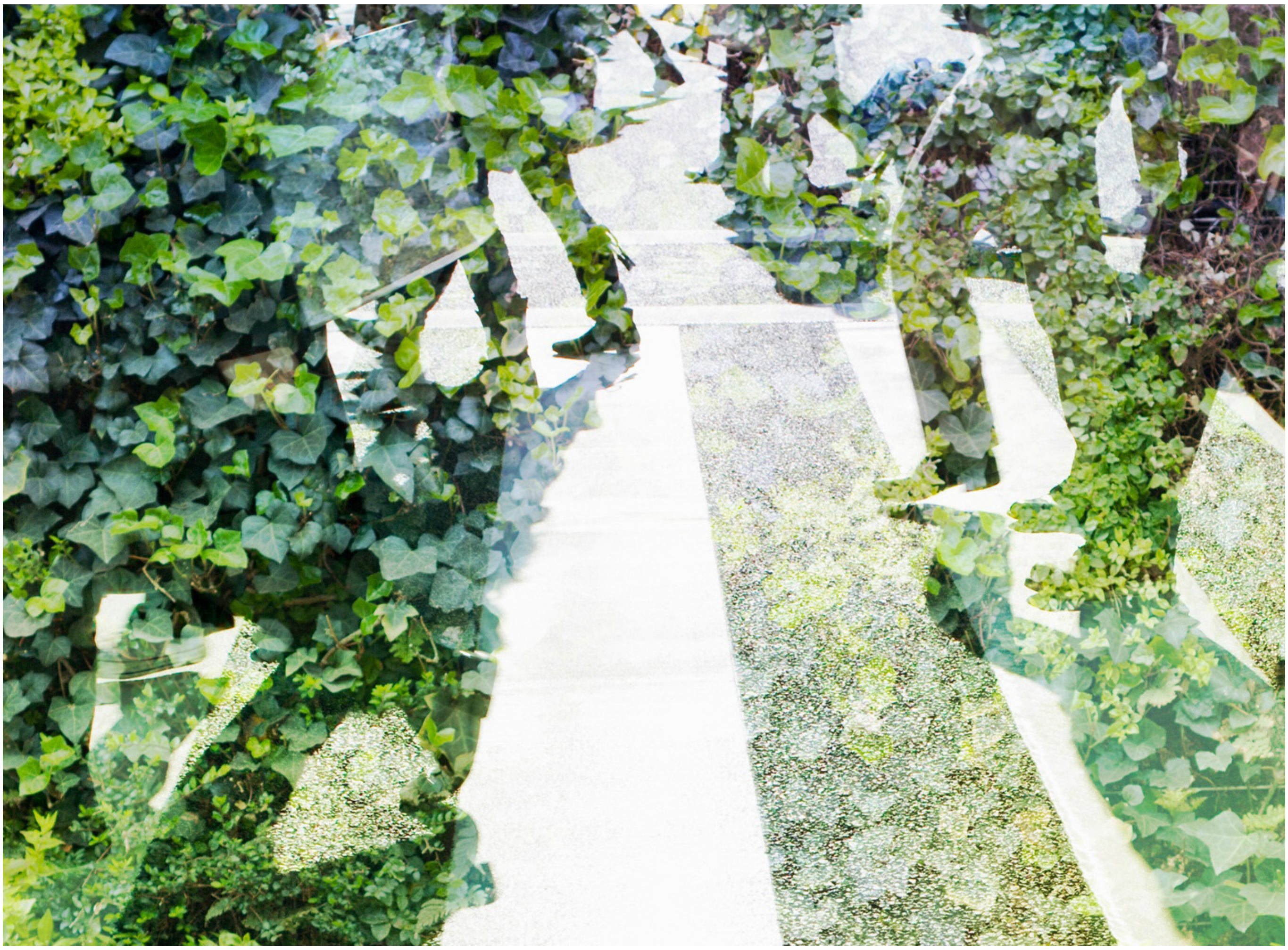

Association for Financial Markets in Europe
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Foreword

The European regulatory framework for sustainable finance has developed at a tremendous pace over the past five years. European leadership in sustainable finance has given rise to several ambitious, and comprehensive regulations. At the same time, the sustainable finance market is growing, supporting real economic change. Despite the challenging macroeconomic environment due to the COVID pandemic, European ESG bond and loan issuance has increased 58.8%, just in 2020, amounting to €398 billion.[1]

While a lot has been achieved, the scale of what will be needed to meet the objectives of the Paris Agreement and the Sustainable Development Goals cannot be understated. According to a recent report by the Global Financial Markets Association and Boston Consulting Group, investment needs will amount to $100-$150 trillion over the next three decades, to fund the transition to a low-carbon economy.[2] This translates to at least $3–$5 trillion of investment per year – an increase of five to eight times from current levels. The United Nations has estimated that for the complementary ambition of reaching the Sustainable Development Goals, the annual funding gap is $2.5 trillion per year.[3]

It is evident that the challenge is staggering – and the financial sector will be crucial in meeting it.

Following the significant progress on the Action Plan on Financing Sustainable Growth, the first stage of the regulatory framework in Europe has now been set. It is time for policymakers, the financial industry, NGOs, and other stakeholders to all look ahead and cooperatively articulate – and implement – a vision for the next stages of this agenda.

The European Commission's forthcoming Renewed Sustainable Finance Strategy is one of the immediate milestones in articulating and promoting this vision.

A central component to unlocking change at the scale needed is for the regulatory framework to enable the procurement and disclosure of high-quality, comparable ESG data.

Data is the lifeblood of financial markets. Without a clear regulatory framework to ensure financial institutions and investors have access to comparable ESG data from borrowers and issuers, allocating capital to supporting real economy transition plans will remain challenging.

To get this right, it will be crucial to appropriately synchronise the development and implementation of the various elements of the ESG disclosure landscape. Simply put, robust corporate disclosures are the bedrock for the rest to follow and should therefore be prioritised. They will enable optimal financial decision making and provide the basis on which the financial sector can build its own disclosures.

This Report, written in partnership with Latham & Watkins, aims to assist with the latter part of this imperative.

It serves as a practical guide for financial institutions to understand the scope of existing ESG disclosure requirements and offers ideas for best practices in compliance.

[1] https://www.afme.eu/Publications/Data-Research/Details/AFME-European-ESG-Finance-Quarterly-Data-Report-Q4-2020
[2] https://www.sifma.org/wp-content/uploads/2020/12/Climate-Finance-Markets-and-the-Real-Economy.pdf
[3] https://www.un.org/press/en/2019/dsgsm1340.doc.htm

It also puts forward practical recommendations for the next stages of development for the ESG disclosure framework, covering the review of the Non-Financial Reporting Directive, the development of more granular guidance for prudential ESG disclosures by banks and investment firms, as well as further guidance for disclosure requirements under the Taxonomy Regulation.

In addition to Latham & Watkins, the Report has benefited greatly from the expertise and input of AFME's members.

I would like to thank all contributors for their time and effort in bringing this Report to fruition. I hope it will be helpful to regulators and all market participants in enabling the data and disclosure required to support Europe's transition to a low-carbon future.

Michael Cole-Fontayn
Chair
Association for Financial Markets in Europe

Executive Summary

This Report has two purposes. It provides a detailed inventory of the key elements of the European regulatory landscape for ESG disclosures, as well as the voluntary TCFD Framework, and aims to help the industry navigate its interrelated components by analysing them through different lenses. The Report also functions as a practical, easy-to-read summary of how financial institutions can navigate these complex and interrelated requirements.

The Report begins by providing an overview of the main sources of ESG disclosure standards relevant to AFME members in their various roles as lenders, underwriters, asset and wealth managers and corporate issuers and then mapping out the different approaches to materiality taken by these standards. It then sets out a framework for how firms may construct their own approach to such disclosures. To achieve this, it breaks down the multiple requirements of the TCFD, NFRD, and Pillar 3 disclosures and the SFDR into distinct disclosure categories, or "pillars" (covering governance, business strategy, risk management, and KPIs) and identifies where common information and metrics can be leveraged across these pillars and the various standards.

Given the prioritisation by regulators and supervisors of the effects of physical and transition risks on the value of financial assets and the smooth adaptation to a low-carbon economy, the Report takes a closer look at the existing and evolving frameworks for climate risk disclosures. This is specifically approached through a more in-depth comparison of the differences, and synergies, between the TCFD and NFRD frameworks. It also zooms in on the regulatory sources requiring product-level disclosures, examining the interplay between these.

Recognising the practical challenges for firms to capture data from within their organisations to feed into the disclosure requirements, the Report maps out information flows, identifying the key divisions within firms which generate sustainability-related data points. It then illustrates how this information either ties into broader entity-level disclosures or relates to product-specific disclosures and examines the interplay with client engagement and communications.

It also provides practical tips for how firms can approach the governance of ESG disclosures across their organisations.

Finally, the Report provides a range of recommendations for policymakers, responding to the upcoming opportunities on the legislative horizon for promoting synchronisation between reporting frameworks, and encouraging simplification of ESG reporting requirements.

1. Introduction

A. Purpose of the Report

A range of recent sustainable finance initiatives are expected to have both direct and indirect effect on information that AFME member firms will be required to report on/consider in their business depending on their roles, for example, as lenders, underwriters of capital markets transactions, asset and wealth managers and corporate issuers.

The ESMA SMSG, in its advice to the ESA's Joint Consultation Paper on ESG Disclosures under SFDR,[4] noted that:

> *"The synergy between different pieces of legislation (in particular the Non-Financial Reporting Directive (NFRD), the Taxonomy Regulation, and the Sustainable Finance Disclosure Regulation (SFDR), but also adjacent legislation such as the Shareholders Rights Directive II and the scheduled reviews of MiFID and UCITS/AIFMD) can contribute significantly to enhancing sustainability in the economy. However, neither the timings nor the concepts of these different pieces of legislation are fully synchronized or aligned with one another."*

This lack of synchronisation and synergy between different EU legislative initiatives associated with sustainability disclosures creates a significant challenge for firms in both identifying and understanding the co-dependencies (or conflicts) between the differing disclosure expectations that will impact them institution-wide.

The purpose of this Report is to provide AFME members with a practical reference point to understand the scope of the various regulatory initiatives and the timelines for implementation. Connected to this, the Report seeks to:

1. Highlight the sources of sustainability disclosure standards; and
2. Flag the overlaps and interdependencies in those standards.

With the above in mind, it is hoped that the European policymakers and regulators will seek to utilise the forward looking regulatory reform opportunities to further align the concepts under the different disclosure standards to reduce the risks that firms are exposed to because of inconsistent interpretations. The recent work of the EBA in aligning CRR Pillar 3 and EU Taxonomy disclosures is noteworthy in this context.

Finally, the Report highlights the challenges that firms might take into account in the context of managing implementation risk and resolving regulatory uncertainty. Firms are focused on mitigating the legal and regulatory risks that they are being asked to assume under the various EU regulatory reform initiatives where the data underlying the disclosure standards is in whole, or in part, unavailable. The legislation itself calls on firms to use best efforts in this regard and, where data is unavailable from investee companies, the expectation is that firms should carry out additional research, cooperate with third party data providers or external experts, utilise proxies or make reasonable assumptions. However, the robustness of those efforts in mitigating disclosure risk must also be viewed in the context of the upcoming Renewed Sustainable Finance Strategy: ESMA wrote to the Commission on 28 January 2021 to highlight the need to address "the unregulated and unsupervised nature of the market for 'ESG' ratings and ESG assessment tools and the need to match the growth in demand for these products with appropriate regulatory requirements to ensure their quality and reliability".[5] In particular ESMA notes that the increasing demand for assessments that provide insights on an entity's ESG profile should go hand in hand with safeguards that ensure the information referred to is robust

[4] ESMA 22-106-2858 14 September 2020
[5] ESMA 30-379-423 28 January 2021

and that the assessments are reliable in preventing the risk of green-washing, capital misallocation, conflicts of interest, and product mis-selling. In short, firms are currently being asked to rely on data providers to meet disclosure obligations at a time when the supervisors have concerns about the integrity of that data.

