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The European Union and sustainable finance

Impacts and outlook for the Italian market

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ASSOGESTIONI
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ANASF, Associazione nazionale consulenti finanziari, is the Association which represents financial advisors authorised to offer investment services outside the premises of financial intermediaries (consulenti finanziari abilitati all'offerta fuori sede) registered in the national official register pursuant to Article 31 of the Consolidated Law on Finance (Legislative Decree no. 58/1998). The Association, founded in 1977, has more than 12,000 members and performs a representative role of the profession interacting with relevant institutions and authorities, at both the European and national level, on all the aspects concerning the regulation of financial advisory and investment services. ANASF has always been devoting particular attention to investor protection and the need to foster greater awareness among citizens with regard to financial planning and savings management, including the knowledge and promotion of topics related to sustainable finance. The Association actively contributes to the initiatives of both the European and national institutions aimed at the development of ESG investments, with particular regard to the role of financial advisors and their relationship with investors. ANASF has been a member of the Forum per la Finanza Sostenibile (FFS) since 2011.

Etica Sgr is the only Italian asset management company that exclusively offers sustainable and responsible mutual funds aimed at private and institutional investors, with the aim of representing the values of ethical finance in financial markets.

The distinctive character of Etica Sgr's funds is the rigorous selection of securities issued by companies and countries that show a special commitment to environmental protection, human rights and good corporate governance.

Etica Sgr sustains a constant dialogue with the management, and exercises its voting rights in the shareholders' meetings of the companies in which its funds invest, in order to urge companies towards more responsible behaviours and help them to achieve this goal.

By embracing ESG criteria, codified in a transparent methodology, Etica Sgr is able to manage risk more effectively and to seize interesting investment opportunities. In Etica Sgr's responsible investment, the goal of achieving positive financial returns goes hand in hand with generating positive effects for the environment and society. As the last phase of the sustainable and responsible investment process we measure the impact of our funds' equity investments, in relation to the social, environmental and governance indicators linked to the United Nations SDGs (Sustainable Development Goals).

Etica Sgr is an integral part of a network of excellence in ethical finance: besides being a member of the Forum per la Finanza Sostenibile and Eurosif, Etica Sgr is part of ICCR and a signatory of PRI (Principles for Responsible Investment) and CDP (ex Carbon Disclosure Project).

The company was the first Italian asset manager to sign, in 2015, the Montréal Carbon Pledge, which is the initiative that involves a commitment to measure and report the carbon footprint of its investments.

The Intesa Sanpaolo Group is the Italian leader in financial activities for families and businesses, with 11.8 million customers and over 4,000 branches in Italy. It is also one of the main banking groups in several central-Eastern European countries and in the Middle East and North Africa where it serves about 8 million customers. The Group's activity includes the "*Banca dei Territori - Bank of the Territories*", which meets the financial needs of private clients, small businesses and professionals, SMEs and non-profit entities; Corporate and Investment Banking that supports the balanced and sustainable development of companies and financial institutions also through specialized companies such as IMI Bank; *Banca Fideuram*, the first network of financial promoters in Italy and *Eurizon Capital*, Italy's leading asset management company, with about 315 billion Euros in assets under management.

The system of equity and bond ethical funds offered to Intesa Sanpaolo's clients by Eurizon Capital was created in order to increase over time the value of the capital raised by investing according to ethical principles. The ethical fund management process requires that investments be selected with positive criteria (inclusive principle) that allow to identify the presence of ethical characteristics in the analyzed companies or entities, and negative (exclusive principle) that allow to identify areas of activity that are considered to be contrary to the ethical principles declared by the funds. The "best in class" principle is also used, and it allows to identify companies that, within certain markets at risk, are distinguished by good socio-environmental practices.



Morningstar Italy is the Italian branch of Morningstar, Inc., a leading provider of independent investment research in North America, Europe, Australia, and Asia. The company offers an extensive line of products and services for individual investors, financial advisors, asset managers, retirement plan providers and sponsors, and institutional investors in the private capital markets. Morningstar provides data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, and real-time global market data. Morningstar also offers investment management services through its investment advisory subsidiaries, with about \$220 billion in assets under advisement and management as of June 30, 2019. The company has operations in 27 countries. Its philosophy is based on six fundamental pillars (First Investor, Great Products, Great People, Uncompromising Ethics, Entrepreneurial Spirit and Financial Success), which are at the basis of its investment strategies and serve as a guide to all internal company decisions; this view helps the company to fulfill its mission “empowering financial success” which means providing investment products and services, useful to the final investors to achieve their financial goals. In 2016 it launched the Sustainability Rating which, together with the Analyst Rating, expands the analysis and the evaluation of the funds. Subsequently it introduced the Morningstar Portfolio Carbon Risk Score that allows to easily identify the low-carbon funds, namely the portfolios that invest in companies oriented towards a low-carbon economy. The Morningstar universe includes Morningstar Indexes that offer investors a clear view of global financial markets and leverage on proprietary investment strategies, equity research and ESG. The indexes, also available in real time, cover all the main asset classes, even in a sustainable version, and are based on transparent methodologies.

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The European Union plays a central role for the stability and good functioning of financial markets in its member States: the stepwise coming into being of the **Capital Markets Union** (announced in November 2014) **is the foundation and common denominator of European and domestic policies** concerning the activity of financial players and the protection of investors. Subsequent to the signing of the Paris Agreement on climate and the UN 2030 Agenda for Sustainable Development, **the European Union resolutely took a course of action aimed to innervate its policy actions with sustainability**, above all in view of transitioning to environmentally sustainable growth models.

