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Finance for Europe

LATHAM & WATKINS

Governance, conduct and compliance in the transition to sustainable finance

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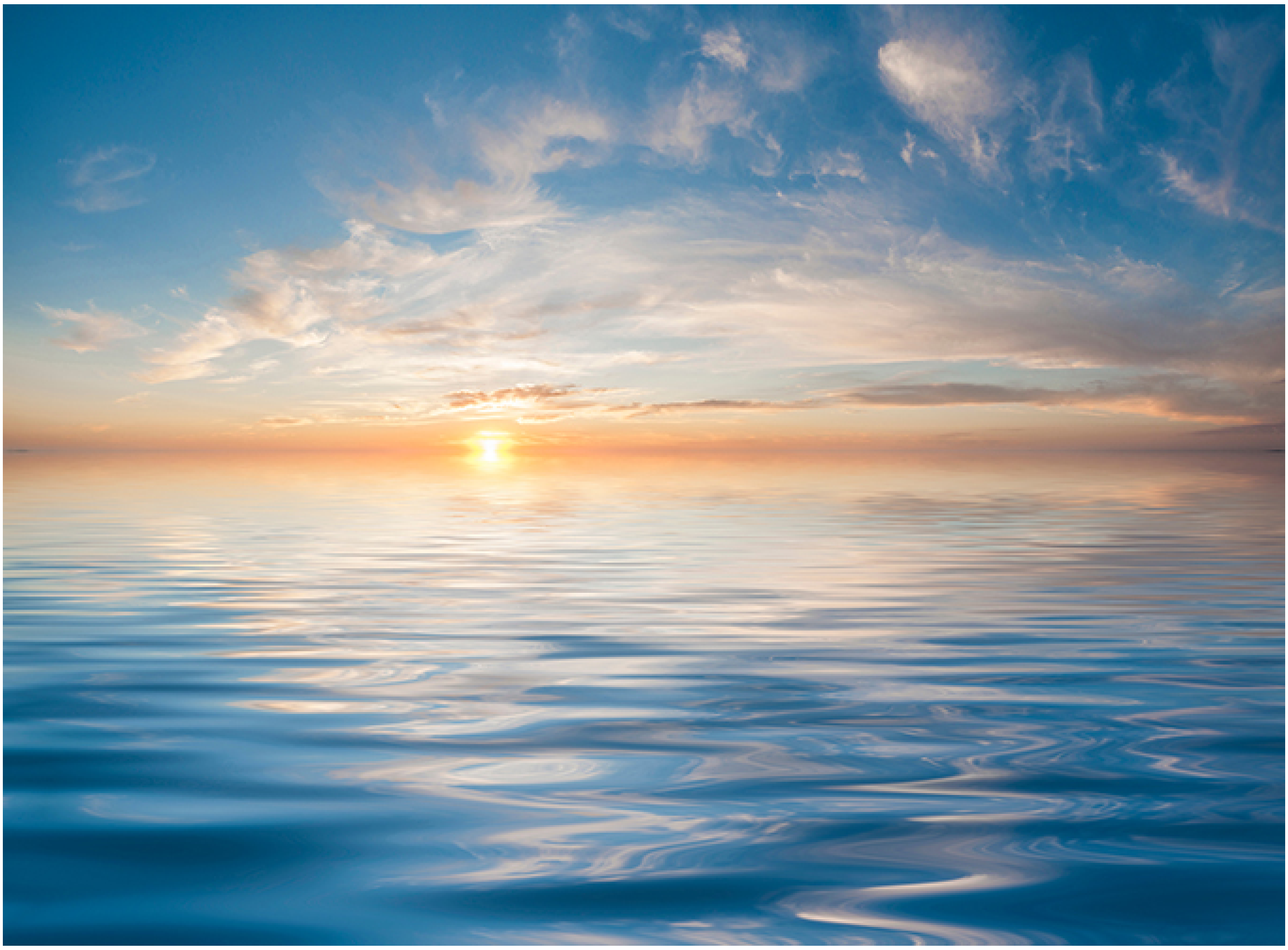

Association for Financial Markets in Europe
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Executive Summary

Sustainable finance has become a priority issue across various industries, not least in the financial services sector. Although the industry as a whole is in the early stages of mapping its overall approach to sustainable finance, firms should look to establish and embed an overall strategy and approach.

This paper is intended as a suggested roadmap to assist AFME members in establishing and/or furthering their corporate purpose and objectives in relation to sustainable finance. It does this by setting out 15 key principles that firms may wish to consider when developing their approach before raising some practical questions that aim to help implement and embed those principles into internal programmes in a systematic manner.