B. Approach

This Report is split into several parts that have the overall goal of providing AFME members with: (i) a macro view of all mandatory / material sustainability initiatives requiring entity or product / service level disclosures; and (ii) a deep dive analysis on certain aspects of sustainability disclosures to highlight the interaction efficiencies and challenges.

1. Introduction
2. Key Terms
3. Timeline
4. Macro Disclosure Landscape
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    - ESG Disclosure Output For Banks
5. Deep Dive Analysis
    - Climate Risk Disclosures
    - Product Level Disclosures
6. Information Flows to Facilitate Disclosures
7. Governance Standards Around Disclosures

C. Key Terms

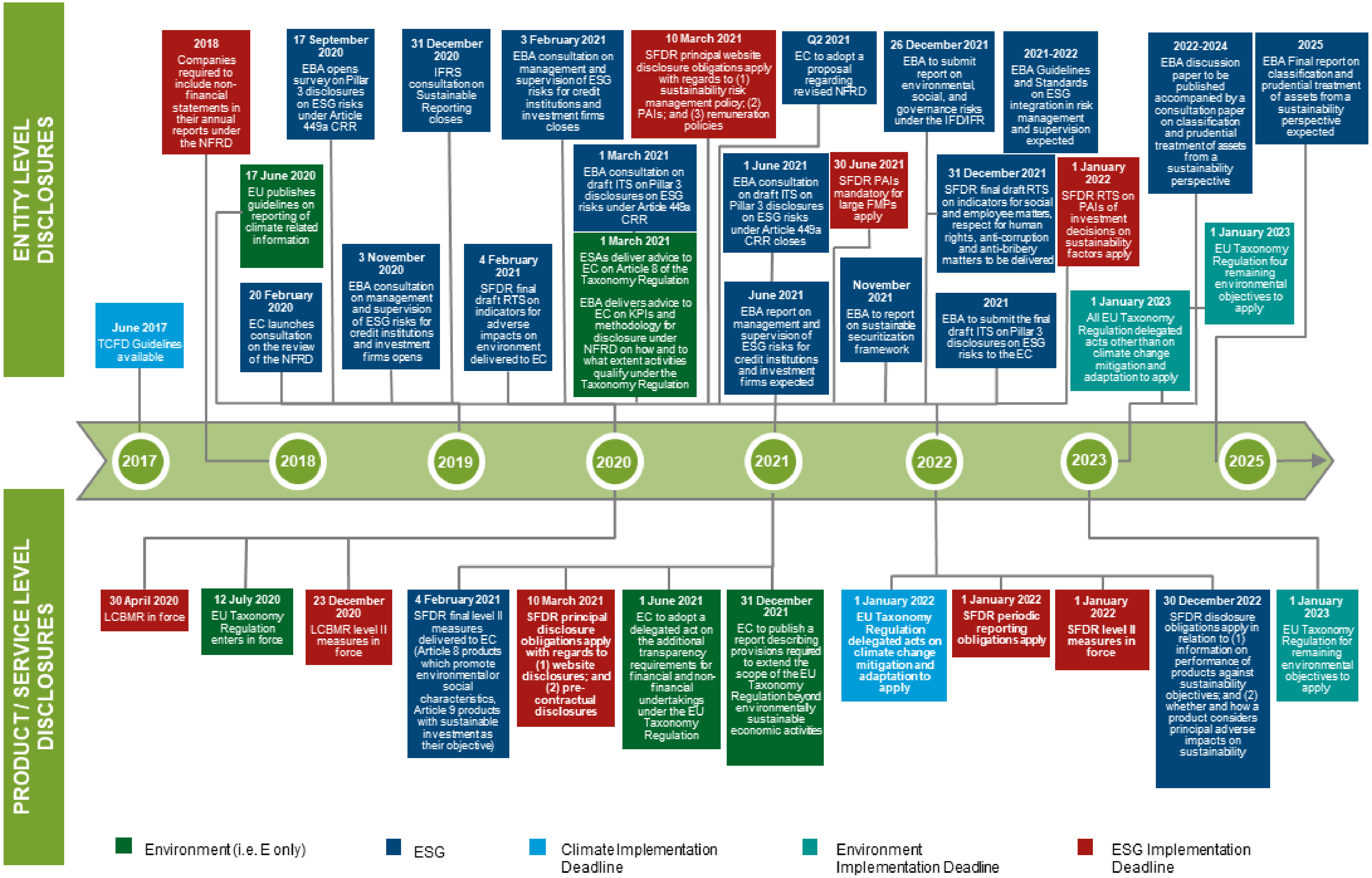
The sustainability initiatives considered by this Report include: The Non-Financial Reporting Directive (“**NFRD”**); the guidelines of the Task Force on Climate-related Financial Disclosures (“**TCFD”**); the Taxonomy Regulation (“**Taxonomy”**); the Sustainable Finance Disclosure Regulation (“**SFDR**”); the Low Carbon Benchmark Regulation (“**LCBMR**”); the ECB Guidelines on climate-related environmental risks and the European Commission guidelines on non-financial reporting and climate risk; and the changes proposed to Pillar 3 disclosures under the Capital Requirements Directive (“**CRD**”), Capital Requirements Regulation (“**CRR”**), Investment Firms Directive (“**IFD”**) and Investment Firms Regulation (“**IFR”**’).

Term	Full Description	Source
CRD	Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (**CRD 5**)	Directive (EU) 2019/878
CRR	Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (**CRR 2**)	Regulation (EU) 2019/876
EC Guidelines	European Commission Guidelines on reporting climate-related information of June 2019	EC Guide
ECB Guidelines	European Central Bank Guide on climate-related and environmental risks of November 2020	ECB Guidelines
Taxonomy	Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (**The Taxonomy Regulation**)	Regulation (EU) 2020/852
FA	Financial Advisor – i.e. an insurance intermediary or undertaking that provides insurance advice with regard to IBIPs as well as credit institutions, investment firms, AIFMs and UCITS management companies that provide investment advice.	As defined in Article 1(1) of the SFDR (see below)
FMP	Financial Market Participant – i.e. an insurance undertaking which makes IBIPs available; investment firms or credit institutions providing portfolio management; IORPs; manufacturers of pension products; AIFMs; PEPP providers; UCITs management companies; managers of qualifying venture capital funds and social entrepreneurship funds.	As defined in Article 1(11) of the SFDR (see below)
IFD	Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (**The Investment Firms Directive**)	Directive (EU) 2019/2034
IFR	Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (**The Investment Firms Regulation**)	Regulation (EU) 2019/2033
LCBMR	Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-	Regulation (EU) 2019/2089

	aligned Benchmarks and sustainability-related disclosures for benchmarks (**The Low-Carbon Benchmark Regulation**)	
NFRD	Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (**The Non-Financial Reporting Directive**)	Directive 2014/95/EU
SFDR	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (**The Sustainable Finance Disclosure Regulation**)	Regulation (EU) 2019/2088
TCFD	The Task Force on Climate-related Financial Disclosures (TCFD) established by the Financial Stability Board (FSB) to develop recommendations for more effective climate-related disclosures. The TCFD's 2017 Final Report sets out recommendations for helping businesses disclose climate-related financial information	The Recommendations of the Taskforce on Climate-related Financial Disclosures

2. Regulatory Timeline – ESG Disclosures

The timeline captures the evolution and forward-looking timeline for key regulatory milestones with regard to ESG disclosure and reporting for banks – at the entity and product level, highlighting specific factors (i.e., climate, environmental and ESG more broadly) that the respective transparency requirements pertain to. The timeline demonstrates the complexity and number of these different initiatives, pointing towards the significant effort, in terms of resources and cost, to operationalise them.



3. Macro ESG Disclosure Landscape

A. Scope & Impact

Firms are subject to a plethora of sustainability requirements. Some of these are mandatory, imposed by regulatory authorities, whereas others are voluntary. For example, in its recent report,[6] EFRAG inventorised circa 70 ESG KPIs that banks should be reporting on across three core legislative measures (NFRD, SFDR and Taxonomy). This Report focuses on the key mandatory requirements and only on those voluntary guidelines that have seen widespread adoption across the financial services industry – i.e. the TCFD Guidelines. **Table 2** below highlights the timing, scope and primary impacts of these regulatory obligations in relation to ESG disclosures.

It is nonetheless important to flag certain other initiatives relevant to the European ESG disclosures landscape. These are the:

1. IFRS Foundation's Consultation on Sustainability Reporting that is believed to establish a foundation for the development of comparable and consistent global sustainability reporting standards;
2. Global Reporting Initiative (GRI) Sustainability Reporting Standards which set out best practice for reporting publicly on a range of economic, environmental and social impacts (including positive and negative contributions to sustainable development); and
3. Sustainability Accounting Standards Board (SASB) Standards which are industry-specific standards that set out a minimal set of sustainability topics and associated accounting metrics.

The UK government has committed to integrating the TCFD Guidelines into the disclosure landscape applicable to financial institutions and across the economy more broadly. The UK's approach to sustainability disclosures may therefore diverge from that adopted by the EU (and as detailed in this Report).

A key scoping point in the context of ESG disclosures is the concept of 'single / double materiality'. There are essentially three variants of materiality lenses depending on the initiative:

- Financial materiality – the financial impact on the entity making the disclosures or the investment risks associated with their activities
- Positive external impacts on sustainability (environmental and societal)
- Negative external impacts on sustainability (environmental and societal)

The different disclosure standards are not directly aligned on the concept of "**single**" and "**double**" materiality and this creates a challenge for firms in determining whether a data point crosses the threshold of materiality, requiring disclosure. Firms will often need to make these assessments for themselves and disclose their policies in doing so. In considering 'materiality', firms must also assess what might be considered material to the relevant audience (e.g. investors; consumers; civil society; and employees). We have highlighted an approach to alignment below:

[6] https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-NFRS_A5_FINAL.pdf

Table 1: A comparison of reporting materiality thresholds

	Financial Materiality	Positive (+) External Impacts on Sustainability	Negative (-) External Impacts on Sustainability
TCFD	Entities should determine materiality for climate-related issues consistent with how they determine the materiality of other information included in their annual financial filings (i.e. financial materiality) TCFD recommends that disclosures related to Strategy & Metrics and Targets involve an assessment of materiality		
NFRD	A company is required to disclose information on environmental, social and employee matters, respect for human rights, and bribery and corruption, to the extent that such information is necessary for an understanding of the company's:		
	Development, performance, position and impact of its activities (affecting the financial position or value of the company)	Impact of its activities (having environmental and social impacts)	
Taxonomy	In-scope entities must disclose contributions to environmental objectives via degree of Taxonomy alignment		Includes concept of "Do No Significant Harm"
SFDR	Financial market participants ("**FMPs**") and financial advisers ("**FAs**") are required to disclose alignment with and financial risks presented by an investment into ESG factors		Disclosure of entity and product level principal adverse impacts in line with 15 mandatory ESG reporting criteria Consider principle of "Do No Significant Harm"

Table 2: A high level comparison of primary ESG disclosures standards impacting financial services firms