The development process of sustainable finance and the political and economic course of the European Union are thus indissolubly connected: for the coming years, the scope of this interconnection will be the **Action Plan for financing sustainable growth** launched in March 2018 by the European Commission in order to **boost investments in sustainable projects and encourage integration of environmental, social and governance (ESG) factors in risk management and in the time horizon of financial players**. Since then, the European institutions have been determined in developing and approving the measures provided for in the Action Plan, prioritizing the reforms aimed to **harmonize the definitions of sustainable investments** and **enhance the transparency** of financial activities and of the products that integrate ESG criteria. The launch of the Action Plan is therefore a turning point and a crucial catalyst in the process of developing sustainable finance in European markets.

During 2019, the **Italian Sustainable Investment Forum (ItaSIF)** decided to promote a **research project** aimed to both analyze the several measures that have been proposed and/or approved and engage the different types of financial players to brainstorm on the impacts on – and future outlook for – the Italian market.

As part of the project, ItaSIF set up a working group and organized four workshops, each focusing on one specific theme of the reform process, with **deep-dive sessions on the specific categories of the financial players** that from time to time turned out to be mostly affected. This publication arises out of the research and analysis conducted by ItaSIF and brainstorming done during the meetings. Consistently with the agenda of the working group, the first chapter of this handbook is dedicated to the taxonomy of environmentally sustainable economic activities, followed by an analysis of ESG disclosure, with an emphasis on institutional investors and, in particular, the amendments to IORP II addressed to pension funds; Chapter 3 is dedicated to climate benchmarks; Chapter 4 to projects for the development of certifications for sustainable financial products, with an emphasis on green bonds; Chapter 5 deals with the integration of sustainability criteria in investment advice. Finally, the last chapter is dedicated to the likely outlook of the reform process and the future impacts on the Italian market.

This publication is meant for both **professionals** and the **general public** alike; it aims to provide the **basics** of the main aspects affected by the action of the European Commission and **food for thought** on the future developments of the reform process.

Hopefully, this work can also be useful for Italian and European policies and for better understanding the role that sustainable finance can play in financial markets.

INTRODUCTION

From the Paris Agreement to the Action Plan Financing Sustainable Growth

By signing of the UN Sustainable Development Goals (SDGs)¹ and the Paris Agreement on climate² in 2015, **the European Union put environmental and social sustainability at the center of its policies**. In particular, the European Commission supports the transition towards a **low-carbon, circular model of economic development** based on **energy efficiency**.

As part of the Paris Agreement, the European Union undertook to achieve **three goals by 2030**:

- reduce at least 40% of greenhouse gas (GHG) emissions compared to 1990 level;
- increase to at least 32% the share of energy produced from renewable sources;
- improve energy efficiency by at least 32.5%.

The European Commission estimated that in order to hit these targets **€180 billion worth of annual investments** will be needed in addition to those already set aside³: hence, it will be **essential to involve the private sector**.

In view of steering the capital market to finance those economic activities that help achieve the aforementioned goals and, in general, those of the 2030 Agenda, the European institutions initiated a program to reform financial markets⁴: in December 2016, the European Commission established an expert group (**High-Level Expert Group on Sustainable Finance – HLEG**) to work out recommendations for the development of sustainable finance.

Based upon HLEG recommendations⁵, in March 2018 the European Commission published the **Action Plan Financing Sustainable Growth** (see Figure 1), which sets forth a schedule with specific measures and deadlines for the same, aimed to:

- reorient **capital flows towards sustainable investments**;
- a more effective management of the **financial risks arising from climate**

1. The Sustainable Development Goals (SDGs) are the goals for 2030 agreed to by UN Member States as part of the Global Agenda for Sustainable Development approved in September 2015. In total, there are 17 goals and 169 targets. The purpose is to tackle the challenges raised by climate change and reduce any form of poverty or inequality, ensuring the economic, environmental and social sustainability of human communities in the long term. For more information: <https://bit.ly/2jHjQmD>

2. The Paris Agreement is an international treaty signed by 195 States within the framework of COP21, the twenty-first annual session of the Conference of the Parties of the United Nations Framework Convention on Climate Change (UNFCCC) that took place in Paris in December 2015. The main commitment of the signatories is to limit global temperature rise well below 2 degrees Celsius (°C) compared to pre-industrial levels and do all that is possible to limit the increase to 1.5°C. For more information: <https://bit.ly/2EVSoXT>

3. European Commission 2018, *Action Plan: Financing Sustainable Growth*, COM(2018) 97, March 8, 2018, p. 1: <https://bit.ly/2JPuTTF>

4. European Commission 2016, *Capital Markets Union – Accelerating reforms*, COM(2016) 601, September 14, 2016, pp. 5-6: <https://bit.ly/2pBjCAZ>

5. High-Level Expert Group on Sustainable Finance 2018, *Financing a sustainable European economy*, Final Report 2018: <https://bit.ly/2DQ91EN>

change, from the consumption of resources, from the environmental degradation and from social issues;

- foster **transparency** and encourage long-termism in financial activities.

