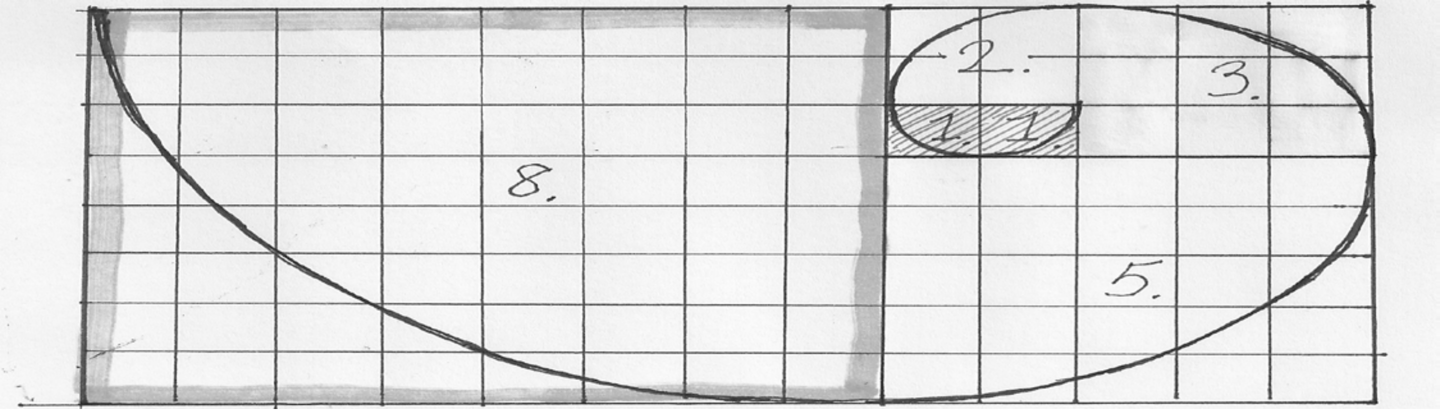

SUSTAINBLE FINANCE
– A REGULATORY PERSPECTIVE –

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Sustainable Finance – A Regulatory Perspective