	TCFD Guidelines	NFRD	Taxonomy Regulation	SFDR	LCBMR	CRR 2 & CRD 5 IFD & IFR Pillar 3 Disclosures
Snapshot	TCFD is a private sector task force with recommendations that are widely recognised as authoritative guidance on the reporting of financially material climate-related information[7]	NFRD sets out disclosure rules for certain in-scope companies in relation to ESG data, to the extent that such information is necessary for an understanding of the company's development, performance, position and impact of its activities	The Taxonomy Regulation sets out a codification system against which certain in-scope financial and non-financial companies will be required to disclose the extent to which their activities are aligned with the Taxonomy's sustainability metrics	SFDR introduces various disclosure-related requirements for financial market participants and financial advisors at both entity and product level	EU LCBMR requires financial benchmarks within scope of EU Benchmark Regulation to specify as ESG / non-ESG and introduces new categories of ESG benchmarks	Requires disclosure of prudential information on environmental, social and governance risks, including transition and physical risk
	Key disclosure point: Scope 3 greenhouse gas ("**GHG**") emissions (i.e. all indirect GHG emissions that occur in the value chain) for bank activities: Lending; project finance; mortgages; commercial real estate; investments; and debt & equity underwriting		**Key disclosure point:** Requires disclosure of % turnover, capital expenditure (CapEx) and operating expenditure (OpEx) in the reporting year from products or services associated with Taxonomy	**Key disclosure point:** Entity and product level disclosure on sustainability risks and principal adverse impacts	**Key disclosure point:** Detailed disclosure standards in order for an index to be categorised as an ESG index[8]	**Key disclosure point**: Detailed metrics allowing investors and stakeholders to assess ESG related risks and vulnerabilities of financial institutions and how institutions are mitigating these risks, including information on how

[7] A number of governments and financial regulators around the world have expressed support for the recommendations and are integrating them into their guidance and policy frameworks. Examples include the UK, Australia, New Zealand, Canada, Hong Kong, Japan, Singapore and South Africa, as well as some EU Member States.
[8] Includes a new definition of 'Paris-Aligned Benchmark' and 'Climate Transition Benchmark' in addition to a broader concept of ESG benchmark

							they are supporting their customers and counterparties in the climate change and sustainability transition adaptation
ESG Focus							
Environ-mental	Climate	Yes	Yes	Yes	Yes	Yes	Yes
	Other	No	Yes	Yes	Yes	Yes	Yes
Social		No	Yes	No[9]	Yes	Yes	Yes
Gover-nance		No	Yes	No[10]	Yes	Yes	Yes
Scope		Voluntary EC encourages companies to implement TCFD guidelines[11]	Mandatory for 1. EU Corporates • 500+ employees • EU listed instruments • Or other companies designated by NCAs are "public interest companies" 2. EU Banks 3. EU Insurers	Mandatory for 1. FMPs 2. Mandatory for companies in scope of NFRD	Mandatory for FMPs & FAs	Mandatory for Administrators and Users in scope of EU Benchmark Regulation	Mandatory for 1. Large financial institutions which have issued securities that are admitted to trading on any regulated market in the EU 2. Class 2 investment firms (i.e. firms subject to the full prudential requirements set out in the IFR and IFD)
Status		Available since June 2017	NFRD in force since 2018	Pending implementation	10 March 2021: Level I in force	30 April 2020: Level I in force	Pending adoption and implementation

[9] Although note the requirement to comply with the minimum safeguards in Article 18 Taxonomy Regulation. Further, it is expected that the Taxonomy will be extended to cover Societal impacts over time.
[10] Although note the requirement to comply with the minimum safeguards in Article 18 Taxonomy Regulation.
[11] European Commission Guidelines on non-financial reporting

				Pending Level II implementation		
Future timing	Local country adoption into formal legislation to be monitored	Q2 2021: EC to adopt a proposal regarding revised NFRD	1 Jan 2022: Climate objectives 1 Jan 2023: Environmental objectives	See timeline for subsequent implementation dates	N/A	28 June 2022: Large financial institutions which have issued securities that are admitted to trading on any regulated market in the EU[12] 26 December 2022: Class 2 investment firms
Primary impact	**Entity**	**Entity**	**Entity / Product**	**Entity / Product**	**Product**	**Entity**
Materiality perspective	**Single**	**Double**	**Double**	**Double**	**Double**	**Double**[13]

[12] Transition arrangements apply such that the detailed disclosures on an institution's scope 3 emissions and disclosure of the green asset ratio on stock of assets for those exposures towards retail and corporates not subject to NFRD are delayed until June 2024. This recognises that the data collection process should be easier and faster in the case of counterparties that are subject to NFRD disclosure obligations, as they shall start disclosing relevant information for the 2021 financial year from January 2022 under Article 8 of the Taxonomy Regulation. It will be more burdensome for those counterparties not subject to the NFRD – information in that case shall be collected on a bilateral basis and the transition date is aligned with the deadlines included in the EBA Guidelines on loan origination and monitoring. During the transitional period, credit institutions shall disclose proxy information on estimates and ranges based on:

i. Private relevant information communicated bilaterally to the institution;
ii. Using as a fallback solution relevant proxies and coefficients on taxonomy alignment by sector, estimated by an independent Commission body, like the JRC/UZH alignment coefficients developed for the objective of climate change mitigation at sector aggregate level.

[13] Note: EBA has a different concept of double materiality than under the Taxonomy / SFDR. The double materiality threshold in the SFDR looks at financial materiality and positive external sustainability impacts, the latter through a financial materiality "lens" as well as a prescribed set of negative external sustainability KPIs. In contrast, the EBA guidelines looks at each concept – financial materiality, positive sustainability impacts and negative sustainability impacts – distinctly.

B. ESG Disclosure Output for Banks

Developing an internal methodology to address common disclosure requirements

The ESG disclosure requirements applicable to banks are contained in a number of different regulatory reform initiatives, which address multiple aspects of the transition to sustainable finance. Banks accordingly need to map the obligations that they (and their divisions – e.g. lending, corporate finance, wholesale markets, asset management and private banking) are subject to across the ESG framework in order to:

- Manage the risk of conflicting or inconsistent information being disclosed
- Ensure consistency and/or alignment of disclosures
- Identify the overlaps in the reporting pillars where common reporting metrics can be leveraged

The identification of common or overlapping disclosures allows for the mapping of disclosure requirements by disclosure category or "pillar" (for example, governance, risk, monitoring, etc.), in order to facilitate a central framework based on common terminology where possible. Accordingly, the table set out below is designed to identify the overlaps and alignments between the different ESG regulatory reform initiatives from which we have identified the following common reporting pillars:

Governance | Business Strategy | Risk Management | KPIs[14]

In addition, the table below identifies the overlapping disclosures where common reporting metrics could be leveraged across the different ESG frameworks as well as areas where alignment between the different disclosure regimes needs to be ensured.

[14] Broadly, the KPIs are used to indicate how activities qualify as environmentally sustainable.

SOURCE	REPORTING PILLAR	OVERLAP	ADDITIONAL REQUIREMENTS
TCFD	**Governance**		
EU NFRD	**Policies and Due Diligence**	Climate: • Describe the board's oversight of climate-related risks and opportunities • Describe management's role in assessing and managing climate-related risks and opportunities	Extends to environmental, social and governance disclosures: A description of the policies pursued by the company in relation to, as a minimum, environmental, social and employee matters, respect for human rights and anti-corruption & bribery matters, including due diligence processes implemented. A description of the diversity policy applied in relation to the company's administrative, management and supervisory bodies with regard to aspects such as, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented, and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case. Material disclosures on due diligence processes implemented, including, where relevant and proportionate, on suppliers and subcontracting chains. Companies may also consider providing relevant information on setting targets and measuring progress. Companies are expected to highlight and explain any material changes to their main policies and due diligence processes in the reporting year. If a company has not developed policies on matters it considers material, it should provide a clear and reasoned explanation for not having developed those policies. Example disclosures:[15] • Describe any company policies related to climate, including any climate change mitigation or adaptation policy • Describe any climate-related targets the company has set as part of its policies, especially any GHG emissions targets, and how

[15] European Commission Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01); European Commission Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01).

			company targets relate to national and international targets and to the Paris Agreement in particular • Describe who in the organisation and governance structure is responsible for setting, implementing and monitoring a specific policy, for instance, on climate-related matters • Describe the role and responsibility of the board/supervisory board regarding environmental, social and human rights policies • Disclosure of the following health and safety information: workplace's policies; contractual obligations negotiated with suppliers and sub-contractors; and resources allocated to risk management, information, training, monitoring, auditing, cooperation with local authorities and social partners • Describe whether and how the company's remuneration policy takes account of climate-related performance, including performance against targets set See also SFDR 'Integration of sustainability risks', 'Adverse sustainability impacts' and 'Remuneration'

CRR Pillar 3	**Qualitative disclosures:**
	
	Governance arrangements
			Extends to environmental, social and governance risks. There is a prescribed template disclosure for each:
			
			Example disclosures:[16]
			
			• Responsibilities of the management body for setting the risk framework, supervising and managing the implementation of the objectives, strategy and policies in the context of:
			  ◦ Environmental risk management covering various transmission channels: such as physical, transition, and liability risks
			  ◦ Societal risk management covering counterparties approaches to:
			    ▪ Activities towards the community and society
			    ▪ Employee relationships and labour standards
			    ▪ Customer protection and product responsibility
			    ▪ Human rights

[16] EBA Consultation Paper Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR, March 2021(EBA/CP/2021/06).

			• Institution's integration in governance arrangements of the governance performance of their counterparties including:
			  ◦ Committees responsible for decision-making on ESG topics
			  ◦ Ethical considerations
			  ◦ Strategy & risk management
			  ◦ Inclusiveness
			  ◦ Transparency
			  ◦ Conflicts
			  ◦ Internal communication of critical concerns
			• Management body's integration of short-, medium-, and long-term effects of environmental factors and risks in the risk appetite framework, organisational structure both within business lines and internal control functions
			• Integration of measures to manage E and S factors and risks in internal governance arrangements, including setting environmental risk-related objectives, targets and limits, the role of risk committees, the allocation of tasks and responsibilities, and the feedback loop from risk management to the management body
			• Lines of reporting and frequency of reporting relating to E and S risk
			• Alignment of the remuneration policy with institution's E and S risk-related objectives

EU SFDR	**Remuneration**		Website disclosure in relation to how the remuneration policy is consistent with the integration of sustainability risks. See NFRD –'Principal risks and their management'
	Adverse sustainability		Extends to environmental, social and governance: Website disclosures in relation to whether or not the principal adverse impacts on sustainability factors (i.e. impacts of investment decisions and advice that result in negative effects on sustainability factors) ("Principal Adverse Impacts") are considered and, for FMPs, a statement on due diligence policies relating to the impacts. The current draft SFDR adverse sustainability indicators overlap with the NFRD reporting pillars as follows:

			SFDR adverse sustainability indicator	**NFRD reporting pillar**
			Climate- and other environment-related indicators	The actual and potential impacts of the company's operations on the environment, and on how current and foreseeable environmental matters may affect the company's development, performance or position
			Social and employee, respect for human rights, anti-corruption and anti-bribery matters:	
			• Social and employee matters • Human rights • Anti-corruption and bribery	Material information on social and employee matters
				Material information on potential and actual impacts of their operations on right-holders
				Material information on how they manage anti-corruption and bribery matters and occurrences
				Material information on supply chain matters that have significant implications for their development, performance, position or impact
			Consider whether NFRD Policies and Due Diligence Processes reporting should include SFDR sustainability risks policy	
TCFD	**Strategy**	• Describe the impact of climate-related risks and opportunities on the company's business model, strategy and financial planning	Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term. See NFRD –'Principal risks and their management'	

		• Describe the resilience of the company's (business model)[17] and strategy, taking into consideration different climate-related scenarios over different time horizons, including at least a 2 °C or lower scenario and a greater than 2 °C scenario	See CRR Pillar 3 - Qualitative disclosures: Business strategy & process
EU NFRD	**Business model**		Extends to social and governance strategy: A brief description of the undertaking's business model should be provided including how the company's business model can impact, as a minimum, the following areas (both positively and negatively): • environmental protection (including climate) • social responsibility and treatment of employees • respect for human rights • anti-corruption and bribery Note that disclosures in relation to the business model should be factual rather than promotional or aspirational.
CRR Pillar 3	**Qualitative disclosures:** **Business strategy & process**		Extends to environmental and social strategy. There is a prescribed template disclosure for each: Example disclosures:[18] • Adjustment of the institution's business strategy to integrate environmental and social factors and risks, taking into account the impact of environmental and social factors and risks on the institution's business environment, business model, strategy and financial planning • Objectives, targets and limits to assess and address environmental and social risk in the short, medium and long term, and performance assessment against these objectives, targets and limits, including forward-looking information in the design of business strategy and processes • Current investment activities and (future) investment targets in sustainable economy and EU Taxonomy-aligned activities • Policies and procedures relating to direct and indirect engagement with new or existing customers on their strategies to mitigate and reduce environmentally and socially harmful activities

[17] NFRD only
[18] EBA Consultation Paper Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR, March 2021(EBA/CP/2021/06)

<table>
<tr><td>TCFD</td><td>Risk Management</td><td rowspan="2">Describe the company’s processes for identifying and assessing climate-related risks (over the short, medium, and long term and disclose how the company defines short, medium, and long term)[19]
Describe processes for managing climate-related risks (if applicable how they make decisions to mitigate, transfer, accept, or control those risks), and how the company is managing the particular climate-related risks that it has identified)[20]
Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the company’s overall risk management</td><td></td></tr>
<tr><td>EU NFRD</td><td>Principal risks and their management</td><td></td></tr>
<tr><td>CRR Pillar 3</td><td>Qualitative Disclosures:

Risk management</td><td></td><td>Extends to environmental, social and governance risks. There is a prescribed template disclosure for each.

