

# EU Sustainable Finance

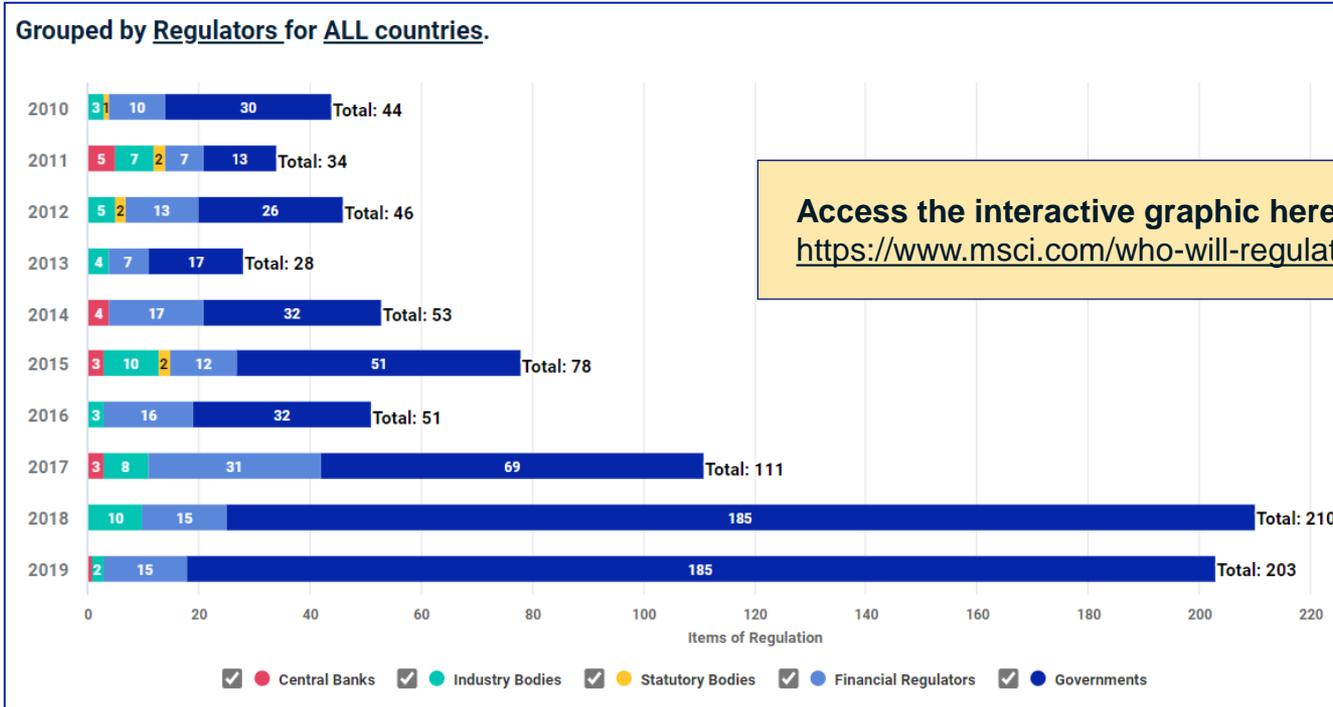
MSCI ESG Research Solutions

November 2020

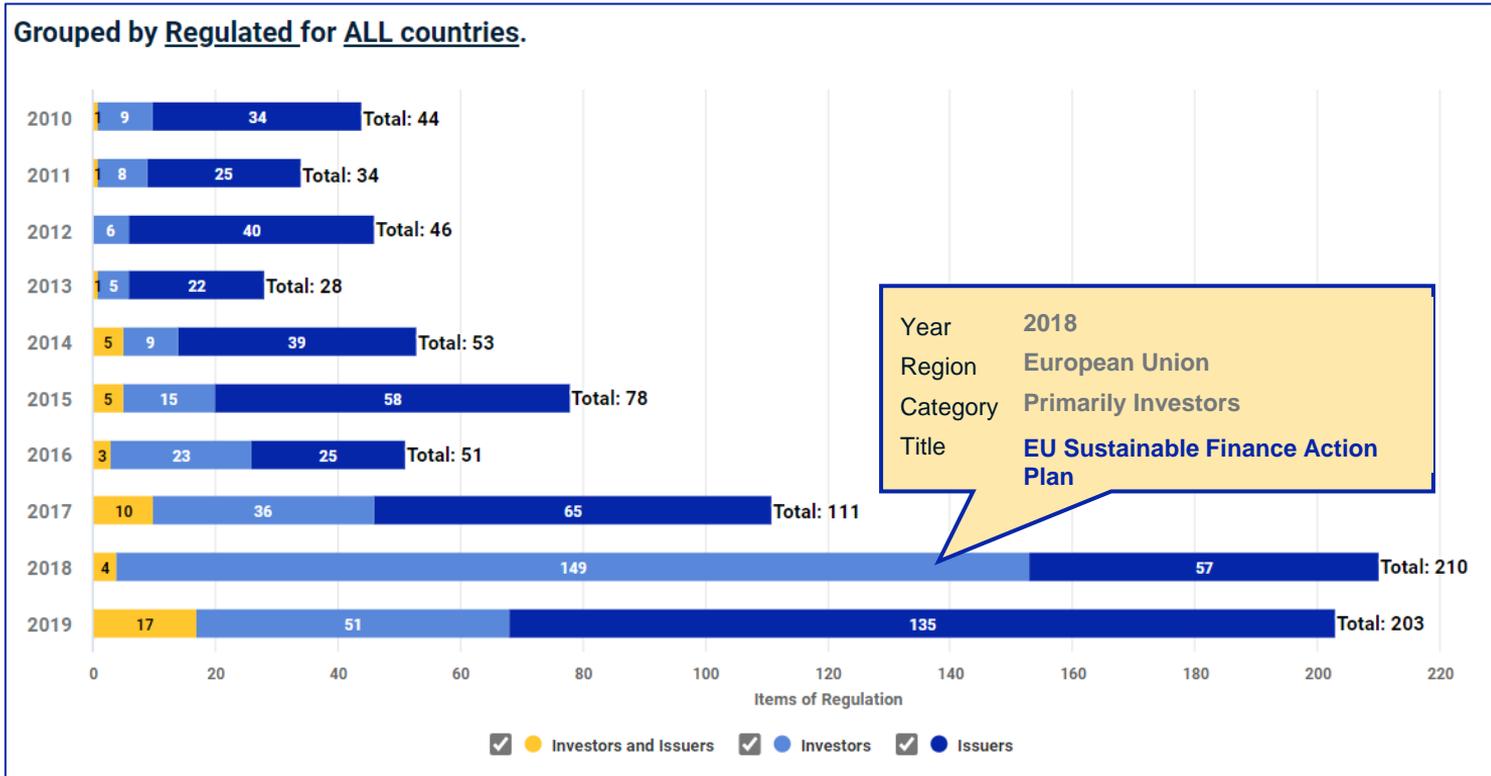
# Regulatory Trends

**EU Sustainable Finance Package**  
**Focus on Transparency**

# Who is regulating ESG?



# ...and who is being regulated?



# EU Sustainable Finance Package

- **One of most ambitious legislative plan globally** which aims to:
  - reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
  - manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
  - foster transparency and long-termism in financial and economic activity.
- Impact  $\neq$  limited to the EU
  - Investment managers outside the EU may be impacted or wish to follow the new norms if they manage European assets
  - Other jurisdictions are also looking at putting in place similar measures



# Focus on Transparency

“In the EU's policy context sustainable finance is understood as finance to support economic growth while reducing pressures on the environment and taking into account social and governance aspects.