The principles cover:

- **Objectives and governance**: Ensuring that a central corporate purpose is set and that there is collective understanding, oversight and accountability in relation to sustainable finance-related risk amongst internal and external stakeholders.
- **Risk management**: Considering whether and how sustainable finance-related risks impact existing financial and non-financial risk factors, or if they create new ones, as well as determining how these risk factors can be integrated into existing risk management frameworks, strategically and in line with the defined risk appetite. Risk factors will differ by firm, but common factors are likely to be financial risk (which is closely linked to counterparty risk), mis-selling risk and disclosure risk.
- **Compliance & Monitoring**: Considering how to measure, monitor and mitigate the key risks arising from the transition to sustainable finance, including the tools and metrics that may be necessary to achieve this as well as the existing processes that can be leveraged.
- **Impact measurement**: Considering how to assess the progress and effectiveness of existing strategies deployed against established sustainable finance goals and determining what adjustments, if any, are required and identifying opportunities for further development and innovation.

In practice, each firm’s approach will differ depending on its individual business type/structure and the market in which it operates. The discussion of risks and possible approaches in this paper should not, therefore, be treated as comprehensive or as uniformly applicable to a firm’s individual circumstances.

The paper is focused on the European regulatory framework. Firms operating globally will of course need to consider the interaction with wider international initiatives.

AFME has partnered with Latham & Watkins LLP on the production of this White Paper.

Background

The transition to sustainable finance is a high priority business issue for firms, and the regulatory framework is developing quickly. The transition will affect all areas of firms' businesses, and it is important for firms to establish a robust and effective governance framework.

Accordingly, AFME has prepared this White Paper to help firms navigate the transition to sustainable finance. Implementing a consistent corporate level strategy is essential to underpin the successful integration of sustainable finance standards into business as usual activity, at both a firm wide and line of business level. The paper therefore focuses on the initial establishment of corporate level sustainable finance principles. In addition, the paper sets out thoughts on potential approaches to managing and mitigating the risks and opportunities associated with the sustainable finance transition as well as the conduct and compliance matters that should be taken into account in this respect.

The paper is intended to help firms with their internal thought process, by identifying the questions that firms need to be asking themselves by way of a roadmap to managing the sustainable finance transition. It should therefore support discussions among compliance, legal, conduct, programme management, senior business management and board level committees.

The paper is organised as follows:

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Objectives & Governance

The development of sustainable finance is an ongoing initiative which is informed by a range of different legislation, regulatory guidance and international best practice that will continue to develop over time. In light of this, the approach to implementation and compliance in this area is different compared to other legal and regulatory change projects.

A key risk that firms need to be aware of in this respect is the risk of a "bottom up" approach whereby different business areas and/or product lines implement sustainable finance measures relevant to them in a siloed way, without any coordination at a wider corporate level. Such an approach would risk leading to a disjointed, and at worst conflicting, approach to sustainable finance across the firm which would inhibit future implementation, monitoring and compliance. Accordingly, the central tenet of firms' roadmap to managing sustainable finance transition is the need to embed an overall strategy and mindset change consistently across the organisation.

Set out below are key principles for firms to consider when defining and setting their corporate purpose and objectives in relation to sustainable finance to prompt as well as to support internal programmes for implementing and embedding sustainable finance in a systematic manner. Defining a central corporate purpose in relation to sustainable finance not only sets the framework for wider implementation but also enables firms to challenge themselves and benchmark their efforts against their central objectives.

Definition of sustainable finance

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

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

In this context firms may wish to consider:

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

Corporate purpose and business strategy

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

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

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

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

In this context firms may wish to consider:

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

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

Oversight

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

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

In this context firms may wish to consider:

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

External engagement

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

In this context firms may wish to consider:

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

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

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

Training

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

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

In this context firms may wish to consider:

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

Risk management

The transition to sustainable finance accelerates existing risks and raises new risks for a business that can impact its profitability, success and even survival.[5] These risks should be assessed across all business lines and jurisdictions in which the firm operates. This section of the paper therefore considers the key risk areas that firms need to consider and address as part of their sustainable finance road map.

Enterprise risk management framework

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

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

In this context firms may wish to consider:

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

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

- How sustainability related risks could have an adverse impact on business continuity.