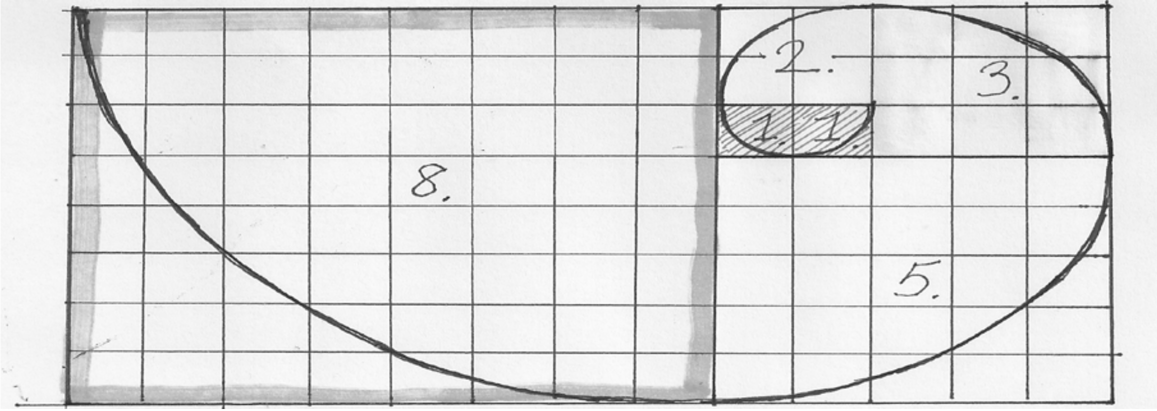
§ 1 - CSR Reporting Directive

§ 2 - Shareholder Right Directive II

§ 3 - Commission Proposals on Sustainable Finance

§ 4 - Sustainable Funds – Tensions Remaining

§ 5 - Outlook & Perspective



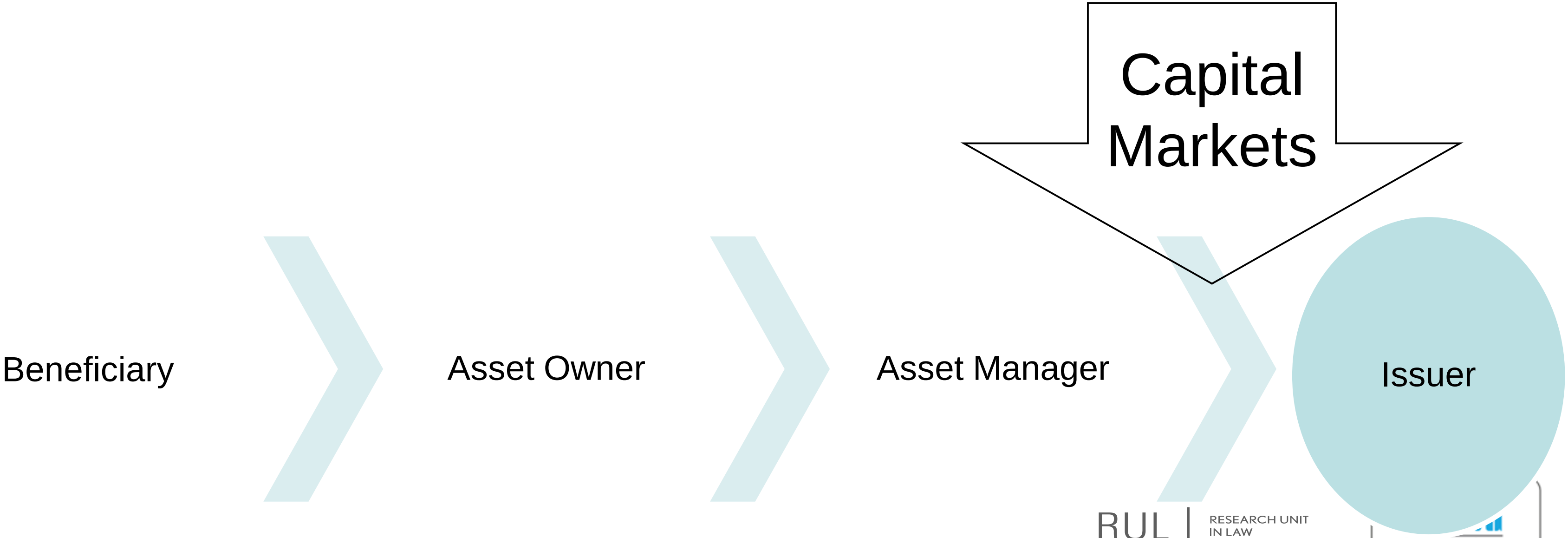
§ 1

CSR Reporting Directive (2014)

CSR REPORTING DIRECTIVE

Directive 2014/95/EU laying down the rules on disclosure of non-financial and diversity information by large companies.

Basis: ‘Action Plan: European company law and corporate governance — a modern legal framework for more engaged shareholders and sustainable companies’ (2012)



CSR REPORTING DIRECTIVE

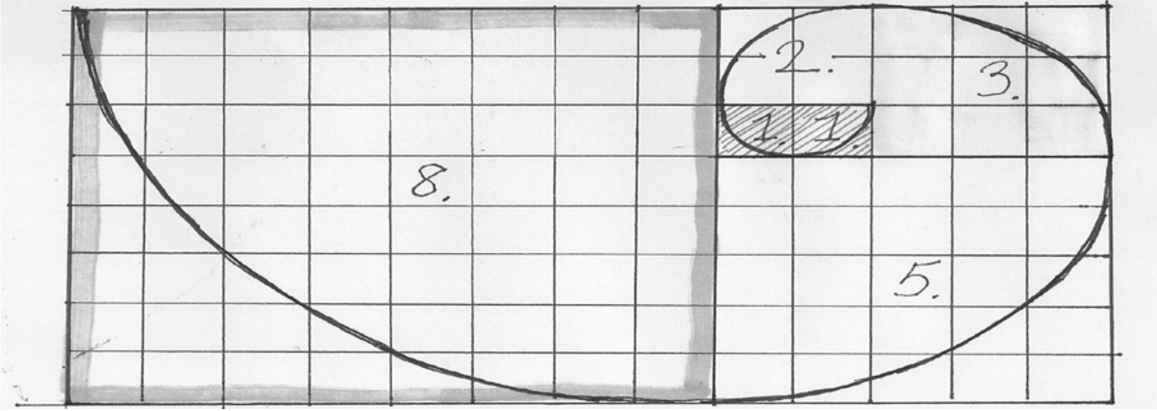
- environmental protection
- social responsibility and treatment of employees
- respect for human rights
- anti-corruption and bribery
- diversity on company boards (in terms of age, gender, educational and professional background)

CSR Reporting Directive

- Applicable to **large public-interest companies** with more than 500 employees
- ca. 6,000 issuers and groups, including
  - listed companies
  - banks
  - insurance companies
  - other companies designated by national authorities as public-interest entities

CSR REPORTING DIRECTIVE

- In June 2017 the European Commission published its guidelines to help companies disclose environmental and social information.
- These guidelines are not mandatory and companies may decide to use international, European or national guidelines according to their own characteristics or business environment.