**Sustainable finance also encompasses transparency on risks related to ESG factors** that may impact the financial system, and the mitigation of such risks through the appropriate governance of financial and corporate actors.”<sup>1</sup>

## 10 point EU Action Plan on Sustainable Finance

- 1 Establishing classification system (taxonomy)
- 2 Creating standards and labels for sustainable financial products (i.e. green bond standard)
- 3 Fostering investment in sustainable projects
- 4 Incorporating sustainability risks and factors in financial advice
- 5 Developing sustainable benchmarks
- 6 Better integration of sustainability in ratings & market research
- 7 Clarifying institutional investor and AM duties
- 8 Incorporating sustainability in prudential requirements
- 9 Strengthening disclosure and accounting rule-making
- 10 Fostering corporate governance and attenuating short-termism

# Combating the greenwashing of funds

## ESG: Greenwashing under scrutiny

BY SUSANNA RUST | JULY/AUGUST 2019 (MAGAZINE)



### Key points

- Greenwashing is understood as making misleading claims about environmental practices, performance or products
- An aim of the European Commission's sustainable finance action plan is to prevent greenwashing, mainly with retail investors in mind
- Language is an issue: ESG and green investments are sometimes incorrectly equated



## Sustainable finance, or just plain greenwashing?

9 January 2020

It's plastered everywhere and purportedly built into everything. It's sustainability, the buzzword that has taken hold in every corner of society and sector of business. Within asset management, too, sustainable finance is gaining in significance. More and more high-net-worth clients are becoming interested in investments that can be made in good conscience because they are economically, ecologically and societally sustainable. Banks have recognised this demand and developed investment strategies to meet it. But is every product marked "sustainable finance" worthy of the label?

Sustainable Investing

## Opinion: For ESG investors, the newest challenge is separating fact from 'greenwashing'

Published: Oct. 15, 2019 at 9:41 a.m. ET

By Meredith Jones

How much is corporate talk of ESG principles just marketing?



# MSCI's ESG Transparency Resources

NOV  
2019

Made public the MSCI ESG Ratings of over 2,800 issuers in our [ESG Corporate Ratings search tool](#)

[Launched provisional climate indexes](#) designed to meet the minimum standards for the “EU Climate Transition benchmark” (CTB) and “EU Paris-aligned benchmark” (PAB) in order to help clients evaluate and test them

JAN  
2020

Published [the MSCI Principles of Sustainable Investing](#), a framework outlining best practices for ESG integration by investors globally

May  
2020

Made public the MSCI ESG Fund Ratings for 36,000 multi-asset class mutual funds and ETFs in our [ESG Fund Ratings search tool](#)

Made public ESG metrics for all MSCI indexes covered by the European Union (EU) Benchmark Regulation (BMR) in our [Index Profile search tool](#)

Nov  
2020

Launch of [Sustainable Finance resource page](#) on msci.com

Launch of the [MSCI ESG Industry Materiality Map](#) which aims to offer a window in the MSCI ESG Ratings model



# Survey: ESG Ratings of Funds Favored Over Metrics

MSCI ESG Research commissioned an independent research firm to survey over 5,000 consumers across five E.U. countries to get their views on the sustainable reporting of funds

## Key takeaways:

- 57% of respondents found a rating score alone was more useful in understanding the sustainability performance of a mutual fund versus metrics alone
- Of the individual metrics, carbon footprint was considered the most important. Gender diversity was the least important. There were no significant differences between countries

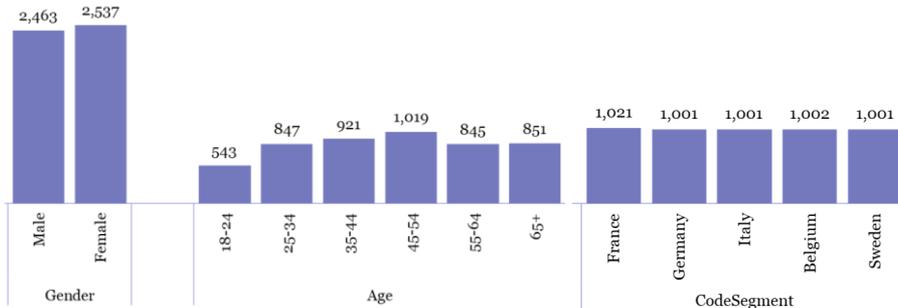
Which indicator is most useful when understanding the sustainable performance of a mutual fund?