FIGURE 1. The ten points of the Action Plan Financing Sustainable Growth

1. Set out a European **"taxonomy" for sustainable finance** i.e., a common system of definition and classification of sustainable economic activities
2. Establish **quality standards and certifications for green bonds** so as to ensure market credibility and bolster investor confidence
3. Boost **investments for sustainable infrastructures** (e.g., transport networks) in both Member States and partner countries
4. Modify MiFID II and IDD as well as the ESMA guidelines on the evaluation of product suitability, including **client preferences on sustainability, as part of advisory services**
5. Enhance the transparency of the methodologies used by index providers when constructing **sustainability benchmarks**, in particular harmonizing low-carbon indices
6. Encourage the integration of ESG criteria by **rating agencies and market research companies**
7. Include **sustainability criteria in the definition of fiduciary duty**, whereby institutional investors are bound to act in the best interests of beneficiaries
8. Consider narrowing down the minimum capital requirements of banks in relation to environmentally sustainable investments (so-called **"green supporting factor"**) where risk profiles are actually lower
9. Improve the quality and transparency of corporate **non-financial disclosures**, by aligning the current guidelines on climate risks to the recommendations of the Task Force on Climate-related Financial Disclosures of the Financial Stability Board (FSB)
10. Encourage the **integration of ESG criteria** and the adoption of a **long-term approach** in the decision-making processes of the **Boards of Directors**

Source: Italian Sustainable Investment Forum from European Commission 2018, *Action Plan: Financing Sustainable Growth*: <https://bit.ly/2JmwPol>

The European Commission chose to focus in the first place on environmental sustainability goals and in particular to combat climate change, in terms of mitigation and adaptation.

In May 2018, the European Commission started to implement the first measures of the Action Plan and made three proposals⁶ to regulate:

- a **classification system of environmentally sustainable economic activities ("taxonomy")**;
- **low-carbon benchmarks and positive carbon impact benchmarks**⁷;
- **disclosure requirements on environmental, social and governance (ESG) factors** for institutional investors.

6. European Commission 2018, *Sustainable finance: Making the financial sector a powerful actor in fighting climate change*, Press Release, May 24, 2018: <https://bit.ly/2pBtLh3>

7. Subsequently reworded as EU Climate Transition and EU Paris-aligned Benchmark (see §3.2.).

Furthermore, the European Commission launched a public consultation on the **integration of ESG criteria in investment advice**, with a view to reforming MiFID II and IDD, which govern financial products and insurance products respectively⁸.

In June 2018 the European Commission appointed a **Technical Expert Group (TEG) on Sustainable Finance**⁹, this being a multi-stakeholder¹⁰ expert group to advise on:

1. **taxonomy**, prioritizing the environment, with an emphasis on mitigation of- and adaptation to- climate change;
2. improving the **guidelines on climate-related disclosure by large enterprises and enterprises which are of public interest** (listed companies, banks, asset managers, insurance companies);
3. **common criteria for the construction of low-carbon benchmarks and positive carbon impact benchmarks**¹¹;
4. **Green Bond Standard**, a European green bond quality certification.

In the second half of 2018 and in 2019, the TEG working groups drew up four reports, one for each of the thematic areas indicated by the European Commission; in parallel to this, the regulations proposed by the Commission were submitted for consultation to the European institutions¹² (so-called “trilogue” among the Commission, the Parliament and the Council of the European Union – see Appendix “The ordinary legislative procedure”, p. 116).

8. On January 4, 2019 the Commission published the first draft rules on how asset managers and financial and insurance advisors are required to take into consideration ESG topics. The adoption of such rules follows after the approval of the new regulation on EGS disclosure.

9. European Commission 2018, *Commission announces members of the Technical Expert Group on Sustainable Finance*, Daily News, June 13, 2018: <https://bit.ly/34eUgZs>

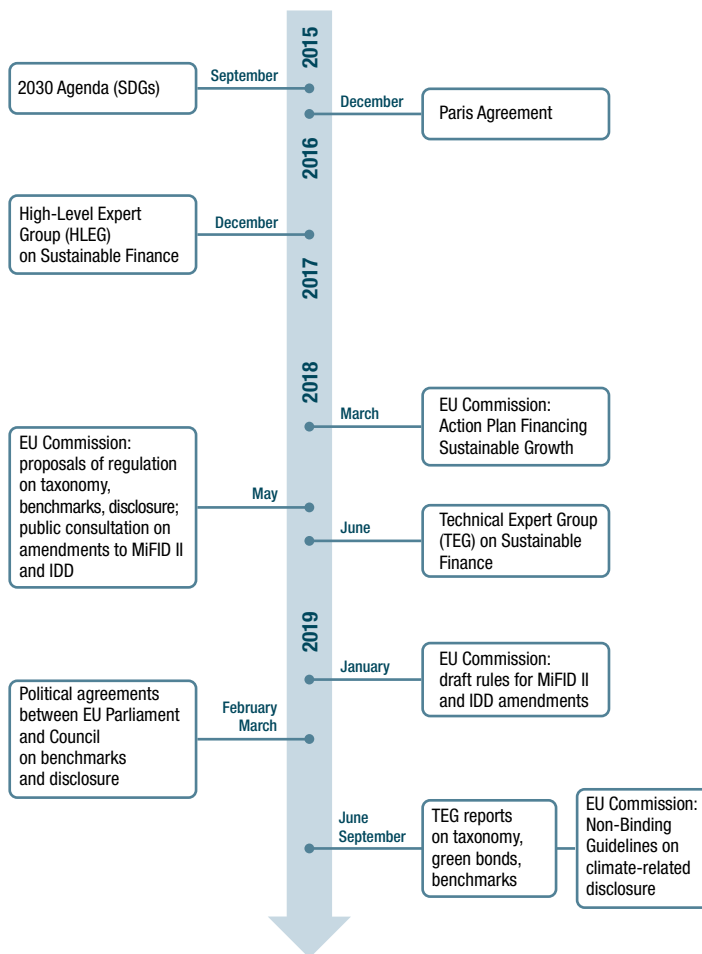
10. The European Commission was also supported by a group of Member States representatives. For more information: <https://bit.ly/2OslYeD>