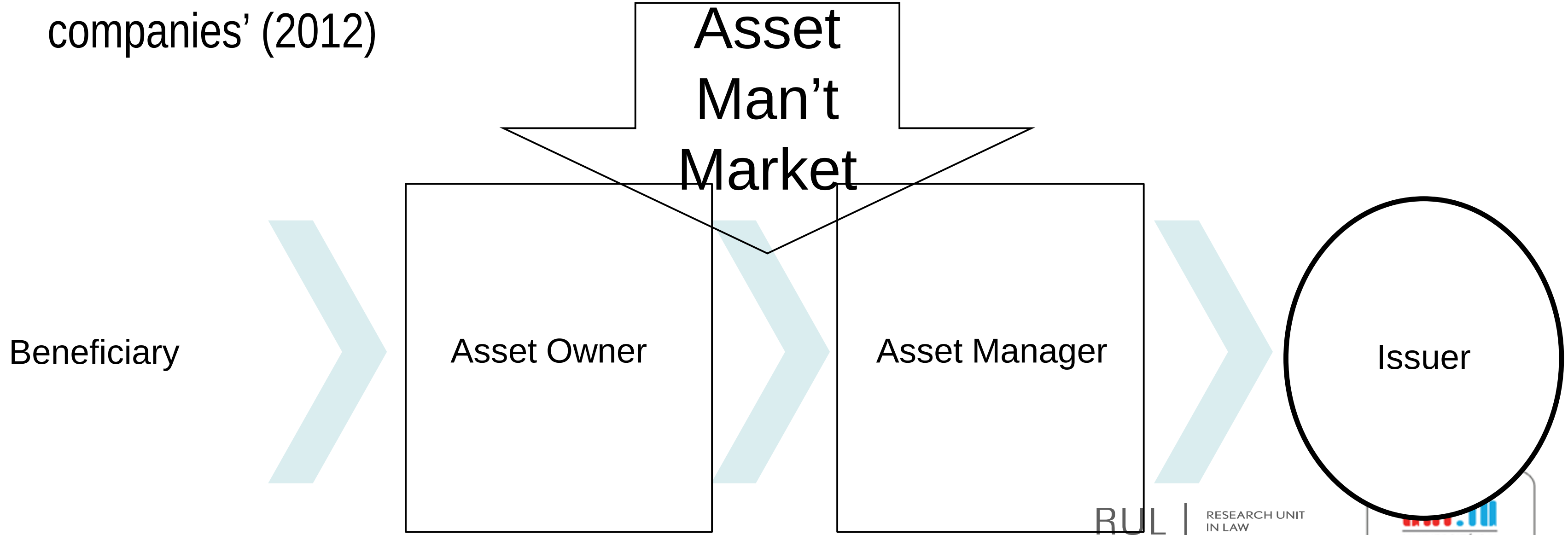
§ 2

Shareholder Rights Directive II

SRD II

Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

Basis: EU Com ‘Action Plan: European company law and corporate governance — a modern legal framework for more engaged shareholders and sustainable companies’ (2012)



Shareholder Rights Directive II

- Countering „short termism“
- Short termism as „short sighted“

SHAREHOLDER RIGHTS DIRECTIVE II

Disclosure of the engagement policy (institutional investors and asset managers)