Financial risk

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

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

In this context firms may wish to consider:

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

Disclosure risk

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

In this context firms may wish to consider:

- Mapping all required disclosures relevant to the group and the entities sitting within it.
- Identify areas where industry standard template disclosures are available and appropriate for use.
- Consider the frequency of updates needed in relation to disclosures and embed a process for refreshing disclosures within the control framework.
- Identifying areas where they may be at risk of conflicting disclosures and develop heightened monitoring around such areas.
- Identifying areas where the firm is exposed due to available data or uncertainty in disclosure standards and consider ways to ensure that the language of disclosures makes any related statements on accuracy.
- Consider whether a phased implementation approach to disclosures may be appropriate – for example, to align with the progress of a firm's broader strategy on the transition to sustainable finance and the integrity of data available during certain time periods.

[6] Physical risks from climate change arise from a number of factors, and relate to specific weather events (such as heatwaves, floods, wildfires and storms) and longer-term shifts in the climate (such as changes in precipitation, extreme weather variability, sea level rise, and rising mean temperatures). Increasing frequency and severity or volatility of extreme weather events including flooding leading to physical damage to the value of financial assets or collateral held by banks, leading to increased credit risk.

[7] Transition risks can arise from the process of adjustment towards a low-carbon economy. A range of factors influence this adjustment, including: climate-related developments in policy and regulation, the emergence of disruptive technology or business models, shifting sentiment and societal preferences, or evolving evidence, frameworks and legal interpretations.

- The tools available to the firm to validate the accuracy of the information disclosed. To the extent such tools are relied upon, consider the control framework in place to ensure the initial and ongoing integrity of the tool.
- Consider whether independent auditing of ESG disclosures may be relevant (treating this information like financial disclosures) (see also **Principle 15** – *Effective Impact Measurement*).
- Engaging legal and litigation functions to track emerging trends in misstatement litigation.
- How the independence of the individual corporate entities within the group will be maintained in light of the potential liability of the parent company for the implementation and management of ESG matters across the whole group.[8]
- How to acknowledge and address the needs of different audiences and different disclosure types and methods.

Conduct risk

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

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

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

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

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

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

- *Greenwashing*: Whilst common definitions and standards are being developed, during the transition to a uniform taxonomy it is not always clear what firms or consumers mean by or expect from "green" or "sustainable" products and services. This creates that risk that consumers suffer harm from

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

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

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

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

Mis-selling risks

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

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

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

Antitrust risk

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

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

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

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

Counterparty risk

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

In this context firms may wish to consider:

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

Compliance & Monitoring

Firms will need to monitor and manage the risks associated with the transition to sustainable finance in line with a defined risk appetite statement (see **Principle 6** – *Enterprise Risk Management Framework*).

Firms should also consider the policies and procedures that need to be put in place in order to support the compliance and ongoing monitoring of sustainable finance priorities in accordance with the firm's regulatory obligations and risk appetite.

Compliance framework

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

In this context, firms may wish to consider:

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

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

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

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

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

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

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

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

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

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

- Consider the key areas (including policies and procedures) impacted and how they should be updated to incorporate sustainable finance factors.
- Determine the key measures and metrics that will be used to monitor adherence to the firm's sustainable finance strategy.
- Consider whether adequate resources and sufficient skills and expertise are devoted to monitoring and ensuring that the transitional steps identified are being implemented and that sustainable finance risks are within the firm's risk appetite.
- Determine the management information that should be provided to the board and relevant sub-committees to enable them to perform this oversight function.

Monitoring

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

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

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

In this context firms may wish to consider:

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

Impact measurement

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

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

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

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

Annex: Sustainable Finance – Summary of Key Initiatives

This document outlines, primarily from an environmental perspective: (i) the key (developed) legislation or legislative proposals under the EU Action Plan on Sustainable Finance and European Green Deal (where it relates to sustainable finance specifically); (ii) the key (developed) guidance on sustainable finance issued by regulators in the UK; and (iii) the significant global initiatives launched to promote and achieve sustainable finance.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
EU Initiatives					
1.	**Action Plan: Financing Sustainable Growth, European Green Deal**	In 2018, the European Commission published its "Action Plan: Financing Sustainable Growth" (the "**Action Plan**") which sets out its three main objectives in the ESG space: • Reorienting capital flows towards sustainable investment to achieve sustainable and inclusive growth. • Managing financial risks stemming from climate change, environmental degradation and social issues. • Fostering transparency and long-termism in financial and economic activity. Following the Action Plan, the Commission published its European Green Deal – a package of measures which targets all sectors and industries for a "*just and inclusive*" transition to achieving climate neutrality by 2050. The European Green Deal sets out a roadmap, with actions, to boost the efficient use of resources by moving to a clean, circular economy, including via pursuing green finance and investment. The various measures described in this section implement the key actions announced in the Action Plan and European Green Deal.	Participants in the financial market – see specific entries below.	Typically mandatory, but see specific entries below.	The Action Plan was published on 8 March 2018 and the European Green Deal was published on 11 December 2019. On 8 April 2020, the European Commission published a consultation document on its Renewed Sustainable Finance Strategy, which aims to build on the initiatives and strategies in the Action Plan and European Green Deal aimed at helping redirect private capital towards sustainable investment. The Renewed Sustainable Finance Strategy is expected to be published in Q4 2020.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
2.	**Taxonomy Regulation (Regulation (EU) 2020/852)**	The Taxonomy Regulation establishes a common framework to help financial markets clearly and consistently identify environmental outperformance and to direct their investments accordingly. The taxonomy serves to prevent: (i) fragmented classifications from developing across EU Member States; and (ii) "greenwashing" – i.e. the practice of marketing products as "green" or "sustainable" when they are in fact not. The framework is to be used by EU Member States when developing ESG-related classification systems, and by financial market participants (as defined in the next column) when making certain financial products available to investors (whether or not the products target "environmentally sustainable investments"). Financial and non-financial companies that fall within the scope of the Non-Financial Reporting Directive (NFRD) will have to disclose information on how and to what extent their activities are associated with environmentally sustainable economic activities. According to the regulation, an environmentally sustainable investment is an investment in an economic activity that complies with the following criteria: • Contributes substantially to one or more of the environmental objectives (climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; protection of healthy ecosystems). • Does not significantly harm any of the environmental objectives.	• EU Financial Market Participants (FMPs), defined as: i. Insurance undertakings that make insurance based investment products available. ii. Alternative Investment Fund Managers. iii. Investment firms and credit institutions that provide portfolio management services. iv. Manufacturers or providers of certain pension products. v. UCITS management companies. vi. Managers of European Venture Capital Funds and European Social Entrepreneurship Funds. • Financial and non-financial companies that are within the scope of the NFRD. • EU Member States.	Mandatory for EU Member States, financial market participants, and companies in scope of the NFRD. Voluntary for other market actors (e.g. SMEs).	The Taxonomy Regulation entered into force on 12 July 2020 and the provisions relating to climate change mitigation and adaptation apply from 1 January 2022 with the remaining provisions applying from 1 January 2023. The detailed Technical Screening Criteria (which helps determine whether an activity qualifies as an environmentally sustainable investment) under the Taxonomy is to be established through delegated acts. It is anticipated that these will be published towards the end of 2020 and over the course of 2021.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		• Is carried out in compliance with the minimum social safeguards. • Complies with technical screening criteria [to be] separately established by the Commission. The Taxonomy Regulation also requires that certain disclosures are made depending on whether the investment concerned has sustainability as its objective, promotes environmental characteristics, or is another type of financial product.			
3.	**Disclosure Regulation (Regulation (EU) 2019/2088)**	The Regulation sets out harmonised rules for financial market participants (as defined above) and Financial Advisors (as defined in the next column) on disclosures around the integration of sustainability risks and the consideration of adverse impacts on environmental and social factors in their processes and the provision of sustainability-related information with respect to certain financial products. Firms within the scope of the Regulation, among other requirements, will have to: • Publish and keep up-to-date written policies on the integration of sustainability risks in their investment decision-making and investment advice processes. • Ensure that marketing communications do not contradict any information disclosed under the disclosure rules. • Make transparent the impact of sustainability risks on investment decisions and returns, as well as how remuneration policies reflect sustainability risks/investments. • For Sustainable Investments (see below), explain how the target of sustainable investment is ensured. • Describe the methodologies used to assess, evaluate and monitor whether the professed	• FMPs (see, above). • Financial Advisors, defined as: i. Investment firms, credit institutions, Alternative Investment Fund Managers, and UCITS management companies providing investment advice. ii. Insurance intermediaries/ undertakings providing insurance advice on insurance based investment products.	Mandatory.	The Disclosure Regulation came into force on 29 December 2019. Most of its provisions will apply from 10 March 2021, but certain provisions became applicable on 29 December 2019, and others will apply from 1 January 2022. The European Supervisory Authorities (ESAs) are required to develop technical standards to supplement the Level 1 Regulation, most of which must be completed by 30 December 2020. ESAs launched a consultation on the draft technical standards, which closes on 1 September 2020.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		sustainability targets are being met, and provide information on the impact of sustainable investments on environmental and social factors. According to the proposal, "Sustainable Investments" are investments in: • An economic activity that contributes to an environmental objective (as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy). • An economic activity that contributes to a social objective, and in particular an investment that contributes to tackling inequality, fostering social cohesion, social integration and labour relations, or in human capital or economically or socially disadvantaged communities, provided that that such investments do not significantly harm any of those other objectives and that companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of relevant staff, and tax compliance.			
4.	**Low Carbon Benchmark Regulation (Regulation (EU) 2019/2089)**	Via an amendment to the Benchmark Regulation, the Low Carbon Benchmark Regulation creates two new voluntary categories of benchmarks: • EU Climate Transition Benchmark ("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 • EU Paris-aligned Benchmark ("PAB") or positive carbon benchmark – i.e. where the underlying	Benchmark administrators.	Mandatory where an in-scope benchmark is provided (such benchmarks need only be provided on a voluntary basis).	The Low Carbon Benchmark Regulation came into force on 10 December 2019 and has been applicable since 30 April 2020. The European Commission has published three delegated acts, which