11. See details under note 7.

12. At the time of writing the final draft of this handbook, consultation on the taxonomy is still underway (last updated on September 26, 2019).

FIGURE 2. From the Paris Agreement to the development of the Action Plan

The chart below shows the milestones of the reform process initiated by the European Commission: the Paris Agreement and the 2030 Agenda laid the groundwork for it and the outcome of the TEG work in 2019 was one of the latest developments.



Source: Italian Sustainable Investment Forum; last update: September 26, 2019

As highlighted earlier, until now the European Commission has been focusing on environment- and climate-related goals; **brainstorming on social issues** was entrusted to the **High-Level Task Force (HLTF) on Investing in Social Infrastructure in Europe** established in February 2017 by the European Long-Term Investors Association (ELTI) in collaboration with the European Commission and chaired by

Romano Prodi and Christian Sautter. The HLTF encouraged greater awareness by politicians of the crucial role of social infrastructures for economic growth and the wellbeing of citizens, with a view to boosting public and private investments in the sector. In January 2018, the HLTF put forward recommendations on public policies and financing methods to fill the investment gap (currently estimated at €100-€150 billion per year, with education, life-long training, housing, healthcare and long-term care being high up on the list of priorities requiring action)¹³.

Starting from 2019, social infrastructures have taken center stage once more through the InvestEU Plan (see below).

INVESTEU: THE EUROPEAN UNION PROGRAM FOR SOCIAL INFRASTRUCTURES (2021-2027)



In January 2019, the European Parliament resolved to kick off InvestEU, the new Community program that will pool European Union financial instruments in a single fund in order to establish synergies and avoid overlapping. From 2021 to 2027 InvestEU will replace the European Fund for Strategic Investments (EFSI) of what was known as the “Juncker plan” (set up to react to the financial crisis that hit Europe in 2011).

Along the same lines as EFSI, InvestEU will focus on four thematic areas:

- small and medium enterprises (SMEs);
- research and innovation;
- sustainable infrastructures;
- social impact investments.

The plan aims to meet the **need for social-infrastructures-related investments** to support projects in the field of education, healthcare and social housing.

Differently from Juncker plan, InvestEU does not provide direct funds but a **public budget guarantee** of €38 billion, which will be used to enhance the risk capacity of public and private investors. InvestEU will cover 40% of this amount (namely €15.2 billion reckoned in the accounts of the European Union) to be set aside for the cases requiring use of such funds. In particular, the program provides for €11.5 billion for sustainable infrastructures, €11.25 billion for SMEs, €11.25 billion for research and innovation, €4 billion for social investments.

13. Fransen, Lieve, Del Bufalo, Gino and Reviglio, Edoardo 2018, *Boosting Investment in Social Infrastructure in Europe*, Report of the High-Level Task Force on Investing in Social Infrastructure in Europe, Discussion Paper 074, January 2018: <https://bit.ly/2DQ5wBc>

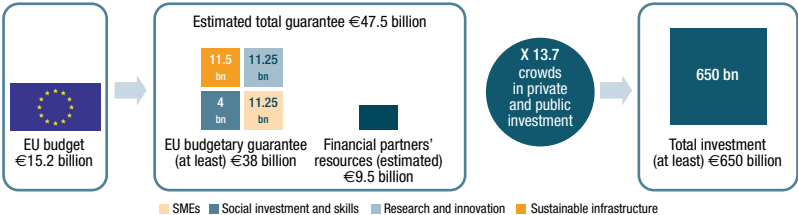
The financial partners of the different projects, starting from the EIB Group¹⁴ (see Glossary, p.112) will be required to contribute up to €9.5 billion to enhance the risk capacity of investments so that the overall fund guarantee will total €47.5 billion.

The multiplier – i.e. the ability of the program to attract additional private resources for the sectors needing action – is estimated at 13.7x (against 15x in the Juncker plan): the overall investment, including the multiplier effect, is estimated by the European Commission to total €650 billion¹⁵. InvestEU focuses investments on **quality and added value of projects**, in addition to – rather than to replace – pre-existing structural investments in Member States.

InvestEU will be comprised of the aforementioned guarantee fund and an advisory hub to provide technical support to fund-seeking investment projects as well as a portal that will put together projects and investors while providing them with an easily accessible databank.

The distinctive feature of the program is its focus on the social sphere. In fact, InvestEU intends to develop and strengthen the new market structures relating to social enterprises, while supporting innovative schemes; encourage access to microfinance instruments for vulnerable groups (jobless, young, migrants, etc.) and social enterprises; build a stronger capital market to support social infrastructures and investments in human capital.