- Description of the engagement policy

- Annual implementation of the policy

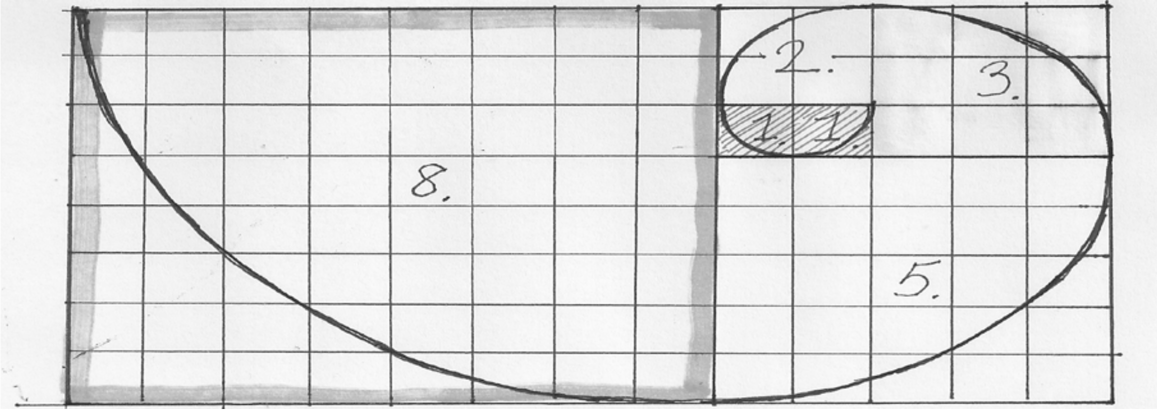
Disclosure requirements for institutional investors

- Main elements of the investment strategy

- Key information about the mandates

Disclosure requirements for asset managers

- Key information about investment approach and execution of mandate



§ 3

European Commission Proposals on Sustainable Finance

Action Plan on Sustainable Growth (3/18)

Three main objectives

- **reorient capital flows towards sustainable investment**, in order to achieve sustainable and inclusive growth
- **manage financial risks** stemming from climate change, environmental degradation and social issues
- **foster transparency and long-termism in financial and economic activity**

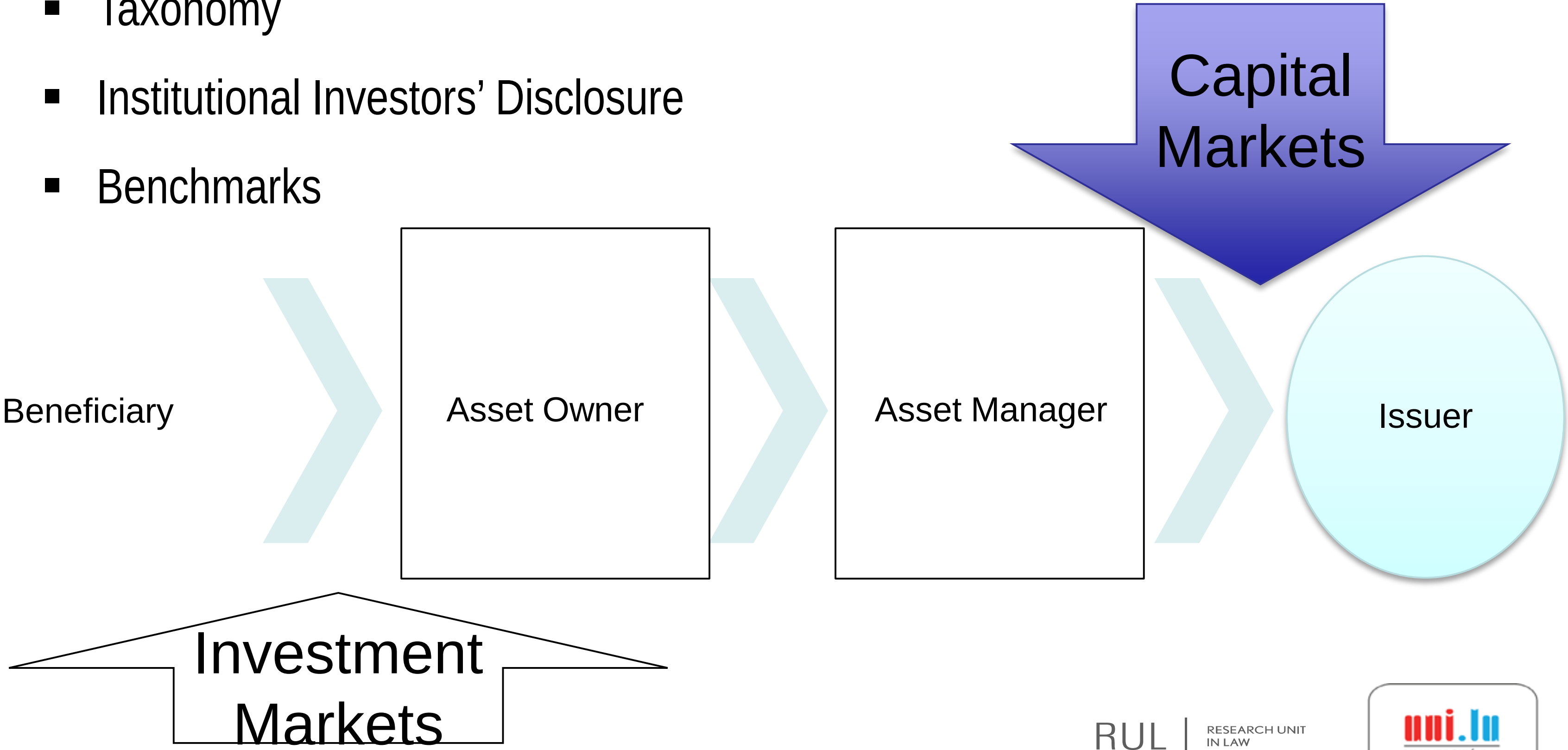
EC PROPOSALS ON SUSTAINABLE FINANCE (5/18)