Example disclosures:[21]

Environmetal & Social
Definitions, methodologies and international standards on which the disclosures on environmental and social risks are based
Processes to identify, measure and monitor activities and exposures (and collateral where applicable) sensitive to environmental and social risks (including due diligence policies)
Activities, commitments and exposures contributing to mitigate environmental and social risks
Implementation of risk tools for identification, measurement and management of environmental and social risks</td></tr>
</table>

[19] NFRD only
[20] NFRD only
[21] EBA Consultation Paper Draft Implementing Standards on prudential disclosures on ESG risks in accordance with Article 449a CRR, March 2021(EBA/CP/2021/06)

			• Results and outcome of the risk tools implemented and the estimated impact of environmental risk on capital and liquidity risk profile
			• Data availability, quality and accuracy, and efforts to improve data status
			• Description of limits to environmental and social risks (as drivers of prudential risks) that are set, and triggering escalation and exclusion in the case of breaching these limits
			• Description of the link (transmission channels) between environmental and social risks with credit risk, liquidity risk, market risk and operational risk in the risk management framework
			Governance
			• Institution's integration in risk management arrangements the governance performance of their counterparties considering:
			  ◦ Ethical considerations
			  ◦ Strategy & risk management
			  ◦ Inclusiveness
			  ◦ Transparency

EU SFDR	**Integration of sustainability risks**		Extends to environmental, social and governance risks. Written policy on website in relation to integration of sustainability risks in the investment decision-making process/investment advice. Alignment with EU NFRD disclosures in relation to the definition of sustainability risk. Sustainability risk is defined in Article 2(22) of EU SFDR as an environmental, social or governance event or condition that, it if occurs, could cause an actual or potential material negative impact on the value of the investment. Under EU NFRD a company is expected to disclose relevant information on: 1. The actual and potential impacts of its operations on the environment, and on how current and foreseeable environmental matters may affect the company's development, performance or position;

			2. Material information on social and employee matters; 3. Material information on potential and actual impacts of their operations on right-holders; 4. Material information on how they manage anti-corruption and bribery matters and occurrences; and 5. Material information on supply chain matters that have significant implications for their development, performance, position or impact. Companies in scope of EU NFRD and EU SFDR should ensure that their internal definition of 'sustainability risks', including the parameters as to what amounts to an environmental, social or governance event or condition, is aligned with their EU NFDR reporting, in particular in relation to limbs 1 and 2 from the EU NFRD reporting pillars identified above. Consider whether NFRD Policies and Due Diligence Processes reporting should include SFDR sustainability risks policy See CRR Pillar 3 Qualitative Disclosures Risk Management
TCFD	**Metrics & targets**	• Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets (TCFD) / describe the outcomes of the company's policy on climate change, including the performance of the company against the indicators used and targets set to manage climate-related risks and opportunities (NFRD – Disclosure on Outcomes) • Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks (TCFD) / describe the development of GHG emissions against the targets set and the	Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process (TCFD).

EU NFRD	**Disclosure on Outcomes**
	
	Key performance indicators
		related risks over time (NFRD – Disclosure on Outcomes)
		• (Significant institutions are expected to disclose the institution's financed Scope 3 GHG emissions for the whole group, including:
		  ◦ The amount or percentage of carbon-related assets in each portfolio in € millions or as a percentage of the current portfolio value and, to the extent possible, a forward-looking best estimate of this amount or percentage over the course of their planning horizon;
		  ◦ The weighted average carbon intensity of each portfolio, where data is available or can be reasonably estimated and, to the extent possible, a forward-looking best estimate of this weighted average carbon intensity over the course of their planning horizon;
		  ◦ The volume of exposures by sector of counterparty and, to the extent possible, a forward-looking best estimate of this volume over the course of their planning horizon; and
		  ◦ 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.
		• Institutions are expected to disclose or reference the methodologies used and
			Disclosure on outcomes
			Companies should provide a useful, fair and balanced view of the outcome of their policies to help investors and other stakeholders understand and monitor the company's performance. As a minimum, these disclosures must cover environmental, social and employee matters, respect for human rights and anti-corruption & bribery matters.
			
			The analysis of outcomes should include relevant non-financial KPIs. Companies are expected to disclose the KPIs that they consider most useful in monitoring and assessing progress and supporting comparability across companies and sectors. Where appropriate, companies may also consider presenting and explaining this information in relation to targets and benchmarks. Companies may also consider explaining the relationship between financial and non-financial outcomes, and how this is managed over time.
			
			A company may consider including specific disclosures explaining:
			• Actual carbon emissions, carbon intensity;
			• Use of hazardous chemicals or biocides;
			• Natural capital impacts and dependencies;
			• Comparison v targets, developments over time;
			• Mitigating effects of policies implemented; and
			• Plans to reduce carbon emissions.[24]
			
			Key performance indicators
			Companies are expected to report non-financial key performance indicators relevant to the particular business addressing, as a minimum, matters relation to environmental, social and employee, respect for human rights and anti-corruption & bribery.

[24] European Commission Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01)

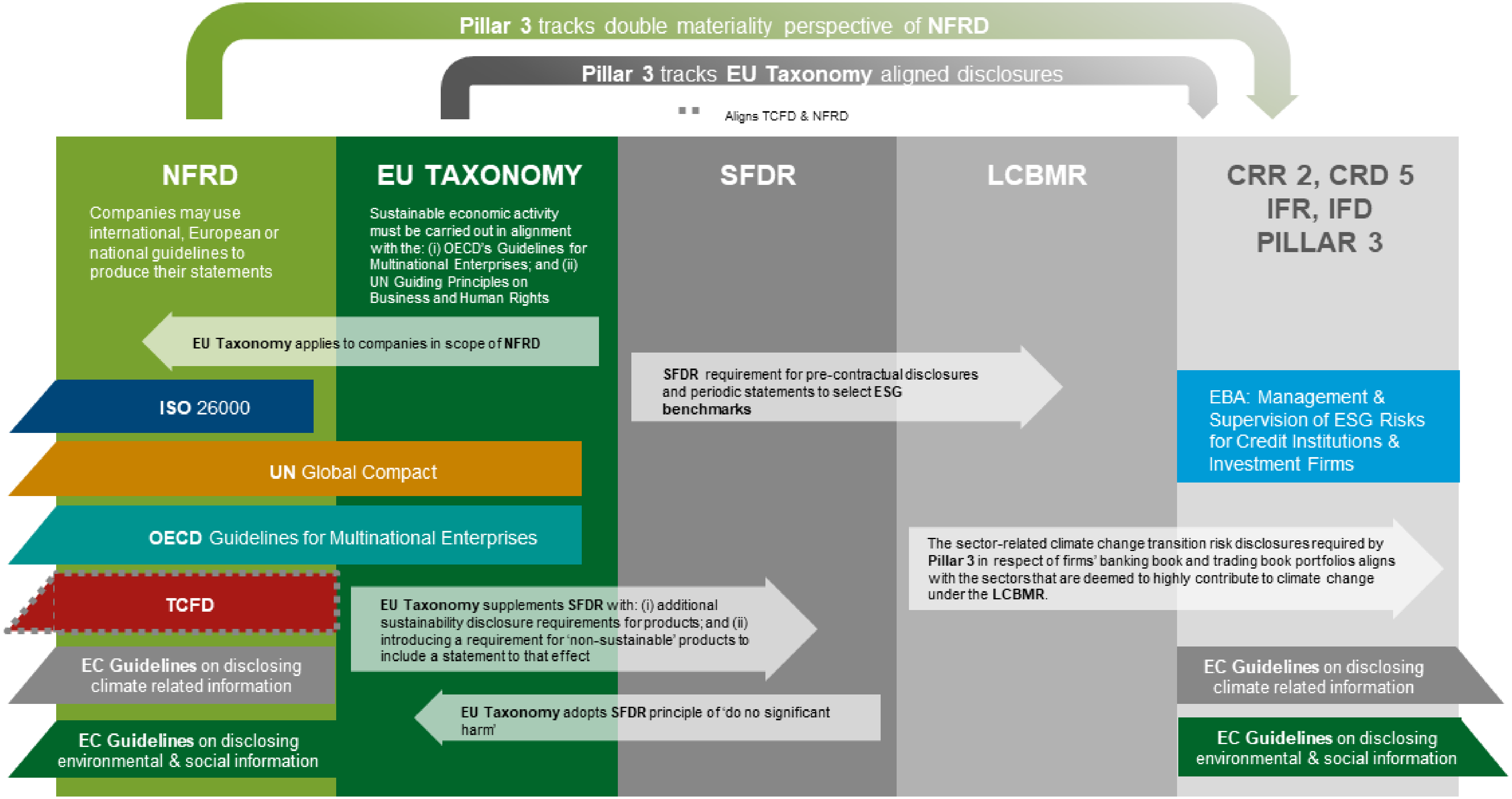
		assumptions made. In particular, this includes the definitions and formulae for the computation of the metrics detailed above[22] • KPIs: GHG emissions; Energy; Physical risks See SFDR 'Remuneration' • (Institutions are expected to disclose the KPIs and KRIs used for the purposes of their strategy setting and risk management, as well as their current performance against these metrics. Institutions are expected to disclose the metrics used, including relevant targets and the current performance of the institution against those targets. Using the aforementioned metrics, the institution is expected to describe the short-, medium-, and long-term resilience of its strategy in the light of different climate-related scenarios.)[23]	

[22] Significant institutions only – under the ECB Guide on climate-related and environmental risks a proportionate application is recommended for less significant institutions
[23] Significant institutions only – under the ECB Guide on climate-related and environmental risks a proportionate application is recommended for less significant institutions

CRR Pillar 3	**Quantitative disclosures**		Quantitative disclosure templates exist to highlight live exposures to climate (and other environmental) risk. The timing of disclosures is sequential to align with the EU Taxonomy.
Taxonomy Regulation	**Key performance indicators**	**Overlap with NFRD** This information is to be disclosed in the non-financial statement or consolidated non-financial statement and builds on the existing NFRD requirements. The European Commission Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01) currently include the following KPIs: • Percent turnover in the reporting year from products or services associated with activities that meet the criteria for substantially contributing to mitigation of or adaptation to climate change as set out in the EU Taxonomy Regulation; and/or • Percent investment (CapEx) and/or expenditures (OpEx) in the reporting year for assets or processes associated with activities that meet the criteria for substantially contributing to mitigation of or adaptation to climate change as set out in the EU Taxonomy Regulation.	Non-financial undertakings subject to NFRD will be required to use the following KPIs: • The proportion of their turnover; • Their capital expenditure; and • Their operating expenditure. related to activities that qualify as environmentally sustainable under Articles 3 and 9 of the Taxonomy Regulation. These KPIs therefore go beyond the scope of the existing NFRD KPIs to cover activities that meet the following four criteria: • It contributes substantially to one or more environmental objectives set out in Article 9 of the Taxonomy Regulation (climate change mitigation (addressed in the current NFRD KPI); climate change adaptation (addressed in the current NFRD KPI); the sustainable use and protection of water and marine resources; (d) the transition to a circular economy; pollution prevention and control; the protection and restoration of biodiversity and ecosystems); • It does not significantly harm any of the environmental objectives in Article 9 of the Taxonomy Regulation; • It is carried out in compliance with minimum safeguards; and • It complies with technical screening criteria set by the Commission.