Rating score alone  
57%

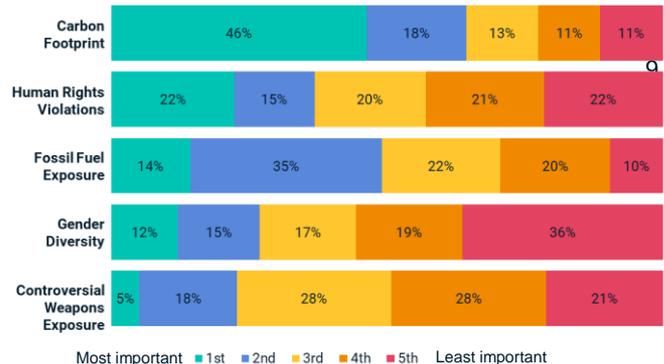


Fund Metrics alone  
43%

## Survey respondents:



What sustainability metrics were most important in helping you rank mutual funds?



\* Survey conducted by Savanta, August 2020 <https://savanta.com/>

# Key Legislative streams: EU Taxonomy and SFDR

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Overview and Timeline  
MSCI Solutions

# EU Sustainable Finance Package Overview

## KEY LEGISLATIVE STREAMS



### SUSTAINABLE FINANCE DISCLOSURE REGULATION (SFDR)

✔ The EU is harmonizing ESG disclosure standards, requiring financial market participants to **integrate** sustainability risk in the investment process and to **report** on such integration at both the entity and product level.

▶ Beginning in March 2021 for principle-based disclosures in the Level One text

Detailed, prescriptive disclosures delayed until likely January 2022



### GREEN TAXONOMY

✔ The EU is establishing a classification system for **sustainable activities** and investments.

▶ End of 2021 for climate mitigation & adaptation. End of 2022 for the other four objectives



### CLIMATE BENCHMARKS & ESG DISCLOSURE

✔ The EU established the **minimum standards** for two new voluntary categories of indexes, EU Climate Transition benchmarks and EU Paris-Aligned benchmarks. The EU also set out **disclosure requirements** for ESG indexes.