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		assets are selected on the basis that their carbon emissions savings exceeds their carbon emissions in such a way that it aligns with the objectives of the Paris Climate Agreement. Benchmark administrators will have to disclose the methodology used to determine/create benchmarks that pursue or take into account ESG objectives. The rules also set out elements of the methodology to be followed. With the exception of benchmarks related to interest rates and FX, all benchmarks will have to disclose, in their benchmark statement, whether or not they pursue ESG objectives.			are pending formal adoption. They relate to: • The minimum standards for CTBs and PABs to be labelled as such, the action to be taken if these standards are not met and the methodology for transparency requirements. • The minimum explanation to be provided on how ESG factors are reflected in all benchmarks (including templates). • The minimum explanation to be provided for all benchmarks on how ESG factors are reflected in the benchmark methodology (including templates).
5.	**Draft Delegated Acts on MiFID product governance, MiFID suitability, IDD**	The proposed amendments would require MiFID investment firms and insurance intermediaries and insurance undertakings to incorporate ESG factors into their organisational, risk-management, investment advice and produce governance processes.	• MiFID investment firms. • Insurance intermediaries and	Mandatory.	The European Commission consulted on the draft delegated acts, which were published on 8 June 2020. The final

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
	& Solvency II (June 2020)	The proposed amendment to the MiFID II regime would require MiFID investment firms to: • Integrate sustainability factors, risks and preferences into certain organisational requirements and operating conditions. • Obtain information from clients on their sustainability preferences and take those preferences into account when selecting products to be offered and making relevant disclosures (depending on the activities performed). • Integrate sustainability factors and preferences into their product governance obligations. The proposed amendment to the Insurance Distribution Directive (IDD) and Solvency II regimes would require firms to: • Obtain information from clients on their ESG preferences and take those preferences into account when selecting suitable products to offer to clients (and include details on how those preferences have been taken into account in the suitability statement). • Integrate sustainability risks in certain governance processes.	insurance undertakings.		delegated acts are expected to be adopted in Q3 or Q4 2020.
6.	**European Commission Review of the Non-financial Reporting Directive (NFRD)**	The NFRD requires companies to include non-financial statements in annual reports which outline the policies implemented in relation to various ESG (and other) factors. The European Commission has already published non-binding and flexible guidelines on reporting climate-related information, which aims to integrate the TCFD's recommendation. This review is expected to introduce stricter reporting requirements aimed at developing a (likely) mandatory EU-wide standard for ESG reporting by developing common metrics, benchmarks and KPIs.	Currently: Large listed companies and public interest companies (including all banks and insurance companies) with more than 500 employees. The scope is likely to be broadened as part of the review process.	Mandatory (pending final rules).	The consultation was published on 20 February 2020. The European Commission's legislative proposal is expected to be published in Q1 2021.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
7.	**EU Ecolabel for Retail Financial Products (technical report published December 2019)**	The EU Ecolabel is a voluntary labelling system which serves to enable consumers to recognise high-quality environmentally friendly products (provided that certain criteria are met). The European Commission's Joint Research Centre (JRC) has proposed that the label be used in respect of retail financial products, including investment products subject to the PRIIPs regulation as well as fixed-term and savings deposit products. The following assessment criteria have been identified as indicative of investments which enhance environmental benefits: • Portfolio composition, in particular in terms of green economic activities (as defined in the Taxonomy Regulation). • Exclusions based on environmental aspects. • Exclusions based on social aspects and corporate governance practices. • Engagement - driving improvements through interacting with companies. • Information for retail investors and information appearing on the EU ecolabel.	Manufacturers of retail financial products that are registered or authorised for marketing or distribution in an EU member state.	Voluntary.	The final criteria is expected to be published in Q3 or Q4 2021 and will have to be adopted under the EU Ecolabel Regulation.
8.	**EU Green Bond Standard (EU GBS)**	It is currently proposed that the EU Green Bond Standard should be a voluntary standard that issuers may follow when issuing green bonds. The standard requires the following core requirements to be met: • That the green bonds issued align with the principles/objectives set out in the standard (for example, it must be detailed how the issuer's strategy aligns with the environmental objectives of the EU Green Bond programme, and proceeds allocation and impact reporting must be conducted).	Listed or unlisted bonds or capital market debt instruments issued by a European or international issuer.	Voluntary.	The EU's Technical Expert Group on sustainable finance (TEG) has published a draft model of an EU Green Bond Standard, which is subject to a decision of the European Commission on next steps. The Commission has launched a public consultation on the creation of an EU GBS.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		• The proceeds, or an amount equal to such proceeds, must be exclusively used to finance or refinance in part or in full new and/or existing green projects (as is to be described in the bond documentation). • The alignment of the instrument with the standard is verified by an approved verifier in accordance with the standard.			The consultation is due to close on 2 October 2020.
9.	**European Central Bank (ECB) Guide on Climate-related and Environmental Risks**	This ECB Guide sets out the ECB's understanding of the safe and prudent management of climate-related and environmental risks under the current prudential framework. Amongst other items, the ECB expects firms to: • Understand the impact of climate-related and environmental risks on the business environment in which they operate and integrate these into their business strategies and risk appetite frameworks. • Ensure that their management bodies consider climate-related and environmental risks when developing overall business strategy, objectives and their risk management framework (and assign responsibility for the management of climate-related risks within the organisational structure in accordance with the three lines of defence model). • Report (internally) aggregated risk data that reflects exposure to climate-related and environmental risks with a view to enabling management body and relevant sub-committees to make informed decisions.	Significant institutions directly supervised by the ECB.	Voluntary.	The Guide applies as of its date of publication (May 2020). From end-2020, significant credit institutions are expected to inform the ECB of any divergences from the expectations outlined in the Guide.
10.	**European Commission Sustainable**	The European Commission is proposing a directive that would embed sustainability into corporate governance frameworks. The purpose of the	Companies.	Most likely, mandatory.	The Inception Impact Assessment was published on 30 July