4. ESG Disclosure Interdependencies

Following the above analysis, the graph below helps visualise the overlaps and interdependencies across the various ESG-related initiatives that have been or are being implemented in the European Union. It is worth noting that the disclosure landscape is expected to remain extremely dynamic and will continue to actively evolve over the next 5-10 years to, at the very least, reflect the forthcoming revision of the Non-Financial Reporting Directive in the EU and the potential development of globally consistent reporting standards as recently signalled by the IFRS Foundation and IOSCO.[25]



[25] On 24 Feb 2021, IOSCO published a statement recognising an urgent need for globally consistent, comparable, and reliable sustainability disclosure standards and announcing its priorities and vision for a Sustainability Standards Board under the IFRS Foundation. On 8 Mar 2021, IFRS Foundation released a statement concerning their strategic direction, following the previous announcement about the establishment of an international sustainability reporting standards board within the existing governance structure of the Foundation.

5. Deep Dive Analysis

A. Climate Risk Disclosures

The importance of climate risk management

Financial institutions are both impacted by and capable of contributing to climate risks in a number of ways. This is why many global regulators are prioritising appropriate climate risk disclosures as part of ensuring the broader transition of the financial services industry to more sustainable, and positively impactful, business models.

A financial institution has to manage the risks it faces as a result of both:

- Physical risk – Increasing frequency and severity or volatility of extreme weather events leading to physical damage to the value of financial assets or collateral held by banks, leading to increased credit risk; and
- Transition risk – Failing to keep pace with the broader economic 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.

To do this it is essential that financial institutions develop a framework that both identifies the required disclosure standards and their materiality triggers, alongside a comprehensive understanding of precisely which activities of the institution influence their entity level disclosures.

Understanding the relevant frameworks

The most commonly referenced framework in the case of climate disclosures is the TCFD framework. In recognition of this, regulators in the EU have referenced the TCFD framework throughout the development of legislation and supporting guidance on climate-related disclosures. A number of financial institutions throughout the EU already make TCFD-aligned disclosures since they have global applicability and recognition and are a useful starting point when considering which standards a global financial group should adhere to. Diagram 4 (below) sets out a comparison between TCFD and NFRD in this context and highlights where NFRD places additional obligations on firms. In particular, it builds on the existing helpful work of the ECB in identifying the overlaps between TCFD and NFRD. It further seeks to assist firms in understanding how the activities of particular business units within a bank will feed into climate risk disclosures.

Sourcing data to make climate-risk disclosures

Financial institutions are exposed to climate-related risks through both:

- Their own operational impacts
- The activities of their borrowers, customers, or counterparties

Banks that provide loans or trade the securities of companies with direct exposure to climate-related risks (e.g., fossil fuel producers, intensive fossil fuel consumers, real property owners, or agricultural/food companies) may accumulate climate-related risks via their credit and equity holdings. In addition, as the markets for lower-carbon and energy-efficient alternatives grow, firms may assume material exposures in their lending and investment businesses. Firms could also become subject to litigation related to their financing activities or via parties seeking damages or other legal recourse. Investors, lenders, insurance underwriters, and other stakeholders need to be able to distinguish among banks' exposures and risk profiles so that they can make informed financial decisions.

Diagram 3: ECB examples of climate-related and environmental risk drivers

<table>
<tr><th colspan="5">Examples of climate-related and environmental risk drivers</th></tr>
<tr><th rowspan="2">Risks affected</th><th colspan="2">Physical</th><th colspan="2">Transition</th></tr>
<tr><td>Climate-related</td><td>Environmental</td><td>Climate-related</td><td>Environmental</td></tr>
<tr><td></td><td>• Extreme weather events
• Chronic weather patterns</td><td>• Water stress
• Resource scarcity
• Biodiversity loss
• Pollution
• Other</td><td>• Policy and regulation
• Technology
• Market sentiment</td><td>• Policy and regulation
• Technology
• Market sentiment</td></tr>
<tr><td>Credit</td><td colspan="2">The probabilities of default (PD) and loss given default (LGD) of exposures within sectors or geographies vulnerable to physical risk may be impacted, for example, through lower collateral valuations in real estate portfolios as a result of increased flood risk.</td><td colspan="2">Energy efficiency standards may trigger substantial adaptation costs and lower corporate profitability, which may lead to a higher PD as well as lower collateral values.</td></tr>
<tr><td>Market</td><td colspan="2">Severe physical events may lead to shifts in market expectations and could result in sudden repricing, higher volatility and losses in asset values on some markets.</td><td colspan="2">Transition risk drivers may generate an abrupt repricing of securities and derivatives, for example for products associated with industries affected by asset stranding.</td></tr>
<tr><td>Operational</td><td colspan="2">The bank’s operations may be disrupted due to physical damage to its property, branches and data centres as a result of extreme weather events.</td><td colspan="2">Changing consumer sentiment regarding climate issues can lead to reputation and liability risks for the bank as a result of scandals caused by the financing of environmentally controversial activities.</td></tr>
<tr><td>Other risk types (liquidity, business model)</td><td colspan="2">Liquidity risk may be affected in the event of clients withdrawing money from their accounts in order to finance damage repairs.</td><td colspan="2">Transition risk drivers may affect the viability of some business lines and lead to strategic risk for specific business models if the necessary adaptation or diversification is not implemented. An abrupt repricing of securities may reduce the value of banks’ high quality liquid assets, thereby affecting liquidity buffers.</td></tr>
</table>

DIAGRAM 4: A comparative analysis of TCFD & NFRD – Planning for the EU Taxonomy

Aligning TCFD & NFRD – additional considerations

Disclosure location – The TCFD proposes that its recommended disclosures are published in the company's "annual financial filings". The NFRD allows Member States to permit companies to publish their non-financial statement in a separate report under certain conditions, and a majority of Member States have taken up this option. If a company subject to the NFRD wants to the meet the recommendations of the TCFD regarding the location of its climate-related disclosures, it should publish these disclosures in its management report. A standard format for reporting under Article 8 of the Taxonomy Regulation (see below) within non-financial statements will be developed by the EBA. This too can be included in the management report of the NFRD.

Time horizon – TCFD requires that climate-related risks and opportunities should be identified over the short, medium, and long term. Organisations should define what they consider the relevant short-, medium- and long-term time horizons, taking into consideration the useful life of the organisation's assets or infrastructure and the fact that climate-related issues often manifest themselves over the medium and longer terms. NFRD supplements this by stating companies should consider a longer-term time horizon than is traditionally the case for financial information. This should ultimately align with the EBA's work on Pillar 3 disclosures.

Materiality – The materiality perspective of the NFRD covers both financial materiality and environmental and social materiality (i.e. the ways in which the company's business model can impact the climate, both positively and negatively), whereas the TCFD has a financial materiality (impact of climate risk on the company's financial performance) perspective only.

TCFD takes the view that its disclosures on Governance and Risk Management should be made irrespective of materiality. In principle, information considered material from the perspective of the TCFD should also be material from the perspective of the NFRD.

The TCFD disclosures related to the Strategy and Metrics and Targets recommendations involve an assessment of materiality. For asset managers and asset owners, the Task Force recommends including carbon footprinting information in reports to clients and beneficiaries.

- **Financial disclosures:** Organisations should determine materiality for climate-related issues consistent with how they determine the materiality of other information included in their annual financial filings. Although it may be necessary to apply a longer timeframe to that assessment in the case of climate risk.
- **Non-financial disclosures:** When providing disclosures outside mainstream financial filings, asset managers and asset owners should consider materiality in the context of their respective mandates and investment performance for clients and beneficiaries.

Omissions – Firms must disclosure the rationale for omitting to disclose any information prescribed by a field of TCFD or NFRD reporting.

Audit – Firms must have their non-financial statements audited in line with the standards of NFRD (and ultimately the EU Taxonomy). The ECB Guidelines on climate-related financial disclosures expressly state that it is not intended to impose additional auditing standards. Nevertheless, firms looking to align with TCFD will find the guidelines a useful basis for compliance.

Aligning the EU Taxonomy with existing frameworks

Article 8 Taxonomy Regulation: This article requires any undertaking which is subject to the NFRD reporting requirements to include in its non-financial statement or consolidated non-financial statement information how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under the EU Taxonomy Regulation. How entities will ultimately report under Article 8 will depend on guidance from the European Supervisory Authorities (ESAs) on the key performance indicators (KPIs) and associated methodology that should be used to disclose information on how and to what extent their activities are aligned with the Taxonomy. The European Commission is expected to adopt level 2 (delegated acts) measures by June 2021 based on the ESA's advice. The EBA is responsible for the advice covering credit institutions and investment firms and has published its advice on March 1 (and ESMA published its final report on the information to be provided by non-financial undertakings and asset managers to comply with their disclosure obligations under the NFRD at the same time). In parallel, the EBA has also launched a public consultation on a proposal for updating Pillar 3 ITS.

The NFRD review will take very close account of the Taxonomy and SFDR. One of the aims of the NFRD review will be to ensure that companies report the necessary information for the Taxonomy and SFDR. Some of the information reported may also be useful as input for environmental economic accounts.

B. Product Level Disclosures

Of the sources outlined in this Report, the SFDR, Taxonomy Regulation and LCBMR, prescribe product-level disclosures. This section considers the product-level disclosures required by each source as well as the interplay between them.

SFDR

The product-level disclosure requirements apply to certain types of firms (FMPs and FAs) in respect of their "**Financial Products**" – i.e. the list of instruments set out in Article 2(12) SFDR, being: (i) MiFID-managed portfolios, (ii) AIFs, (iii) IBIPs, (iv) pension products, (v) pension schemes, (vi) UCITS, and (vii) PEPPs. Certain disclosures must be made in respect of all relevant products – i.e. regardless of whether they are "sustainable" products – whereas others will apply only in respect of products which:

- Promote environmental or social characteristics, provided that the investee company also follows good governance practices ("**Article 8 Products**"); or
- Constitute "sustainable investments" as defined in the SFDR – in summary, these are investments that: (i) contribute to an economic or social objective, (ii) do not significantly harm any other economic or social objective, and (iii) involve an investee company that follows good governance practices ("**Article 9 Products**").

The SFDR sets out where, and in what format, the disclosures should be made.[26]

All Financial Products

For all Financial Products, in-scope firms must include, in pre-contractual disclosures: (i) the manner in which sustainability risks are integrated into investment decision-making or investment advice, and (ii) the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products made

[26] Note that the distinction between what constitutes an Article 8 Product and an Article 9 Product is not always clear and the financial services industry has raised concerned with relevant policymakers over this lack of clarity.

available. Firms that do not consider sustainability risks relevant to their activities must include a clear and concise explanation as to why.