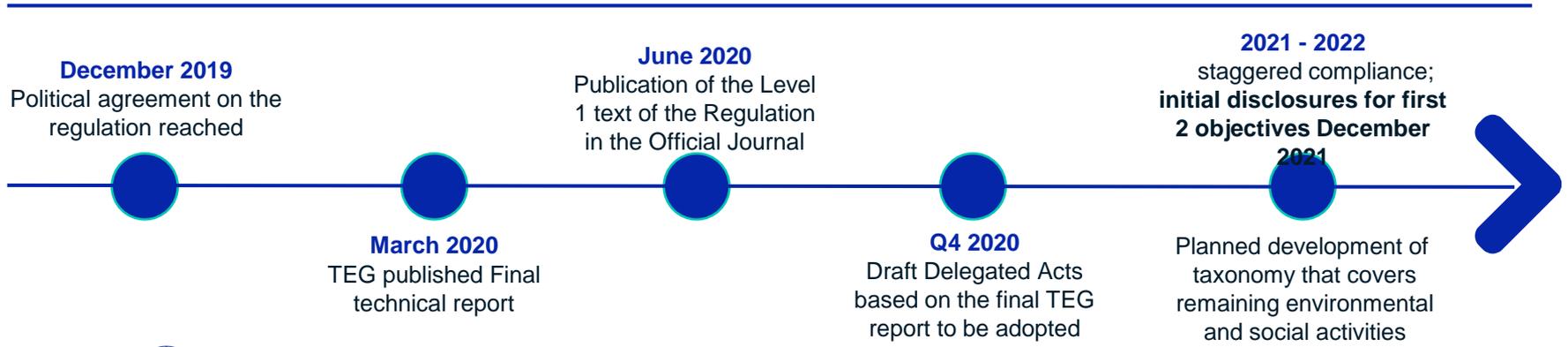
▶ December 2020

Goals

Timelines

# Overview of EU Taxonomy: a green classification system

- Taxonomy sets out the criteria for determining if an economic activity is contributing to six environmental objectives:
  - **Climate change mitigation**
  - **Transition to circular economy, waste prevention & recycling**
  - **Climate change adaptation**
  - **Pollution prevention & control**
  - **Protection of healthy ecosystems**
  - **Sustainable use & protection of water & marine resources**
- Initial focus is on climate change mitigation and adaptation
- Aims to support sustainable development financing
- Strong emphases on disclosure to determine eligibility

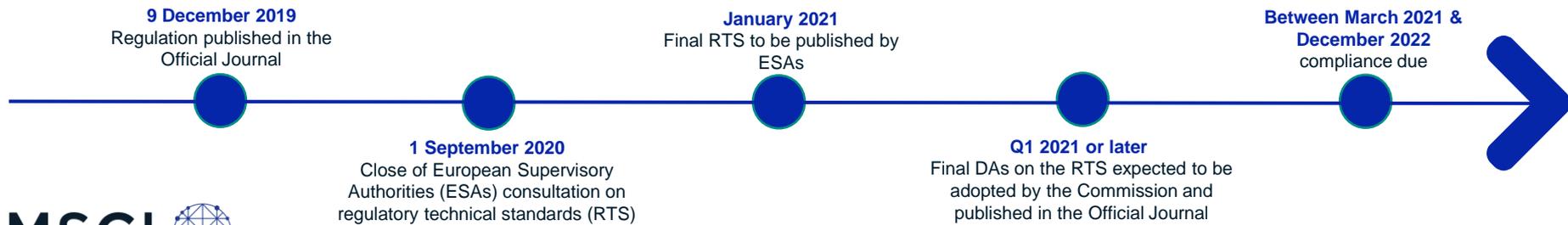


# EU Taxonomy environmental objectives



# Overview of Sustainable Finance Disclosure Regulation (SFDR)

Entity Level		Product Level
<p>By March 10, 2021, financial market participants* (FMPs) must disclose:</p>	<p>By March 10, 2021, financial advisors must disclose:</p>	<p>FMPs must disclose starting March 10, 2021:</p>
<p>On their websites,</p> <ul style="list-style-type: none"> <li>- Information on the integration of sustainability risks in their investment decision-making process (and if not relevant, why)</li> <li>- When “principal adverse sustainability impacts” are being considered, statements with their due diligence policies (and if not relevant, why) (Compulsory for firms with 500+ employees)</li> <li>- Principal adverse impacts statement (Annex I) – <i>now delayed until likely January 2022</i></li> </ul> <p>In pre-contractual disclosures (and if not relevant, why):</p> <ul style="list-style-type: none"> <li>- Manner in which sustainability risks are integrated into their investment decisions</li> <li>- Likely impacts of sustainability risks on the returns of the financial products</li> </ul>	<p>On their websites, information on integration of sustainability risks (including principal adverse sustainability impacts) in their investment advice or insurance advice on their websites (and if not relevant, why)</p> <p>In pre-contractual disclosures (and if not relevant, why):</p> <ul style="list-style-type: none"> <li>- How sustainability risks are integrated into their investment or insurance advice</li> <li>- The result of the assessment of the likely impacts of sustainability risks on the returns of the financial products</li> </ul>	<p>On their website, information on products pursuing sustainable objectives (Article 9 products) or promoting E&amp;S characteristics (Article 8 products)</p> <p>In periodic reports (e.g., annual reports) information how sustainable objectives or E&amp;S characteristics are met</p> <p>(Also note requirements + separate timing on principal adverse sustainability impacts)</p>