How InvestEU works



Source: Ec.europa.eu, *EU budget for the future*: <https://bit.ly/2wgCGoj>

14. The EIB Group is comprised of the European Investment Bank (EIB – see Glossary, p. 112) and the European Investment Fund (EIF), specializing in financing mid- and small-caps.

15. The European Parliament approved an amendment that provides for the increase in the guarantee in the accounts of the European Union to €40.8 billion (at current prices) to mobilize over €698 billion of additional investments across the Union. The budget will be decided as part of negotiations on the next Multiannual Financial Framework (MFF).



As it seems, the sustainable finance “movement”, after a long, complex and bumpy journey is nearing a turnaround. Over the years, several attempts have been made (some of which failed) to raise the awareness of public opinion, institutions and investors on sustainability-related issues. Supply has often prevailed over demand in this process. Advisors and managers have anticipated the legitimate opportunities inherent in this thematic area and each has worked out its own value proposition introducing significant product and process innovations which, however, sit on a scarcely fertile ground as yet to be tilled. As a result, multiple approaches and products have proliferated in specific market niches. In this context, demand had difficulties in understanding and hence growing. Also, it had difficulties in providing its contribution in terms of clarifying the needs and direction of supply.

Currently, after several years of testing and above all after a social and environmental emergency has been overtly declared, what appeared to be almost like a “cultural frill”, a topic of interest to only few pioneers, has become of general interest. The current and foreseen state of suffering of our planet in terms of both the environment and society goes unquestioned: it's a fact acknowledged by all (save for a few instrumental and opportunistic exceptions). **Today, “sustainability” is a given** and can no longer be ignored. This applies to international and domestic institutions and efforts are being made the world over along this path in order to reverse a trend which, unless stemmed, might jeopardize the future of mankind.

The European Commission Action Plan Financing Sustainable Growth follows in the wake of this collective awareness raising. Its goal is to outline the framework within which finance will move in the future. It is a significant step forward in terms of awareness raising and to systematize this topic, which can without a doubt be the turnaround mentioned earlier. Without neglecting the unknowns and possible side effects (just think of the complexity, management-wise, that it will bring with it, on the demand and supply side; or of the risk, as has often been the case, that good intentions boil down to mere formalities), on the wake of the Action Plan, this issue can no longer be avoided.

Having regard to banking Foundations, it should be pointed out in the first place that sustainability is a fairly “crowded” area of action in terms of provision of funds. Not only because environmental and social topics are regulated by the law (legislative decree 153/99), but also because **Foundations are rooted in- and keen on- the sustainable development of local communities** around which their action revolves in its entirety.

On the front of asset management, until now Foundations have been less active, though they have always been interested in this topic: both Acri, which represents them all, and some individual Foundations, for example, have been for some years now members of the Italian Sustainable Investment Forum. This, however, is likely ascribable to two main reasons. The former relates to the already mentioned build-up over time of multiple approaches/products that has made it more complex for investors to form their own strategy. The

latter, which may be even more important, relates to the very nature of Foundations, which are at the same time both institutional investors and key players in supporting the social, cultural and economic development of their local communities. As a result, their assets, besides generating income through which funds are then provided, can also provide with Mission Related Investments, subject always to the principles of asset protection and generation of adequate profitability. A typical example of this are the investments by many Foundations in **social housing funds** which, besides generating income, made it possible to implement the national social housing plan managed by CDP Investimenti sgr, which is also extremely keen on energy saving and soil consumption. Until now, this trend has drawn the attention of Foundations in the definition of their investment strategies. Still, the creation of a European reference framework on sustainable finance should drive convergence and usher in an era of finance keen on humans and the planet.

ASSET MANAGEMENT TO SPEED UP A GLOBAL SHIFT TO A MORE SUSTAINABLE ECONOMY

ASSOGESTIONI (THE ASSOCIATION OF THE ITALIAN INVESTMENT MANAGEMENT INDUSTRY)



The asset management industry is called upon to make a crucial effort: speed up a global shift to a more sustainable, inclusive and responsible economy. In the asset management world, the focus on environmental and social factors is already a widespread and growing practice: Morningstar estimates that in Europe sustainable assets are growing three times faster than traditional ones. At the end of June 2019, assets invested in ESG funds grew by 7% to €1.06 trillions, up against €992 billion last year. During the same period, the assets of the other European funds grew by 2%¹⁶. Admittedly, however, the integration effort required of the industry by the new set of European rules is supportable as much as it is challenging.

Stepwise and proportioned: key criteria in the evolution of ESG

Assogestioni believes it is **crucial for regulations to be flexible, stepwise and proportioned** so as to avoid market distortions and a merely formal respect of rules or constrain innovation.

Flexible: based on shared principles and criteria rather than overly stiff prescriptions that leave no room for product and process innovation for both the asset management industry and issuers.

Stepwise: in the shift from a self-regulated world where managers used to define their idea of sustainability without necessarily using a common, standardized language – to a scenario characterized by a much more detailed disclosure, in the name of the utmost transparency.

16. Baselli, Valerio 2019, "Gli asset sostenibili crescono al triplo della velocità di quelli tradizionali", *Morningstar.it*, July 31, 2019: <https://bit.ly/2kun8uG>

Proportioned, in that it should reflect the peculiarities of the different companies, such as assets under management, product complexity and time horizon.

This being a radical change, it will take time to absorb and implement it. Companies make available more and more information. Still, in order to systematically incorporate it in management models and strategies that agree with the new taxonomy they will be required to meet precise criteria of usability, standardization, comparability and reliability.