In addition, where an FMP considers Principal Adverse Impacts under Article 4 SFDR, it must also: (i) explain whether, and if so, how a Financial Product considers Principal Adverse Impacts on sustainability factors, and (ii) provide a statement that information on Principal Adverse Impacts is available in periodic reports. For FMPs that do not consider Principal Adverse Impacts under Article 4, they are required to provide, for each Financial Product, a statement that it does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefore.

Article 8 Products

In respect of Article 8 Products, the following information must be disclosed: (i) information on how the product promotes environmental or social characteristics, and (ii) if an index has been designated as a reference benchmark, information on whether and how the index is consistent with those characteristics. In respect of (ii), FMPs must also provide an indication of where the methodology used for the calculation of the index is to be found.

Periodically, FMPs must also disclose the extent to which the Article 8 Product(s) continue to meet the relevant environmental and social characteristics (i.e. that qualify the relevant Article 8 Product as such).

FMPs must also disclose the information above on their websites together with information on the methodologies used to assess, measure, and monitor the environmental or social characteristics or the impact of the sustainable investment selected for the financial product, including: its data sources, screening criteria for the underlying assets, and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product.

Article 9 Products

In respect of Article 9 Products, the following information must be disclosed: (i) if an index has been designated as a reference benchmark, an explanation as to why and how the designated index aligned with that objective differs from a broad market index; and (ii) where no index has been designated as a reference benchmark, an explanation of how the relevant sustainable investment objective is to be attained. In respect of (i), FMPs must also provide an indication of where the methodology used for the calculation of the index is to be found.

Further, for those Article 9 Products which have as its objective, a reduction in carbon emissions, the disclosure should include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives set out in the Paris Agreement (i.e. to limit global warming to two degrees Celsius above pre-Industrial levels).

Periodically, FMPs must also disclose: (i) the overall sustainability-related impacts of the financial product by means of relevant sustainability indicators, and (ii) where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators (the sustainability indicators are to be set out in Delegated Regulation).

FMPs must also disclose the information above on their websites together with information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investment selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product.

EU TAXONOMY

There is some overlap between the scope of the Taxonomy and that of the SFDR. Broadly, the Taxonomy Regulation applies to FMPs in respect of Article 8 Products and Article 9 Products (as defined above) with environmental objectives, although (as in respect of the SFDR) certain disclosures must be made in respect of all Financial Products whether or not they promote environmental objectives. In essence, it supplements the transparency requirements set out in the SFDR by requiring greater disclosures in respect of Article 8 and/or 9 Products which have environmental objectives.

Note that any relevant disclosures must be made via the same means as that prescribed by the SFDR.

Article 9 Products

Article 9 Products that invest in an environmental objective (as defined by reference to only those environment-related criteria in the Article 2(17) SFDR definition of "sustainable investments" as opposed to any Article 9 Product) must provide: (i) information on which of the six prescribed environmental objectives the relevant product contributes to, and (ii) a description of how and to what extent the investments underlying the product are economic activities that qualify as "environmentally sustainable".

To qualify as *environmentally sustainable*, an economic activity must satisfy the following tests. It must:

- Contribute substantially to one or more of the prescribed environmental objectives, being: (i) climate change mitigation, (ii) climate change adaption, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circulate economy, (v) pollution prevention and control and protection and restoration of biodiversity and ecosystems, or (vi) be an "enabling"[27] or "transitional"[28] activity.
- Not "significantly harm" any of the environmental objectives;
- Comply with OECD Guidelines, UN Guiding Principles on Business and Human Rights, and conventions listed under the ILO Declaration on Fundamental Rights and Principles at Work and International Bill of Human Rights; and
- Comply with the specific technical screening criteria (set out in delegated regulation).

The Taxonomy Regulation also requires that Article 9 Disclosures set out the shares of investments in environmentally sustainable economic activities, including details on the respective proportions of enabling and transitional activities, as a percentage of all investments selected for the Financial Product.

Note that for these purposes the concept of "do no significant harm" (or "**DNSH**") in the SFDR is broader than that under the Taxonomy Regulation. The former covers environmental, social and potentially governance criteria whereas, in respect of the latter, economic activities are taxonomy compliant when they contribute to one or more of the environmental objectives and do not significantly harm any other environmental objective.

Article 8 Products

The disclosures set out for Article 9 Products above must also be given in respect of those Article 8 Products that promote environmental characteristics (and not Article 8 Products that promote social characteristics). In addition, the product's pre-contractual and periodic disclosures must contain the following statement:

> *"The "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities."*

[27] Note that an "enabling" activity is one that directly enables other activities to make a substantial contribution to an environmental objective and:

i. does not lock-in assets that undermine long-term environmental goals; and
ii. has a substantial positive impact based on life-cycle considerations.

[28] A "transitional" activity is one which as no technologically and economically feasible low carbon alternative but supports the transition to a low carbon economic and can be regarded as contributing significantly to the climate change mitigation objective if the activity:

i. has greenhouse gas emission levels equal to the best performance in the sector or industry;
ii. it does not hamper the development and deployment of low-carbon alternatives; and
iii. it does not lead to a lock-in or carbon-intensive assets, considering the lifetime of those assets. In addition, transitional activities should not significantly harm other environmental objectives and must pass minimum safeguards – i.e. align with the guidelines/principles described at (c) below.

Although there is no direct DNSH requirement in the SFDR for Article 8 Products that do not make sustainable investments, the Taxonomy Regulation in essence requires the DNSH assessment to be performed from an environmental perspective.

Other Financial Products

For Financial Products that are not Article 8 or Article 9 Products, the following statement must be made in pre-contractual and periodic disclosures:

> *"The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities."*

LCBMR

The LCBMR applies ESG disclosure standards to all financial benchmarks within scope of the EU Benchmark Regulation. It does this by introducing the concept of an ESG index (undefined) and two new types of (voluntary) benchmarks:

- The EU Climate Transition Benchmark (the "**CTB**") or a low carbon benchmark – i.e. a version of a standard benchmark in which the underlying assets are selected so that the resulting portfolio has lower carbon emissions; and
- The EU Paris-aligned Benchmark (the "**PAB**") or positive carbon benchmark – i.e. where the underlying assets are selected on the basis that their carbon emissions savings exceed their carbon emissions in such a way that it aligns with the objectives of the Paris Climate Agreement.

Benchmark administrators are required to make certain disclosures in respect of the methodologies that they use to determine CTBs and PABs, as well as, for all benchmarks, an explanation of how the key elements of the methodology used reflect ESG factors. In addition, for each benchmark or family of benchmarks that pursue or take into account ESG objectives, administrators must set out (in the benchmark statement) an explanation of how the benchmark reflects ESG factors.

Interplay with the SFDR

Apart from requiring benchmark administrators to adopt the methodology set out in the SFDR when disclosing an in-scope benchmark's alignment with the objectives of the Paris Agreement, FMPs are likely to rely heavily on benchmark administrators disclosures when explaining how and why their reference benchmarks align with the characteristics or objectives of their Article 8 and/or 9 Products, as well as when drawing a distinction between the reference benchmark and broad market indices. It is noteworthy in this context that there is a potential lack of alignment between the constituent elements of ESG benchmark disclosure under LCBMR and the required data points under the SFDR disclosure rules for Article 8 and Article 9 products. The effect of this is yet to play out but FMPs looking to rely on ESG benchmarks should be aware of the additional diligence burden when selecting indices to ensure they aid compliance with the disclosure standards of SFDR.

Diagram 5: The table below summarises the disclosure requirements in the SFDR and Taxonomy Regulation and indicates the interplay between these obligations they relate to Financial Products

Disclosure Requirement	Article 8 Products	Article 9 Products	All Other Financial Products
Pre-contractual disclosure: Information relating to: (i) the integration of sustainability risks into the investment decision making and advice processes; (ii) whether the likely impact of sustainability risks on returns is assessed and if so, the outcome; and (iii) Principal Adverse Impacts on sustainability factors. *Article 6 SFDR (applies 10 March 2021); Article 7 SFDR (applies 30 December 2022).*	Yes	Yes	Yes
Pre-contractual disclosure: Information on how a Financial Product is a "sustainable product" and if the Financial Product has a reference benchmark, information on how that index is consistent with the sustainability factors referenced. *Articles 8 and 9 SFDR (applies 10 March 2021).*	Yes – Specifically, FMPs should provide information on the environmental or social characteristics promoted and how good governance practices are met.	Yes – Where there is a designated reference index, the disclosure should cover (i) how the index aligns with the products sustainable investment objective; and (ii) why and how the designated index differs from a broad marked index. Where there is no such designated index, the disclosure should explain how the sustainable investment objective is to be attained.	N/A
Pre-contractual disclosure: Information on how low carbon objectives will be obtained. *Article 9 SFDR (applies 10 March 2021).*	N/A	Yes, but only if the product has a reduction in carbon emissions as its objective.	N/A
Periodic disclosure: Assessment of the extent to which a Financial Product is meeting its sustainability goals. *Article 11 SFDR (applies 1 January 2022).*	Yes – The disclosure should cover the extent to which environmental and social characteristics are met.	Yes – The disclosure should cover the impact of the Financial Product by reference to sustainability indicators or, where there is a reference benchmark, the related impact of the Financial Product with the impacts of the designated index and of a broad market index through sustainability factors.	N/A

Website disclosure: Information set out in Articles 8 or 9 (as applicable) and 11 as well as: (i) a description of the environmental or social characteristics or the sustainable investment objective; and (ii) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product. *Article 10 SFDR (applies 10 March 2021)*	Yes	Yes	N/A
Information on the environmental objective(s) to which the Financial Product contributes and a description of how and to what extent the investments underlying the Financial Product are in economic activities that qualify as environmentally sustainable. Information on the shares of investments in environmentally sustainable economic activities as a percentage of all investments selected for the Financial Product. *Articles 5 & 6 Taxonomy Regulation (applies 1 January 2022 in respect of Financial Products that have climate mitigation or adaptation objectives and 1 January 2023 in respect of all other environmental objectives).*	Yes – provided the Financial Product promotes environmental characteristics. In addition, a disclosure must be made (using prescribed language) must state, where relevant, that the remaining portions the product do not take into account the Taxonomy Regulation criteria for environmentally sustainable economic activities.	Yes – provided the Financial Product contributes to an environmental objective.	N/A
Prescribed disclosure that a product does not take into account the Taxonomy Regulation criteria for environmentally sustainable economic activities. *Article 7 Taxonomy Regulation (applies 1 January 2022 in respect of Financial Products that have climate mitigation or adaptation objectives and 1 January 2023 in respect of all other environmental objectives).*	No	No	Yes

6. Information Flows to Facilitate Disclosures

A key challenge when considering an appropriate framework for ESG disclosures is to identify and understand the activities of the financial institution that influence those disclosures in order that an appropriate process can be established to ensure that the relevant data points are collected. This understanding should be established at an early stage to ensure that each business line is taking the steps required to achieve the short-, medium-, and long-term targets of the institution in achieving and reporting on sustainability. The diagram below identifies the key divisions within member firms, the sustainability-related data points that they generate and the resulting disclosures that will have to be made and how these disclosures tie into the broader disclosure landscape – i.e. whether these disclosures will feed into to broader entity-level disclosures, whether they relate to product-specific disclosures, and the interplay with client engagement and communications.

There are a number of industry guides that are shaping the way that various bank divisions are meeting both upstream and downstream demand for sustainable products and services. These guides can be leveraged, by firms, to simplify the data collection process or to ensure that market-standard data points are being gathered.