In May 2018: Three Commission proposals:

- establishing a **unified EU classification system** of sustainable economic activities ('taxonomy')
- improving **disclosure requirements** on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes
- creating a **new category of benchmarks** which will help investors compare the carbon footprint of their investments.

EC PROPOSALS ON SUSTAINABLE FINANCE (5/18)

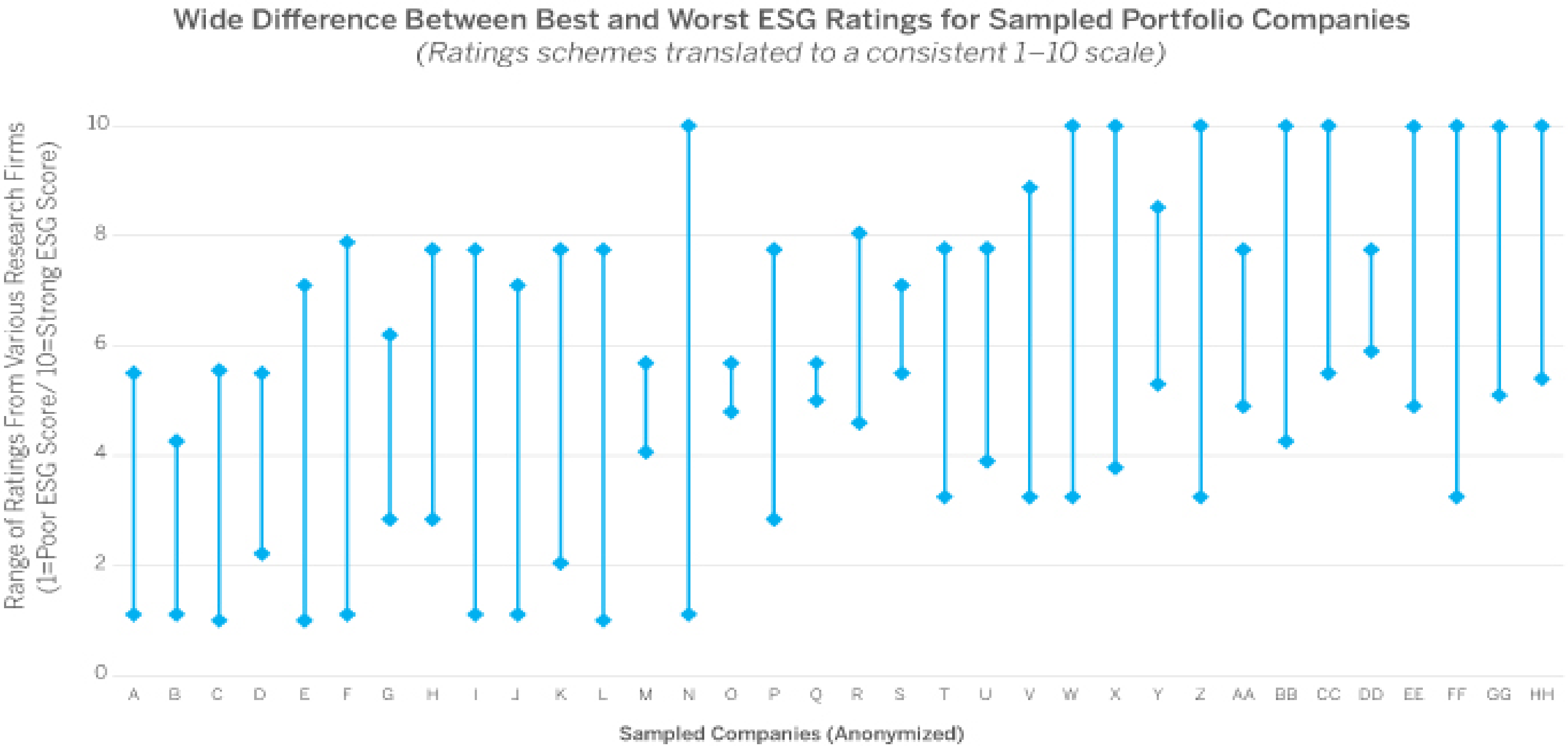
- Taxonomy
- Institutional Investors' Disclosure
- Benchmarks