# Sustainable Finance: ESG Research & Data Solutions

**Substantially contribute to environmental objectives**



**MSCI Estimated EU Taxonomy Alignment\***

**MSCI Environmental Impact Metrics**

**Sustainability Risks & Objectives**



**MSCI ESG Ratings**

**MSCI Sustainable Impact Metrics**

**Avoid Harm – Environmental Violations**



**MSCI ESG Controversies**

**Climate Risks & Objectives**



**MSCI Climate Change Solutions**

**Minimum social safeguards**



**MSCI ESG Controversies**

**Business Involvement Screening Research**

**Adverse Impacts**



**MSCI EU SFDR Adverse Impact Metrics\***

**MSCI ESG Ratings & Metrics**

**MSCI ESG Controversies**

**MSCI Climate Change Metrics<sup>5</sup>**

# MSCI EU Sustainable Finance Solutions

## DATASETS



### EU SFDR Adverse Impact Metrics

Data on 5 principal adverse impact indicators plus 2 of the additional indicators for approximately 10,000\* global companies.

Equivalent/supplemental datapoints for assessing adverse impact

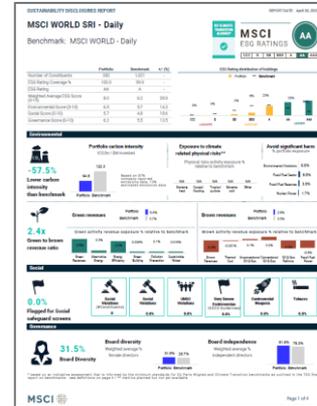


### Estimated EU Taxonomy Alignment

% revenue from activities likely to address one or more of the six environmental objectives of the EU Taxonomy for approximately 10,100 companies; incorporates controversial practices that could indicate breach of the Taxonomy's Minimum Safeguards and Do No Significant Harm criteria.

Underlying data inputs: Environmental Impact Metrics, ESG Controversies, Business Involvement Screening Research: Tobacco & Controversial Weapons

## PORTFOLIO-LEVEL REPORTS



### Sustainability Disclosures portfolio report

Metrics informed by the EU Taxonomy, Benchmark ESG Disclosure, and Climate Benchmark requirements

Planned: Incorporation of Estimated Taxonomy Alignment and Adverse Sustainability Impact indicators

## OTHER RESOURCES



- Webinars
- EU Taxonomy Screening Guide
- Adverse Sustainability Impact Indicator Mapping
- Sustainable Finance Resource page on msci.com
- Index Profile Search Tool
- Climate Indexes

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# Contact us

AMERICAS		EUROPE, MIDDLE EAST & AFRICA		ASIA PACIFIC	
Americas	+1 888 588 4567 *	Cape Town	+ 27 21 673 0100	China North	10800 852 1032 *
Atlanta	+ 1 404 551 3212	Frankfurt	+ 49 69 133 859 00	China South	10800 152 1032 *
Boston	+ 1 617 532 0920	Geneva	+ 41 22 817 9777	Hong Kong	+ 852 2844 9333
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Monterrey	+ 52 81 1253 4020	Milan	+ 39 02 5849 0415	Seoul	00798 8521 3392 *
New York	+ 1 212 804 3901	Paris	0800 91 59 17 *	Singapore	800 852 3749 *
San Francisco	+ 1 415 836 8800			Sydney	+ 61 2 9033 9333
São Paulo	+ 55 11 3706 1360			Taipei	008 0112 7513 *
Toronto	+ 1 416 628 1007			Thailand	0018 0015 6207 7181 *
				Tokyo	+81 3 5290 1555

\* = toll free

msci.com  
clientservice@msci.com

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