Demand and supply

In order for the growing commitment of asset managers to drive a real growth of sustainable finance, there needs to be a **growing awareness on the demand side**. It should be reminded that an SGR manages clients' assets and, in line with its due diligence, it is required to comply with the client mandate.

Unless specifically indicated by asset owners – be they retail or institutional clients – the SGRs have little room to steer investment strategies towards the pursuit of sustainability goals beyond the integration of ESG variables in risk assessment. It is for this reason that in order for the benefits of the action of the Commission to be fully felt, it is fundamental to also work on the demand side, through retail investors supporting long-term investments and by strengthening the role of patient institutional investors (typically, pension funds).

The **greater transparency of information** and the **requirement to verify preferences** relating to sustainability under the amendments to MiFID, in the discussion between distributors and clients, enhance the role and responsibility of the final investor in steering investments towards sustainability and make it crucially necessary to raise awareness and improve the understanding of financial topics. It is therefore increasingly urgent to work on financial education. Due to the lack of information, investors underuse sustainable investments; those who believe they have broader competencies, instead, invest a more significant share of their portfolio in ESG funds and expect higher returns¹⁷.

The commitment of Assogestioni in Italy

Already a while ago, Assogestioni put sustainability at the center of its action as the driver of the evolution of the asset management industry, by promoting the adoption of a sustainable approach to investments and supporting the SGRs in taking on the role of responsible investors in investee companies.

The 2019 edition of Salone del Risparmio, dedicated to the sustainability of financial investments, recorded a significant interest in this topic, not only by asset managers but also by financial advisors, who are at the forefront in raising the awareness of their clients, i.e. those who are increasingly focused on the sustainability of their lifestyle and who, by adopting the same approach for their investment choices, can be the driver of a real turnaround towards a new growth model.

17. Schroders 2018, *Global Investor Study 2018*: <https://bit.ly/2oOWKNS>



It is by now clear that Europe intends to lead the fight against climate change and thus become the land of choice for sustainable investments.

Banks are important players in this process and the European Banking Federation has set up a dedicated working group, the Task Force on Green Finance, being aware that considering the **environmental risk** for the banking sector is no mere compliance exercise or a reputational issue but means considering a risk that **has an impact linked to the profitability of banks**.

The **role of the banking industry** turns out to be crucial from two viewpoints:

- reduction of the direct impacts of companies through **energy efficiency actions**;
- reduction of the indirect impacts of companies through a **different capital allocation**.

Also, they are impacted from a financial point of view in that they are required to **assess the ESG risks of their investments** and in turn have shareholders who are keen on these topics.

Regarding the reduction of direct impacts, for example, BPER Banca has added to its Business Plan a structured system for reducing consumption and for producing renewable energy; as to indirect impacts, instead, it started some years ago to seize market opportunities, especially in relation to energy efficiency and renewable energy production. Since 2016, BPER Banca has been the pilot bank in Italy for a **project finance instrument** – the Private Finance For Energy Efficiency (PF4EE), supported by the EU as part of the LIFE Program – defined as part of a common agreement between the European Investment Bank (EIB) and the European Commission. The agreement provides for the creation of a portfolio of investments, guaranteed by the EIB, of up to €50 million and dedicated to small, medium and large enterprises.

The European Commission, through PF4EE, intends to encourage investments in energy-efficiency projects, by facilitating access to dedicated sources of funds, thanks to awareness raising activities addressing European financial institutions and by boosting the resources available to the system for attracting more investments.

As part of this project, called BPER LIFE4ENERGY, BPER Banca will provide to the enterprises involved specialist investment advice relating to the main public facilities available locally and help with energy diagnoses and in the identification of possible solutions thanks to the involvement of selected partners.

Funds are available for multiple areas:

- actions relating to buildings (insulation, windows, heating/cooling, lightning, etc.);
- actions relating to manufacturing facilities;
- heating/cooling systems;
- public lightning infrastructures;

- high-efficiency plants for the co-generation of heat and electricity.

Another European initiative dedicated to the banking sector is the **European green mortgages project**. Funded by the Horizon 2020 European Funds, it is sponsored by an international Consortium comprised of the European Mortgage Federation – European Covered Bond Council (EMF-ECBC), the Royal Institute of Chartered Surveyors (RICS), E.ON, Università Ca' Foscari di Venezia and the Goethe University of Frankfurt. It is a program that involves dozens of stakeholders and banks (over 40 across Europe, of which nine in Italy, including BPER Banca), with Italian entities or entities operating in Italy (ABI, Enea, CRIF, Green Building Council, RICS, MPS, BPM, BPER Banca, Crédit Agricole, Société Générale, Volksbank, Friulovest Banca, Unicredit), besides several public institutions and companies specializing in energy and real estate.

The goal is to create a standardized “green mortgage” that encourages private entities to carry out energy efficiency works in owned buildings or purchase high-energy-efficiency buildings.

This project assumes that energy efficiency can mitigate the bank's risk thanks to the increase in value of the building.

BPER Banca also participates in other industry projects such as Enforcer and SAVE the HOMES which are focused on energy efficiency aiming for zero-emissions new buildings.