SUSTAINABLE FINANCE TAXONOMY

“One specific challenge is a **lack of standardization** — every ratings system prioritizes different factors when defining a ‘good’ ESG company. […] Some prioritize transparency and disclosure; others prioritize a company’s environmental or social track record or its past controversies; others prioritize current carbon emissions. Depending on which ratings service you choose, you may see wildly different results.”

SUSTAINABLE FINANCE TAXONOMY

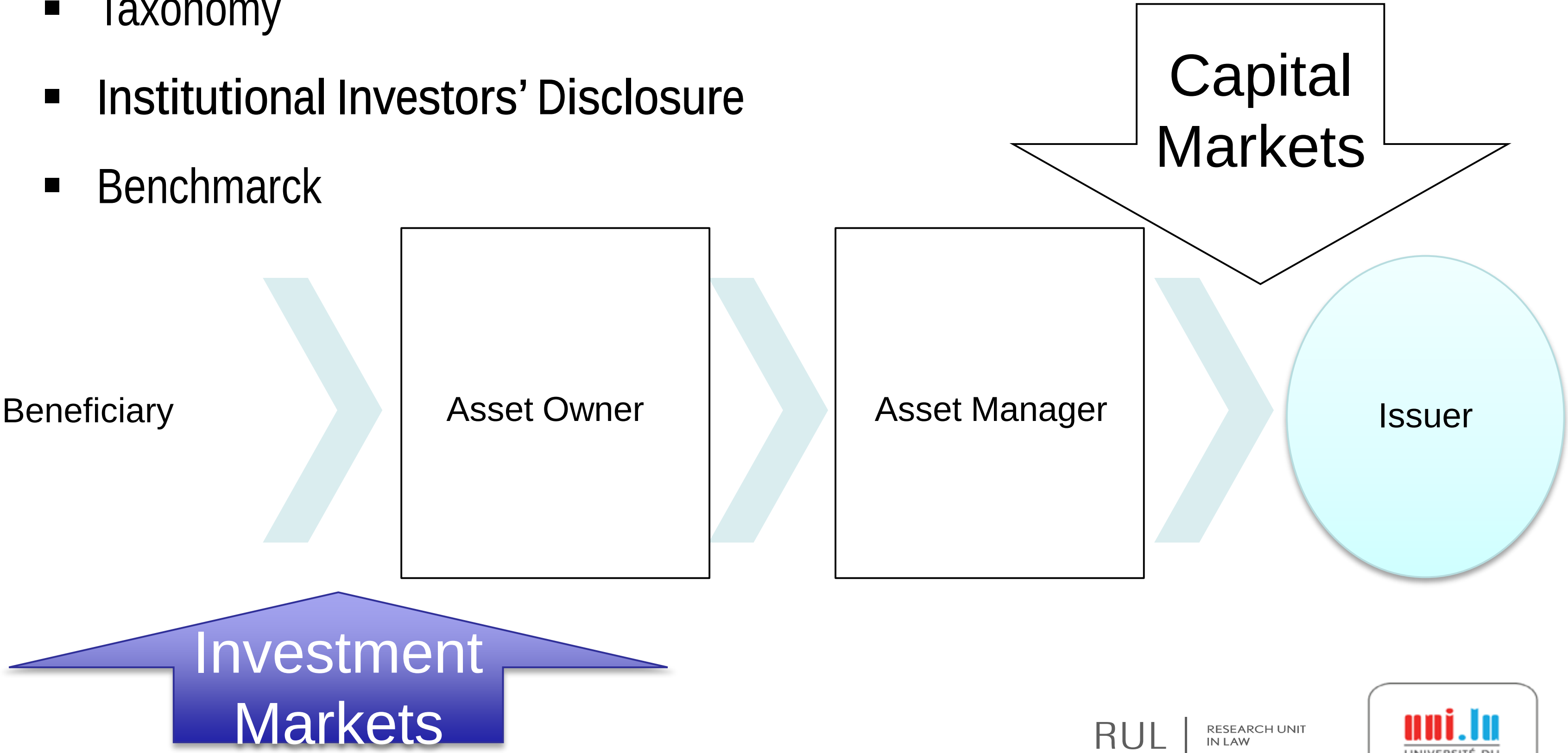


INSTITUTIONAL INVESTORS DISCLOSURES

- initiative aims at strengthening financial stability and asset pricing by clarifying that institutional investors and investment managers have a **duty to consider the materiality** of sustainability factors.
- Missing element relating to sustainable finance re the Investment Market
- After implementation, full service value chain from investment market over asset man’t services market to capital markets is tailred to SI objective

EC PROPOSALS ON SUSTAINABLE FINANCE (5/18)

- Taxonomy
- Institutional Investors' Disclosure
- Benchmarck



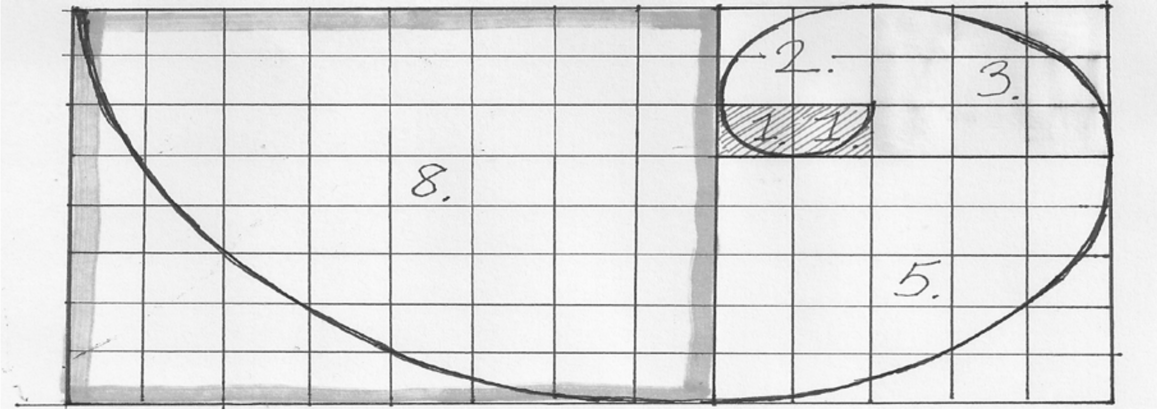
SUSTAINABILITY BENCHMARK

⇒ amending Benchmark Regulation 2016/1011 to ensure orderly composition of SI relevant indices

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks



§ 4

Sustainable Funds – Tensions Remaining

SUSTAINABLE FUNDS – REMAINING TENSIONS

- Investment Fund Law as Fiduciary Law: furthering the CIS perspective
- Basic CIS perspective is not sustainability, but long-term profits
- If sustainability is equally or more profitable on risk-adjusted basis => no tension, no legislative push necessary

  $\Rightarrow$ Is sustainability equally profitable?

- CIS objective can be adjusted by fund statutes. If sustainability is defined as core criterion => no tension, but weak case for investment

  $\Rightarrow$ Is sustainability equally profitable?

Sustainable Investments – the Logic

- Conventional funds have more investment options and less costs for rating and pre-selection (transaction costs)
- Unless the SI rating itself creates value (as noteworthy portfolio pre-selection or as tax advantages)
- cnservative funds will perform better

The Data

Sustainable investing grows in popularity, but is dogged by performance questions

Published: July 17, 2018 10:35 a.m. ET

Sustainable US funds rated by Morningstar (2018) as a group performed better than the overall fund universe in 2017. The returns of more than half of the funds, or 54%, ranked in the top half of their respective Morningstar Categories. That showing was consistent across stock and bond funds. And the group has performed similarly well in the past three calendar years, even as it has grown from 119 funds with full-year records in 2015 to 181 in 2017.

