Accelerating Sustainable Finance
Implications of the EU Commission Action Plan

“Sustainability is the theme of our time.”1 Environmental, social and governance (ESG) issues are becoming ever more important aspects in the investment needs of current and future generations.

Financial services organizations are facing the dual pressure of tightening regulatory expectations and increasing customer awareness of and demand for sustainable finance solutions. This comes at a time when the integration of ESG considerations into investment decisions is only just beginning to move into the mainstream of the finance agenda. Many organizations have yet to develop robust strategies and processes that incorporate sustainability factors into their operations.

The regulatory dynamic on sustainable finance has accelerated significantly in light of this, with the EU Commission recently launching a strategy for reforming the EU financial system to support its climate change and sustainable development agenda. The “Action Plan: Financing Sustainable Growth,” released on 8 March 2018, represents an ambitious roadmap aimed at embedding sustainability considerations firmly into the mainstream of financial markets.

Building on the recommendations of the EU High Level Expert Group on Sustainable Finance (HLEG) published earlier this year, the Action Plan’s key objectives are set out below:

- Establishing a common taxonomy to help redirect capital flows toward sustainable investments
- Mainstreaming sustainability into risk management by clarifying investor fiduciary duties as well as capital requirements for environmental and climate risks
- Taking action to enhance sustainability governance as well as corporate disclosure of non-financial information

EY’s integrated competencies in financial services and sustainability management offer a unique suite of services aimed at supporting organizations in navigating the emerging regulatory landscape and at fully leveraging the opportunities associated with the growing demand for sustainable finance solutions.

1 EU High-Level Expert Group on Sustainable Finance, Final Report 2018

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Emerging Market Standards on ESG
To facilitate the reorientation of capital toward sustainable investments, the Commission’s Action Plan recognizes the need for legislative action to classify sustainable activities and financial products. The subsequent objective is to integrate sustainability taxonomy into EU law. This taxonomy will serve as a basis for developing further standards, labels, green-supporting factors for prudential requirements and for measuring financial flows.

The plan also outlines its intent to clarify investor fiduciary duties to consider ESG factors, although the EC has yet to provide details on legislative proposals. The HLEG report has suggested in this context an EU omnibus proposal that could amend multiple EU Directives such as IORP II, PEPP, Solvency II, MiFID II, UCITS, AIFMD and the Shareholder Rights Directive. The Commission has also launched a fitness check of EU legislation on public corporate reporting, including the Non-Financial and Diversity Information (NFI) Directive. Conclusions of this assessment that will inform any future legislative proposals will be published by the second quarter of 2019. The revised guidelines should provide further recommendations for companies on how to consider sustainability factors in their strategy and investment decisions, in particular on climate-related risks in line with the TCFD’s¹ recommendation.

### Key challenges addressed

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<tr>
<th>Key challenges addressed</th>
<th>Actions taken by the EC</th>
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<tr>
<td>No common definition of “sustainable” investment</td>
<td>EU classification (taxonomy) of sustainable activities</td>
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<td>Risk of “greenwashing” of investment products</td>
<td>Set standards and benchmarks for low-carbon/positive impact financial products to give investors certainty</td>
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<td>Insufficient consideration of climate and environmental risks by financial institution</td>
<td>Analyze whether capital requirements should reflect exposure to climate change and environmental risks</td>
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<td>Underestimation of ESG factors and their impact by investors</td>
<td>Clarify institutional investors’ and managers’ (fiduciary) duties to integrate ESG factors into investment process</td>
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<td>Insufficient information on corporate sustainability-related oversight and activities</td>
<td>Enhance non-financial information disclosure and foster more sustainable corporate governance</td>
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### EC goals

- **Reorienting capital flows toward sustainable investments**
- **Mainstreaming sustainability into risk management**
- **Fostering transparency and long-termism**

### Timeline

- **2015** Paris Agreement
- **March 2018** Action Plan
- **June 2018** Technical Working Groups
- **Q2 2019** Implementation of Action Plan Elements based on TEG Reports
- **Q3 2019** Regulation on EU Taxonomy
- **Q3 2019** “Fitness check” of EU legislation on public corporate reporting
- **Q3 2019** Creation of EU-Ecolabel
- **Q2 2019** Creation of EU-Ecolabel
- **Full implementation of Action Plan between 2021 and 2022**
- **Subsequent Expansion to social sustainability criteria**
The Action Plan aims to raise the industry bar on sustainable finance by facilitating the emergence of a more mature and transparent marketplace. While many financial organizations have already started the process of considering ESG factors in certain areas of the investment chain, most are not yet sufficiently prepared to fully benefit from an accelerated mainstreaming of sustainable finance trends. Challenges exist in particular in the development of clear sustainability strategies and responsible investment policies that in turn would guide an effective implementation of material ESG factors in investment decision-making and risk management. Reporting on ESG across the financial sector remains inconsistent and lacks alignment with emerging regulatory developments.

The Action Plan presents an open-ended legislative road map with an aggressive timeline. Companies approaching these challenges proactively will be ideally positioned to leverage the opportunities resulting from the growing demand for sustainable finance.

### Implications for companies

The need for action for companies can be categorized into four main areas:

- **Sustainability Strategy and Investment Policy**
  - Mapping organizational design and benchmarking approaches
  - Taking sustainability management to the next level (using stakeholder analysis, materiality matrix, value creation modelling)

- **Research and Investment Process**
  - Analyzing research and investment processes to ensure that appropriate ESG methodology and ESG metrics are applied
  - Consolidating required data and research sources
  - Implementing streamlined ESG research processes and ESG metrics

- **Risk Management and Data Management**
  - In-depth analysis of system and data architecture
  - Verifying the availability and consistency of ESG data required within the relevant systems
  - EY ESG Big Data Tool

- **Reporting**
  - Reviewing ESG data requirements from institutional investors and implementing appropriate reporting processes
  - Evaluating upcoming regulatory requirements to align management and disclosure approach
### EY Service Offering

EY integrates unique competencies in financial services and sustainability management. We offer a modular set of sustainable finance solutions that can be tailored to organizations at different stages of the ESG maturity scale.

#### Sustainable Strategy Advice
- Advice on sustainable strategy including:
  - stakeholder analysis
  - materiality matrix
  - value creation modelling
- Benchmarking sustainability policy and organizational design
- Building a business case for long-term value creation

#### Maturity assessment, KPI development, value and impact measurement
- Support in developing value creation and impact measurement models
- ESG maturity assessment and benchmarking
- Definition of ESG KPIs
- Impact investing feasibility study

#### ESG Risk and Portfolio Management support
- Embedding ESG risks and opportunities in ERM framework
- ESG risk modelling and scenario analysis support
- Development of systems and data architecture

#### ESG Big Data Tool
- EY tools for next generation ESG data analysis
- ESG scanner analyzing unstructured data with machine learning
- Predictive ESG models that test ESG impact on valuation

#### Assurance on non-financial information (NFI)/ESG reporting
- Preparing disclosure to align with emerging transparency requirements (e.g. EU Action Plan, TCFD)
- Assurance on NFI reports and other industry assessments (e.g. PRI)
- Certification of sustainable finance products (e.g. green bonds)
- ESG due diligence (e.g. Equator Principles)

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