THE GOALS OF ITALY ON CLIMATE AND ENERGY:

THE 2021-2030 ENERGY AND CLIMATE INTEGRATED NATIONAL PLAN

ARPINGE



EU Regulation 2018/1999 of the European Parliament and Council **on energy governance and climate action** introduces institutions and procedures to attain specific energy and climate targets by 2030, i.e.:

- **reduction of GHG emissions** by at least 40% over 1990, with a specific target being set for each Member State: for Italy the target by 2030 is -33% over its level in 2005;
- **increase** by 32% in the share of energy from **renewable sources** in the gross final consumption of energy;
- **increase** by at least 32.5% **of energy efficiency**, with specific energy saving requirements being set for every Member State.

In order to achieve these targets, the EU Regulation outlines **five macro-areas of action**:

- a. energy security;
- b. domestic energy market;

- c. energy efficiency;
- d. decarbonization;
- e. research, innovation and competitiveness.

The **ten-year (2021-2030) PNIEC** (Piano Nazionale Integrato per l'Energia e il Clima – Integrated National Plan for Energy and Climate), that all Member States are required to draw up, is the key instrument required by the EU to achieve the 2030 targets. These Plans must respect the requirements outlined by the EU Regulation, i.e.:

- provide an **overview of the energy system** and of the current roadmap;
- set out **domestic targets** and related **analytical policies and measures** aimed to achieve these targets;
- **guarantee** that **plans** are **consistent with the UN SDGs** and are conducive to their achievement.

Member States can rely on existing domestic strategies or plans. For Italy, the reference framework is the **National Energy Strategy (Strategia Energetica Nazionale – SEN 2017)**, the Government's ten-year plan for anticipating and managing the change in the energy system.

This is the background for the Italian proposal for an **Integrated National Plan for Energy and Climate (2021-2030)**. This proposal sets out goals rather than instruments. The plan **pursues decarbonization by 2030**, through the development of renewables, energy efficiency and security, in view of energy transition. These targets are **by far way more ambitious than those set out in SEN 2017**, i.e.:

- **reduction of GHGs** for non-ETS (Emission Trading System¹⁸) sectors by **33%** (3% more than the UE);
- share of **renewables** in the gross final consumption of energy equal to **30%** (against the EU 32% target)¹⁹;
- **reduction of primary energy consumption by 43%** (against the EU 32.5% target).

The **challenges introduced by PNIEC** appear to be extremely **ambitious** and call for a general reorganization of the entire domestic energy system and of the renewables sectors, of energy efficiency and mobility, **with significant infrastructural investments**. In the renewables sector alone, the PNIEC targets could translate into **new 45 GW installed power between 2021 and 2030 (estimated investment of €30-€50**

18. The EU Emission Trading System is the European CO₂ marketplace. The EU ETS operates on the basis of the principle of limitation and trading of emissions: a cap is set on the total quantity of a number of GHGs that can be emitted by the facilities covered by the system. The cap decreases over time, so as to progressively reduce total emissions. Within such cap, companies receive or purchase emissions which, if need be, they can trade. Capping total emissions allows to give a value to available emissions. For more information: https://ec.europa.eu/clima/policies/ets_en

19. Renewables: 55.4% electricity, 33% heat and 21.6% transportation.

billion) – quite a demanding target if one compares the 4.5 GW annual average to the historic trend of the last ten years (3.5 GW).

This target is even more challenging if set against the current regulatory framework as the latter can only partially support these goals. For example, **Decree FER1**, in force since August 10, 2019, **provides that incentives will only be granted for a maximum power of 8 GW, out of the 45 GW of PNIEC**, though it spans a shorter timeframe compared to the ten years of PNIEC.

In order to make it possible to actually achieve the demanding goals of PNIEC one should **wonder which instruments can be used in practice to implement the Plan and which structural changes need be made to the system**, the latter being transformations without which the willingness to implement PNIEC is hardly credible.

For this reason, the broad debate that has been going on in Italy amongst the players of the renewables industry has led to the definition of an integrated package of policies, including:

- **encourage a widespread use of mid-to-long term energy sale and purchase agreements** based upon market parity (PPA);
- **build storage facilities** that are capable of filling the gap generated by the poor programmability of renewable sources, curb over-generation and the resulting risk of price cannibalization;
- **adjust market functioning** to allow for a greater penetration and competitiveness of renewables through, for example, the introduction of **ongoing programming** of energy input plans (with the markets' gate closure approaching delivery), in a process of harmonization and integration of intra-day markets currently underway in the European Union;
- **simplify authorization processes and/or reduce their timing** so as to **encourage**, for example, **Revamping and Repowering activities** aimed to increase the installed power relative to soil consumption²⁰.

20. For more information on the proposals to be implemented see also: Arpinge 2019, *Transizione energetica: analisi e proposte per conseguire gli obiettivi del PNIEC*, Quaderno n. 1, July 2019: <https://bit.ly/2UjEBUh>

1.

Sustainable finance: definitions and common criteria



Over the last few years, the sustainable finance market has posted a significant growth across the world, Europe and Italy: assets managed according to sustainable and responsible strategies are growing and so is the number of players that integrate ESG (environmental, social and governance) criteria in their strategies and investment choices.

Still, there is room for improvement in terms of transparency and sharing common criteria relating to the applications of the concept of sustainability for investments. These aspects are crucial in view of boosting investors' confidence and steering capital flows to activities aligned with international environmental and social objectives²¹, according to the Action Plan.