Lending

- Green Loan Principles – APLMA, LMA & LSTA[29]
- Sustainability Linked Loan Principles – APLMA, LMA & LSTA[30]
- ESG diligence questionnaire – LSTA[31]

Corporate Finance

- Guide for Company Advisers to ESG Disclosure in Leveraged Finance Transactions – LMA, ELFA[32]
- Recommended ESG Disclosure and Diligence Practices for the European High Yield Market – AFME[33]
- Discussion Paper: ESG Disclosure and Diligence Practices for the European Securitisation Market - AFME[34]
- ICMA Green Bond Principles[35]
- ICMA Social Bond Principles[36]
- ICMA Sustainability-Linked Bond Principles[37]
- ICMA Climate Transition Finance Handbook[38]
- World Federation of Exchanges Sustainability Principles[39]
- EU Green Bond Standard (when adopted)

Wholesale Markets

- Overview of ESG-related Derivatives Products & Transactions, ISDA[40]

[29] https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf
[30] https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/LMASustainabilityLinkedLoanPrinciples-270919.pdf
[31] https://www.lsta.org/content/esg-diligence-questionnaire/
[32] https://www.lma.eu.com/application/files/8816/1105/1620/Guide_for_Company_Advisers_to_ESG_Disclosure_in_Leveraged_Finance_Transactions.pdf
[33] https://www.afme.eu/Publications/Reports/Details/detail/AFME-Recommended-ESG-Disclosure-and-Diligence-Practices-for-the-European-High-Yield-Market
[34] https://www.afme.eu/Portals/0/DispatchFeaturedImages/ESG%20Disclosure%20and%20Diligence%20Practices%20for%20the%20European%20Securitisation%20Market%20FINAL-2.pdf
[35] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/
[36] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/social-bond-principles-sbp/
[37] https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-Principles-June-2020-171120.pdf
[38] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/
[39] https://www.world-exchanges.org/our-work/articles/wfe-sustainability-principles
[40] https://www.isda.org/2021/01/11/overview-of-esg-related-derivatives-products-and-transactions/

Diagram 6: The table below summarises information needs across various business functions in the context of existing ESG reporting frameworks.

ENTITY LEVEL DISCLOSURES

TCFD – Financially material climate information

NFRD – Financial & societal impacts of environmental and social performance

EU Taxonomy – Proportion of Taxonomy aligned activities

CRR / CRD IFR / IFD – Pillar 3 disclosures

SFDR
1. Sustainability Risk Integration Policy
2. Principal Adverse Impact statement
3. Remuneration Policy

1. ESG business strategy in terms of risks and opportunities in relation to the firm's products & services
2. Detailed breakdown of principal risks by business activity and key sectors, geographies and related products and services the firm is active in
3. Exposures in the different lending, investment and underwriting activities to sectors perceived as contributing to climate change which may create reputational risk for the financial institution
4. Exposure of own account financial assets or assets under management to climate related risks
5. Disclosure of business relationships, products or services which are likely to cause adverse impacts and how they will be managed

DIVISIONAL IMPACTS

UPSTREAM METRICS

EXTERNAL DIVISIONAL DISCLOSURES

LENDING

1. GHG Scope 3 Emissions data on financing activities
2. Significant concentrations of credit exposure to carbon related assets
3. Volume of collateral highly exposed to climate-related risks and the impact of the selected scenarios on its value
4. Volume of real estate collateral by energy efficiency rating according to energy performance certificates.
5. Volume of real estate collaterals highly exposed to physical risk in comparison to total collaterals

CORPORATE FINANCE

1. GHG Scope 3 Emissions data on underwriting activities
2. Embed ESG risks into underwriting pricing models

WHOLESALE MARKETS

1. Market risk - Shifts in supply and demand for financial instruments (securities & derivatives)
   - Risks arising from debt, equity and equity-related financial instruments in the trading book
   - Foreign exchange positions and commodities risk positions
2. Credit risk spread arising from positions measured at fair value and at cost, and the risk arising from equity exposures
3. Enhanced metrics around commodity price movements
4. Enhanced metrics around sovereign holdings
5. Embed ESG risks into trade pricing models

PRIVATE BANK & ASSET MANAGEMENT

See wholesale markets data points and consider relevance

Note: Specific Pillar 3 templates outline metrics across the banking and trading book from June 2022

CLIENT FACING

Corporate Finance

1. Product governance: ESG preferences to be included within the target market. Note that there are no product governance-specific disclosure requirements.
2. Compliance with Green Bond Standards

Wholesale Markets

1. Index administration
   - To disclose within benchmark statements and methodologies whether index tracks ESG objectives
   - Negative ESG statements to be included on all non-ESG indices – referencing whether the bank otherwise produced ESG indices
2. Product governance: ESG preferences to be included within the target market

Private Bank & Asset Management

1. SFDR: Product / service level disclosures
   - Website: ESG products (Art 8 & 9 SFDR) – investment objectives; methodologies; (plus info below)
   - Pre-contractual mandatory reporting templates
   - Periodic reports mandatory templates
2. Product governance: ESG preferences to be included within the target market

COMMERCIAL ARRANGEMENTS WITH CLIENTS

1. **Client engagement**: Disclose the firm's engagement with its value chain (upstream & downstream) on climate related issues
2. **Due diligence**: Identify client relationships that may have adverse societal impacts – (e.g. a review of current and projected GHG emissions, the market environment, supervisory requirements for the companies under consideration, the likely impacts on borrowers' profitability and solvency, etc.)
3. **Onboarding**: Define appropriate general risk indicators or ratings for counterparties. Use of heat maps that highlight sustainability risks based on the relevant of individual (sub-)economic sectors for a given client
4. **Pricing models**: Client incentives to consider ESG risk so as to improve their creditworthiness and resilience towards such risks
   - Discounts on the interest rate of an environmentally sustainable loan
   - Linking interest rates to sustainability targets
   - Differentiating pricing for exposures according to their energy efficiency or by including a sector / client specific charge

7. Governance Standards Around Disclosures

The European Commission's Non-Binding Guidelines on Non-Financial Reporting (June 2017) contain 6 key principles for good non-financial reporting, namely that disclosed information should be:

1. Material;
2. Fair, balanced and understandable;
3. Comprehensive but concise;
4. Strategic and forward-looking;
5. Stakeholder oriented; and
6. Consistent and coherent.

Firms are required to make ESG-related disclosures both in relation to their corporate purpose and across their regulated activities, services and product types. The following key consideration should further help firm in managing this disclosure risk:

- Map 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)
- 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 light of the potential liability of the parent company for the implementation and management of ESG matters across the whole group
- How to acknowledge and address the needs of different audiences and different disclosure types and method

8. Policy Recommendations

As evidenced by this Report, the regulatory landscape for ESG disclosures is inherently complex, requiring careful sequencing and alignment of requirements to ensure financial institutions are able to comply while avoiding excessive disclosure risk and regulatory risk. Specifically, the appropriate design of these requirements needs to:

- Take into account the need to avoid duplicative mandates (e.g. revised NFRD reporting should seek to consolidate as much as possible the reporting requirements across the disclosure spectrum, as appropriate);
- Take into account the need to ensure that financial institutions are able to access high-quality data from their non-financial corporate clients in order to comply with their own disclosure requirements, as well be given the time to assess the quality of this data; and
- Take into account the global nature of the business of reporting undertakings, both financial and non-financial.

The concurrent nature of the progress on these different regulatory initiatives, including the simultaneous development of Level 1 and Level 2 requirements for distinct but interlinked files, underlines the necessity to ensure constant cooperation and alignment of efforts among the European Commission, European Supervisory Authorities, and co-legislators – as well as consultation and cooperation with international standard-setters.

These recommendations, while non-exhaustive, are meant to assist in ensuring the aforementioned considerations are taken into account in the context of key files, thus facilitating the development of a coherent and aligned regulatory framework for ESG disclosures that will enable the allocation of capital efficiently towards corporates in transition.

An additional recommendation, albeit not covered extensively in detail in the recommendations below, would be the Commission's careful consideration of the potential regulating of ESG ratings and research provisions in the context of the Renewed Sustainable Finance Strategy – which may assist in the prevention of greenwashing, capital misallocation, conflicts of interest and product mis-selling, especially in instances where direct data from investee companies may not be available.

Finally, the digitalisation of ESG data is a significant enabling factor in facilitating its accessibility, comparability, and usefulness.[41]

Key Messages:

1. The scope of the NFRD should be appropriately and proportionally expanded to include non-listed companies and SMEs.
2. The revised NFRD and elaboration of the European non-financial reporting standard should reflect a continued assessment of the TCFD reporting framework as a benchmark for the disclosure of climate risk.
3. Article 8 disclosure requirements under the Taxonomy should be appropriately sequenced, with non-financial corporate clients of financial institutions reporting 12 months in advance of financial institutions.
4. DNSH reporting requirements for the purposes of Article 8 disclosure requirements should be introduced in a staggered way, with further guidance on simplified reporting released by the European Commission and the EU Platform on Sustainable Finance.
5. The Green Asset Ratio variables should be restricted to banking book EU exposures in the first instance.

[41] For further analysis of AFME's key asks in the context of the forthcoming proposal for a European Single Access Point, please refer to https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20ESAP%20CP%20response%20guiding%20principles%2012032021.pdf

6. Reporting requirements linked to the forthcoming sustainable corporate governance proposal should be aligned with those expected under the revised NFRD. In addition, the European Commission and EU Platform on Sustainable Finance should consider the extent to which adherence to the minimum social safeguards of the Taxonomy can be aligned with reporting requirements under the NFRD.
7. International regulatory convergence in ESG reporting should be a key consideration in the further elaboration of the European reporting framework. The European Commission should duly consider how to best ensure cooperation and ongoing dialogue with international standard-setters, including through the work of the International Platform on Sustainable Finance, to facilitate the development of an aligned and harmonised system of reporting requirements.

1. NFRD Scope

In terms of disclosures by non-financial corporates, the scope of the reviewed NFRD should be expanded to large non-listed companies and SMEs, the latter in a proportional manner. The expanded scope would facilitate financial institutions having access to the data needed to meet their own regulatory disclosure requirements across the board.

Process: Proposal for a review of the NFRD (L1)

The forthcoming review of the NFRD is expected to be an opportunity for the re-evaluation of in-scope undertakings.[42] As a general consideration, financial institutions under the scope of the Taxonomy, SFDR, as well as the forthcoming Pillar III disclosures as part of CRR2, require disclosed information from non-financial corporate clients and counterparties in order to be able to fully assess the range of ESG risks and impacts linked to the portfolios. Considering that many of these clients and counterparties are non-listed, ensuring their inclusion under the revised NFRD scope would act as a horizontal enabler for the provision of relevant data to financial institutions, facilitating in turn their own disclosure requirements across the spectrum of relevant regulations.

2. NFRD – TCFD Reporting

The TCFD framework is widely considered a benchmark for the disclosure of information to demonstrate an undertaking's approach to responding to climate risks and opportunities. We encourage policymakers to continue to assess the usefulness of the framework as a helpful reference for the development of a both an EU-based and potential global reporting regime for the disclosure of climate risk.

Process: Development of the EU non-financial reporting standard, NFRD (L1)

The TCFD framework constitutes one of the most widely used references for the disclosure of climate-related risks and opportunities, adopting a single materiality approach. The framework specifically outlines reporting requirements around four topics, cohesively meant to provide a complete view of the reporting undertaking's approach to the management of climate-related risks and opportunities:

1. **Governance** around climate-related risks and opportunities;
2. Impact of climate-related risks and opportunities on **business strategy,** where material;
3. **Identification and management** of climate-related risks and opportunities; and

[42] For further analysis of AFME's key asks in the context of the forthcoming review of the NFRD, please refer to https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20ISDA%20NFRD%20revision%20consultation%20response_Final_11062020.pdf

4. Disclosure of **metrics and targets** for the assessment of climate-related risks and opportunities. In all, the TCFD framework has gained widespread adoption across the financial services industry.