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
	Corporate Governance Inception Impact Assessment	proposal is to address concerns that many companies focus too much on short-term financial performance compared to their long-term development and sustainability aspects. The exact type of initiative would be based on the outcome of the impact assessment. It is envisaged that it could include modifying the codified company law Directive (2017/1132) and the consolidated Directive on Shareholder Rights (2007/36) to include an appropriate combination of corporate and directors' duties with a view to requiring that categories of limited liability companies do no harm and to empower corporate directors to integrate wider interests into their decisions.			2020. Feedback is to be provided by 8 October 2020.
UK Initiatives					
11.	Prudential Regulation Authority (PRA) Supervisory Statement 3/19 and Policy Statement 11/19	The PRA has stated that firms must understand and assess the financial risks from climate change that affect them. Specifically, the PRA has produced supervisory guidance, indicating that firms should: • Embed considerations of financial risks from climate change in governance arrangements (including appointing a Senior Manager to be allocated responsibility for identifying and managing these risks). • Incorporate the financial risks from climate change into existing risk management practices. • Use long-term scenario analysis to inform strategy setting, risk assessment, and identification. • Develop an approach to disclosure on the financial risks (to the firm) from climate change.	PRA-authorised firms (insurers, banks, building societies and PRA-designated investment firms).	Supervisory Statement 3/19 is in the form of regulatory guidance, but in practice, PRA-authorised firms are expected to comply in full with the PRA's expectations. The PRA has stated that it will publish more detailed expectations in due course.	Supervisory Statement 3/19 took effect in April 2019. The PRA expected firms to have an initial plan in place to address the expectations and submit an updated Senior Management Function (SMF) form by 15 October 2019. The PRA also expects firms to consider the evolution of what best practice in this sphere might look like. The Bank of England has published a consultation on its proposal for stress-testing the financial stability