The results imply there is no statistically significant difference in risk-adjusted returns between sustainable and conventional funds. However, conventional funds tend to outperform sustainable funds during recovery periods. Further, we discover sustainable funds being less exposed to the market and small companies, with difference in exposure to the market only present during the recession period. (Christensson & Skagekad, 2018)

The Data

Morgan Stanley institute for sustainable investing:

- 84% of global asset managers are pursuing or considering ESG investments.
- Skepticism about whether ESG strategies add value compared with simply investing in the market through an index-based product rests on 2 factors:

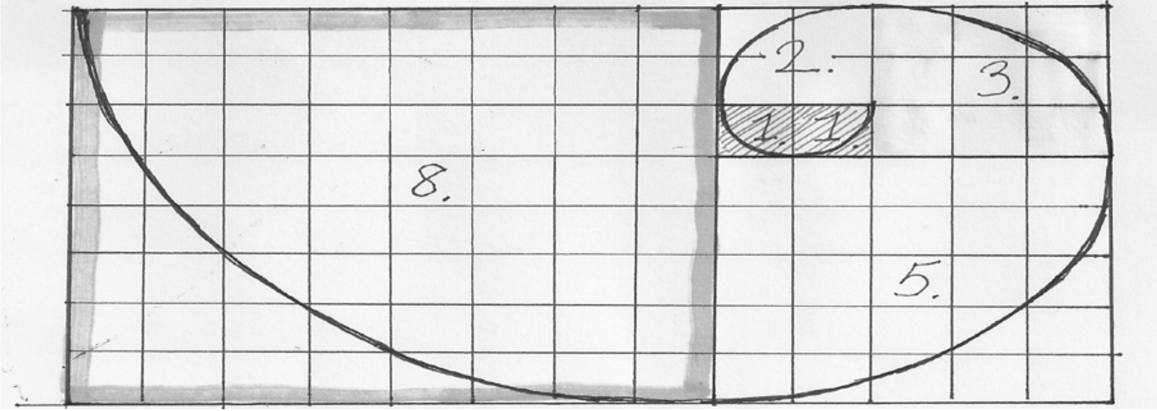
(1) 23% of respondents named the **quality of ESG and sustainability-related data**

(2) 24% **cited “proof of market-rate financial performance.**

Cerulli Associates:

- **only 19% of the advisers** who use ESG products **cite the strategy’s returns** as the major factor behind their adoption
- **35% of respondents** said concerns over negative performance was a significant factor keeping them from such strategies.

⇒ What drives SI? The sell side (hype)



§ 5

Outlook & Perspectives

OUTLOOK & PERSPECTIVES

- SI markets suffer from information asymmetry. Recent EU Rules focused on two major investment concerns: a) reducing information asymmetry on Sustainable Investments, b) increasing performance transparency.
- Better data will be available on whether SI investments match performance or outperform conventional funds on a risk adjusted basis once transparency increases.
- If they <u>match (at least)</u>: tension between investment objective and performance ceases; SI will become natural choice of asset managers
- If <u>not</u>: SI may be furthered by <u>structured SI funds</u> - with policy driven investors taking the high risk pieces (junior tranches) and performance driven investors the senior tranches.

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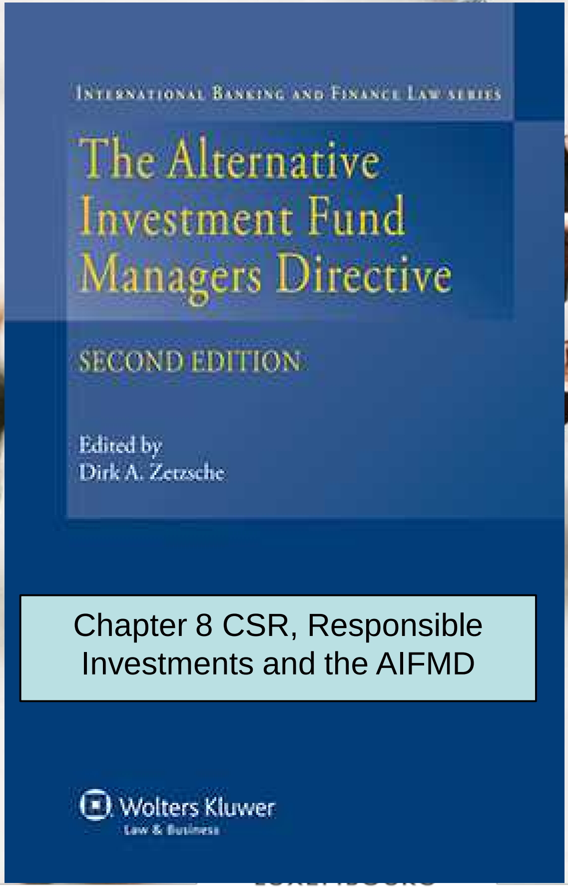

Chapter 8 CSR, Responsible Investments and the AIFMD

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