Currently, disclosure requirements linked to the TCFD framework can be found to overlap with some of the requirements of the current NFRD, as well as the ECB Guide on climate-related and environmental risk. In its own work in the development of the European non-financial reporting standard, EFRAG has considered the four TCFD reporting areas outlined above as a reference framework, with an eye towards aligning users' and preparers' expectations and facilitating the usability of data on the topic of responding to financially-material climate risks and opportunities. In addition, the European Commission has already integrated the TCFD Framework in its 2019 update of the non-financial reporting guidelines accompanying the Directive.[43] We encourage the continued consideration of the framework for the disclosure of climate risk based on these guidelines as part of the Non-Financial Reporting framework, and encourage policymakers to assess the degree of alignment of the new reporting standard with others, such as SASB and the GRI, in further developing a simplified climate risk disclosure regime. As also outlined in EFRAG's recent Recommendations to the European Commission concerning the development of the EU non-financial reporting standard, the Corporate Reporting Dialogue has demonstrated the high level of alignment between the TCFD, CDP, CDSB and GRI frameworks – emphasising the usefulness of the framework as a reference for further elaborating disclosure frameworks for climate risk.

3. Taxonomy (Article 8) – Sequencing

In the context of Art. 8 disclosures, requirements should be appropriately sequenced, ensuring that financial institutions would have access to relevant data from their non-financial clients first, to aid in their own disclosures. As such, a 12-month period between applicability of Art. 8 requirements to financial and non-financial corporates should be introduced.

Process: Proposal of a review of the NFRD (L1), Development of the delegated act specifying the content and presentation of the information to be disclosed under Article 8, expected to be adopted by June 1, 2021.

Article 8 of the Taxonomy Regulation amends the NFRD by requiring the financial and non-financial undertakings within the NFRD scope to disclose information demonstrating the extent to which their activities are environmentally sustainable, according to the Taxonomy provisions. The EBA has recently submitted advice to the European Commission to aid in the further elaboration of the appropriate metrics for this disclosure, settling on the proposal of a Green Asset Ratio for financial institutions. While the specifics of the appropriate disclosure metric for financial corporates are expected to be determined through delegated regulation by June 2021, the accuracy of the disclosed information would be enhanced by ensuring requirements are introduced in a sequenced way, with those for the corporate clients of financial institutions predating those of financial institutions by a 12-month period. The interim period would allow financial institutions to have access to, and perform due diligence on, the data received by clients, thus enabling their own disclosures. Nonetheless, challenges concerning the timely procurement and use of data may remain in relation to non-EU exposures, SMEs and non-listed companies (the latter meant to be addressed by Recommendation #1).

[43] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01)&from=EN

4. Taxonomy (Article 8) – DNSH

In the context of Art. 8 disclosures, requirements should be introduced in a staggered way, with compliance to DNSH criteria introduced sequentially. In addition, the Commission may consider, under the guidance of the EU Platform on Sustainable Finance, the development of Technical Guidance on DNSH, introducing simplified DNSH compliance options for certain exposures – an approach adopted for the application of DNSH in the context of the Recovery and Resilience Facility, for Member States. Overall, the disclosures of financial institutions on DNSH will be dependent on the respective disclosures made by non-financial corporate clients – the difficulties of sourcing this data should be taken into account.

Process: Proposal for a review of the NFRD (L1) and additional development of Technical Guidance for the applicability of DNSH by financial institutions.[44]

Banks have already made demonstrable progress in the assessment of their portfolio exposures linked to undertakings covered by the NFRD, which will aid compliance with Art. 8 requirements. Nonetheless, compliance with DNSH criteria requires the disclosure of further data from non-financial corporates that is not yet readily available. A recent Technical Report by the JRC[45] has explored a variety of scenarios for how investment in Taxonomy-aligned activities may support the low-carbon transition. Nonetheless, DNSH data is sparsely available for the purposes of this analysis, emphasising the difficulties of procuring this data from non-financial corporate clients. As such, the disclosure of DNSH data should be introduced in a staggered way, pending also further definition of the methodologies and requirements for compliance.

In the context of the applicability of the DNSH criteria to the Recovery and Resolution Facility, the European Commission has released specific technical advice aimed at facilitating Member State compliance with the requirement – including through the introduction of simplified disclosure options. The European Commission may request the advice of the EU Platform on Sustainable Finance in the elaboration of similar guidance for financial institutions needing to assess their NFRD exposures for the purposes of Art. 8 reporting.

[44] https://ec.europa.eu/info/sites/info/files/c2021_1054_en.pdf
[45] https://ec.europa.eu/jrc/en/publication/eu-sustainability-taxonomy-financial-impact-assessment

5. **Taxonomy (Article 8) – Green Asset Ratio**

In terms of required disclosures, the GAR KPI ratios should always be measured consistently, and so, if certain activities are excluded from the numerator they should be excluded from the denominator, as stated by the EBA advice on Art. 8 disclosure. The numerator of the proposed GAR should not include counterparties or clients which are not obliged to disclose their level of alignment with EU Taxonomy and / or to whom economic activities cannot be mapped or assessed according to Taxonomy criteria. The proposed GAR should be limited, in the first instance, to EU exposures to non-financial corporates. In terms of additional sources of income to be reflected in the GAR by investment services firms in the context of portfolio management and investment advice, a possible ratio could be the proportion of fee and commission-based income from services associated with Art. 8 and Art. 9 products under the SFDR, to the total fee and commission-based income from products marketed in the EU. For this to be successfully done, the European Commission should release further guidance on the applicability of Art. 8 and Art. 9 products in the context of the Taxonomy. Overall, the exposures covered by the GAR should be limited to the banking book, while further approaches for expanding the Taxonomy to trading book activities should be carefully evaluated in the future.

Process: Development of the delegated act specifying the content and presentation of the information to be disclosed under Art. 8, expected to be adopted by June 1, 2021.

At the current juncture, it is not pragmatic to expect a complete assessment of the performance of the entire balance sheet and income statement vis-à-vis exposures to Taxonomy-aligned activities, requiring a staggered approach to the information used in the context of the GAR. In addition, limiting the information required to EU-based exposures in the first instance would facilitate the procurement and representation of accurate estimates on behalf of financial institutions. In terms of the potential inclusion of fee and commission-based information, it would be significant for the EBA and the European Commission to articulate the significance of this information at the current juncture. Finally, the GAR should be developed through the collection of flow, rather than stock, variables. This provision would allow for a picture of the total volume of financing over a period of time, rather than a singular image at a specific point in time.

6. **NFRD – Corporate Governance/ Taxonomy Social Safeguard Reporting Alignment**

Reporting requirements possibly emanating from the forthcoming proposal on sustainable corporate governance should be covered by the forthcoming requirements of the reviewed Non-Financial Reporting Directive. In addition, the interaction between the reporting requirements under Article 18 of the Taxonomy Regulation (i.e. the social safeguards) and the forthcoming requirements under the revised NFRD should be aligned.

Process: Proposal for a review of the NFRD (L1), proposal for a corporate governance framework (L1), further technical advice by the EU Platform on Sustainable Finance, as per Recital 52 of the Taxonomy Regulation.

The expected proposal for a legislation on sustainable corporate governance,[46] its release set for Q2 this year, may introduce reporting requirements linked specifically to proposed due diligence duties of financial and non-financial corporates. These may include reporting requirements linked to the adherence of future in-scope undertakings with the OECD Guidelines for Multinational Enterprises and related sectoral guidance for financial institutions. The revision of the NFRD is concurrently expected to articulate in further detail the reporting requirements linked to the same frameworks, either through Level 1 provisions or the elaboration of the EU Non-Financial Reporting Standard. Considering the potential thematic overlap of these reporting requirements, it would be important to avoid duplication of requirements, facilitating compliance through a single set of aligned requirements in the context of the revised NFRD.

In addition, compliance with the minimum social safeguards as part of the Taxonomy Regulation is also predicated on the need to ensure alignment with the OECD Guidelines for Multinational Enterprises, and the UN Guiding Principles on Business and Human Rights, albeit the specificities of these compliance requirements have not yet been developed – which remains one of the mandates of the EU Platform on Sustainable Finance. The European Commission, co-legislators, and the EU Platform on Sustainable Finance should explore the extent to which compliance with the social safeguard disclosure requirements would be aligned with those of the sustainable corporate governance proposal, as well as the NFRD.

7. International alignment

The European Commission and EFRAG should continue their close engagement with the IFRS Foundation and other relevant standard-setting bodies in the elaboration of the NFRD review, as well as the accompanying disclosure requirements in the expected EU non-financial reporting standard. This collaboration should ideally ensure, at least at a minimum, aligned disclosure requirements on similar thematic issues. Should divergences be unavoidable, mutual recognition arrangements could be considered upon completion of the NFRD review.

Process: Development of the EU non-financial reporting standard, NFRD (L1)

International alignment in terms of reporting standards is becoming an increasingly significant area of focus for global financial market participants. While the UK has committed to adopting the TCFD framework across all sectors by 2025[47] – and the Securities and Exchanges Commission is consulting on potential action to further facilitate the procurement of consistent, comparable and reliable data on climate change[48] – a proliferation of reporting frameworks remain and/or are being developed: the IIRC, GRI, SASB, and the work being prepared by the IFRS.[49] This diversity of approaches requires careful coordination to ensure continued consistency. As also outlined by IOSCO in its final report on the role of securities regulators in sustainable finance, the lack of consistency and comparability across third-party frameworks could "create an obstacle to cross border financial activities and raise investor protection concerns".

The differing levels of political impetus behind the sustainability agenda in the European Union and other significant jurisdictions, as well as differing levels of progress in the development of reporting frameworks, may risk the creation of requirements that are not aligned, adding more complexity and lack of clarity for financial institutions and their clients, hampering compliance in any one jurisdiction. Differing sets of reporting requirements applied to parent and subsidiary companies across different

[46] For further analysis of AFME's key asks in the context of the forthcoming sustainable corporate governance proposal, please refer to https://www.afme.eu/Publications/Consultation-Responses/detail/AFME-response-to-European-Commissions-Consultation-on-Sustainable-Corporate-Governance

[47] https://www.gov.uk/government/publications/uk-joint-regulator-and-government-tcfd-taskforce-interim-report-and-roadmap

[48] https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

[49] https://www.ifrs.org/news-and-events/2021/02/trustees-announce-next-steps-in-response-to-broad-demand-for-global-sustainability-standards/

jurisdictions further emphasise the administrative complication of complying with different sets of ESG reporting requirements.

The European Commission is uniquely placed to continue promoting coordination with international standard-setting bodies in the context of the forthcoming revision of the NFRD, including through its use of the EFRAG's forthcoming EU non-financial reporting standard. This coordination should have as its outcome a European reporting framework that is duly informed by best practice internationally, while also setting a clear way forward that is appropriate for EU specificities. This outcome would also be coherent with the Commission's ambition of promoting global regulatory convergence in sustainable finance, as outlined in the Communication on "A new EU-US agenda for global change".[50]

[50] https://ec.europa.eu/info/files/joint-communication-new-eu-us-agenda-global-change_en

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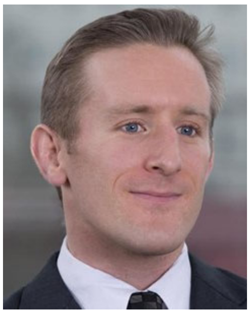

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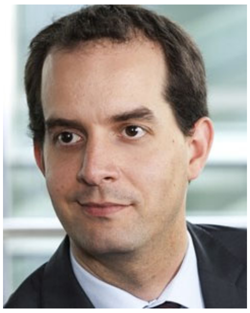

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