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
					implications of climate change. This was due to be published in Q3 or Q4 2020, but has since been delayed until at least mid-2021.
12.	**FCA Consultation Paper 20/3**	The FCA has proposed that premium-listed commercial companies disclose how they have implemented the Task Force on Climate-related Financial Disclosures' (TFCD) recommendations on a comply-or-explain basis. Specifically, these companies would be required to include a statement in their annual financial report which sets out: • Whether they have made disclosures consistent with the TCFD's recommendations. • If they have not made disclosures consistent with some or all of the TCFD's recommendations (or have included some/all of the disclosures in a document other than their annual financial report) an explanation as to why. • Where in their annual financial report (or other relevant document) the disclosures can be found. The FCA is also considering whether sponsors should include a premium-listed company's procedures to comply with the new rule as part of their sponsor declaration in relation to directors' understanding of the Listing Rules and the premium-listed commercial company's established procedures. The FCA is consulting on issuing new guidance (in the form of a Technical Note) regarding existing obligations that already require issuers and others to make disclosures regarding climate-related matters, usually when such matters have material financial implications (e.g. taking into account ESG	• Premium-listed commercial companies and certain sovereign controlled companies. • Market participant generally (in respect of the proposed Technical Note).	Mandatory.	The deadline for comments on the CP has been extended to 1 October 2020 (from 5 June 2020). The FCA was due to publish its final rules by Q4 2020, but this is likely to be delayed given the extension to the consultation period.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		factors when determining whether an inside information disclosure must be made).			
13.	**FCA Policy Statement 19/30**	The FCA has extended the remit of IGCs and GAAs by requiring them to report on their firms' ESG policies and issues, including any concerns that they have raised and how the firms have responded. The reports should be made prominently available on relevant firms' websites. The FCA's goal is to help protect consumers who are likely to be less engaged with their pensions savings from investments that may be unsuitable because of ESG risks. The FCA has also issued guidance on how firms should think about ESG risks and consumer concerns when making investment decisions on behalf of consumers. The guidance requires providers of pension products and investment-based life insurance products to take account of all financially material risks (including financially material ESG risks) as well as non-financial concerns, but only where clients generally share the concerns and there is no risk of significant detriment to other clients (although firms may offer products that involve significant financial risk that is not necessarily compensated by the expected return for products outside of workplace personal pensions, provided that those products are specifically designed to take account of non-financial matters, consumers have actively chosen those products and firms comply with the relevant rules on distributing such products).	• Independent Governance Committees (IGCs), Governance Advisory Arrangements (GAAs) and, indirectly, firms that provide workplace personal pensions. • Providers of pension products and investment-based life insurance products.	Mandatory.	The rules came into force on 6 April 2020.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
13.	**CFRF Guide to Climate-related Financial Risk Management**	The Guide sets out how financial services firms should approach the risks and opportunities that arise from climate change. The Guide is intended to serve as a practical tool to help firms develop their own approach to managing risks across the following four key areas: • Risk management • Scenario analysis • Disclosures • Innovation	Financial services firms.	Voluntary.	The Guide was published on 29 June 2020 and is "live".
Global Initiatives					
14.	**United Nations Sustainable Development Goals (SDGs)**	The UN has set out 17 sustainable development goals which address various global challenges that may hamper achieving a better and more sustainable future. The goals relate to poverty, inequality, climate change, environmental degradation, peace and justice. The SDGs set out overall objectives – i.e. they do not prescribe specific rules or initiatives (although they do make suggestions) but call on governments, businesses, organisations and individuals to translate the goals into a plan of action (and several countries, including the UK, have ratified the SDGs). Many of the initiatives discussed in this Annex derive from the SDGs – for example, the Paris Agreement, UN PRIs and PRBs link to Goal 13 (amongst others) which call for urgent action to combat climate change and its impact.	Global.	Voluntary.	The SDGs were adopted in September 2015 and remain "live".
15.	**United Nations Principles for Responsible Investment (UNPRI)**	The UNPRI's six Principles for Responsible Investment (the PRI) allow a range of possible actions for incorporating ESG issues into investment practice. Signatories commit to:	Institutional investors (globally) that are signatories to the PRI and their service providers.	Voluntary – the UNPRI will delist signatories that fail to report in accordance with its requirements (and	The PRI launched in April 2006 and remain open to new signatories.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		i. Incorporating ESG issues into investment analysis and decision-making processes. ii. Being active owners and incorporating ESG issues into ownership policies and practices. iii. Seeking appropriate disclosures on ESG issues by the entities in which they invest. iv. Promoting acceptance and implementation of the PRI within the investment industry. v. Working together to enhance effectiveness in implementing the PRI. vi. Reporting on their activities and progress towards implementing the PRI. In addition, signatories will be required to report in line with TCFD from 2020 onwards.		publicly announce such delisting).	
16.	**United Nations Principles for Responsible Banking (UNPRB)**	The UNPRB's six Principles for Responsible Banking (the PRB) serve to encourage banks to take a leadership role and use their products, services and relationships to support commitment to environmental and other issues. Signatories commit to the following principles: i. Aligning their business strategies to be consistent with and contribute to individuals' needs and society's goals (as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks). ii. Increasing positive impacts whilst reducing negative impacts on, and managing the risks to, people and the environment resulting from their activities, products and services (including setting and publishing targets where significant impact can be had).	Banks (globally) that are signatories to the PRB.	Voluntary.	The PRB launched in September 2019 and remain open to new signatories.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		iii. Working responsibly with clients and customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations. iv. Proactively and responsibly consulting, engaging and partnering with relevant stakeholders to achieve society's goals. v. Implementing their commitment to the PRB through effective governance and a culture of responsible banking. vi. Periodically reviewing individual and collective implementation of the PRB and being transparent about and accountable for their positive and negative impacts and contribution to society's goals.			
17.	**Task Force on Climate-related Financial Disclosures (TCFD)**	The TCFD seeks to develop climate-related disclosures that are comparable, reliable, clear, efficient and provide decision-useful information to lenders, insurers and investors. The TCFD's recommendations focus on four key themes: • **Governance:** Disclose the organisation's governance around climate-related risks and opportunities. • **Strategy**: Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material. • **Risk Management:** Disclose how the organisation identifies, assesses and manages climate-related risks. • **Metric and Targets:** Disclose the metrics and targets used to assess and manage relevant	Organisations (globally) in the financial sector, including banks, insurance companies, asset managers and asset owners.	Currently, voluntary – a number of countries are currently considering incorporating reporting under TCFD into regulatory requirements (e.g. the UK in respect of premium-listed companies and the EU in relation to the Non-Financial Reporting Directive). Further signatories of the PRI are required to report in line with TCFD (see above).	The TCFD released its final recommendations in July 2017 and published its second report on the status of the implementation of its recommendations in June 2019.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		climate-related risks and opportunities where such information is material. The TCFD has also produced 11 specific recommended disclosures that organisations should include in their financial filings, along with guidance that provides context and suggestions for implementing the recommended disclosures. Further, the TCFD has produced a set of Fundamental Principles of Effective Disclosure, which provide general guidance on the approach to disclosures (for example, disclosures should be specific and complete as well as consistent over time).			
18.	**World Economic Forum Common Metrics**	To address the lack of consistency by which companies measure sustainable value and report on it to investors and other stake holders, the WEF has proposed a common, core set of metrics and recommended disclosures that its International Business Council (IBC) members can use to align their mainstream reporting, thereby reducing fragmentation and encouraging faster progress towards a systematic solution for this issue. The objective is to amplify existing accounting/reporting standards rather than create a new standard altogether. Two sets of metrics are proposed: • **Core metrics**: A set of 22 well-established metric and reporting requirements. These are primarily quantitative metrics for which information is already being reported by many firms (albeit in different formats). They focus, primarily, on activities within an organisation's own boundaries. • **Expanded metrics**: 34 less well-establish metrics which have a wider value chain scope or	IBC Members, but also companies globally.	Voluntary.	The WEF is currently consulting on its proposed metrics. The final set of metrics is due to be published in late August 2020.

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		convey impact in a more sophisticated or tangible way, such as in monetary terms. They represent a more advanced way of measuring and communicating sustainable value creation.			
19.	**Sustainable Stock Exchange Initiative (SSEI)**	Stock exchanges voluntarily commit to provide listed companies with guidance on how to report ESG issues. The SSEI sets out guiding principles on ESG report preparation and the types of information to be disclosed. This includes, amongst other things: • Determining who (including amongst senior management and the board) is responsible for ESG matters and oversight. • Identifying and prioritising the key ESG matters to be disclosed. • Adopting industry standard/accepted key performance indicators to measure ESG performance. • Setting out the company's public commitments towards sustainable development. • The impact of ESG factors on the company's short- and long-term financial performance.	Stock exchanges (globally) that have committed to the SSEI.	Voluntary.	The SSEI launched in 2009 and remains open to new signatories.
20.	**Network for Greening the Financial System Guide to climate scenario analysis for central banks and supervisors**	The Guide provides practical advice on using scenario analysis to assess climate risks to the economy and financial system. The Guide advocates a four-step process: 1. **Identify objective and exposures**. 2. **Choose climate scenarios** – i.e. make design choices to tailor the scenarios to the specific exercise. 3. **Assess economic and financial impacts** across a wide range of economic variables – e.g. GDP, inflation, equity and bond prices, loan valuations, etc. This includes risks that arise	Central banks and supervisors.	Voluntary.	The guide was published in June 2020 and remains "live".

No.	Body/Legislation	Principles/Requirements	Scope	Voluntary/Mandatory	Current Status
		from different physical and transition outcomes across a wide range of sectors and geographies. 4. **Communicating and using results**. Although mainly aimed at central banks and supervisors, many aspects of the Guide may also prove useful for the financial services sector.			

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