This chapter starts with an introduction on sustainable and responsible investments, then moves on to provide an overview of the size and characteristics of the sustainable finance market across the world, Europe and Italy (see §1.1.), dwells on the importance of introducing common definitions and criteria relating to sustainable investing (see §1.2.) and finally presents the proposal made by the European Commission in relation to this, i.e., a taxonomy of environmentally sustainable activities (see §1.3.).

1.1. SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI): ORIGIN, KEY CONCEPTS AND CHARACTERISTICS OF THIS MARKET

Sustainable and Responsible Investment (SRI) is increasingly gaining ground worldwide thanks to the multiple opportunities offered to institutional and retail investors. However, due to the complexity and ongoing evolution of the market, as yet there is no agreement on which are the essential characteristics of a “sustainable investment”.

In 2013, a working group of the Italian Sustainable Investment Forum provided its own definition, which points out that:

Sustainable investments aim to **create value** for investors and society as a whole through a **mid-to-long-term** investment strategy which, when analyzing enterprises and institutions, integrates **environmental, social and governance aspects** into the financial analysis.



According to this definition, sustainable and responsible investments rest on three key pillars:

1. **generation of returns** for investors;
2. **mid-to-long term time horizon**;
3. **integration of ESG criteria** in asset management.

21. UN 2030 Agenda and Paris Agreements in particular.



SRI has a religious origin. In fact, the first investments based on criteria other than strictly financial ones can be traced back to the Quakers in the Seventeenth Century, who prohibited the funding of slave trade.

Still, it was only in the Twentieth Century, in 1928 to be precise, that the first sustainable investment fund (the Pioneer Fund) was launched, based on an exclusion strategy (assets selection relied upon ethical and moral principles and avoided alcoholic beverages and tobacco).

In the 1960s, the US civil rights movement, the Vietnam War, Apartheid in South Africa and other events helped raise social and political awareness globally, such that many religious and lay investors started to pay attention to sustainable investments.

In the 1980s and 1990s, on the wake of growing focus on environmental issues, sustainability became increasingly relevant within society and in investment choices²².

Starting from 2000, there has been a shift away from an approach mainly characterized by exclusions based on ethical and religious principles and towards integrating ESG aspects not only in the definition of the investable universe but also in assets selection and dialogue with enterprises. More in general, investors focused on SRI for multiple reasons: in fact, sustainable investments also attract such investors as are interested in a more effective risk management.

Over the last few years, and in particular subsequent to the 2015 Paris Agreement, SRI has broadened its scope to embrace financial markets regulators and public entities. While there has been a growing awareness of the relevance of ESG factors for global economic and financial stability, the benefits of SRI attract increasingly more public players, as witnessed by the issuance of green bonds by central and local authorities.

Sustainable investments can be based on a diversified range of strategies – each featuring specific targets and methodologies – which are not mutually exclusive and can therefore apply to one and the same portfolio and to different asset classes (shares, bonds, private equity and private debt, etc.).

Set out below are the most widespread SRI strategies²³ (see Figure 3).

22. The first SRI index, the KLD 400 Social Index (currently MSCI KLD 400 Social Index) was launched in 1990.

23. At present there is no single, shared classification of SRI strategies: this handbook refers to the classification proposed by Italian Sustainable Investment Forum.

FIGURE 3. Most widespread SRI strategies**Exclusions:**

exclusion of a number of issuers, sectors or countries based on given principles and values (amongst the most widely used criteria are weapons, pornography, tobacco etc.).

**Norm-based screening:**

selection of investments based on compliance with international rules and treaties (the most widely used being those defined by the OECD, the UN and its agencies).

**Best in class:**

selection or weighting of investments in the portfolio according to ESG criteria, favoring the best of a sector, category or asset class.

**Engagement:**

constructive dialogue with issuers on sustainability issues and exercise of voting rights related to the stocks held in the capital of investee companies.

**Sustainability themed investments:**

assets selection based on one or more ESG topics (e.g.: climate change, energy efficiency, healthcare, etc.).

**Impact investing:**

investments in enterprises, organizations and funds with the intention of generating a positive and measurable social and environmental impact alongside a financial return.

Source: Investiresponsabilmente.it, *Cos'è l'Investimento Sostenibile e Responsabile?*: <https://bit.ly/2MNjeZn>

Market size worldwide, in Europe and in Italy

According to the data of the Global Sustainable Investment Alliance²⁴, in early 2018 **the capital invested globally based on SRI strategies totaled \$30.7 trillion**. Sustainable and responsible investments grew by 34% in two years (against 25.2% in the previous two years). Most investments are in Europe (which accounts for 46% of the global SRI market) and in the USA (39%).

Having regard to the **European market**, the latest edition of the **European SRI Study**²⁵, published by Eurosif (see Glossary, p. 114) in November 2018, confirms **a growing focus on sustainable investments**. In a market that has historically been led by institutional investors, the retail share is increasing steadily, up from 3.4% in 2013 to 30.8% in 2017. There also is a growing tendency to integrate

24. The mission of the Global Sustainable Investment Alliance is to promote the knowledge and practice of sustainable investments in the financial system and the integration of sustainability criteria in investment processes in collaboration with local Sustainable Investment Forums (SIFs), with the European market being represented by Eurosif. For more information: <http://www.gsi-alliance.org/>

25. Eurosif 2018, *European SRI Study 2018*: <https://bit.ly/2Yb3za2>

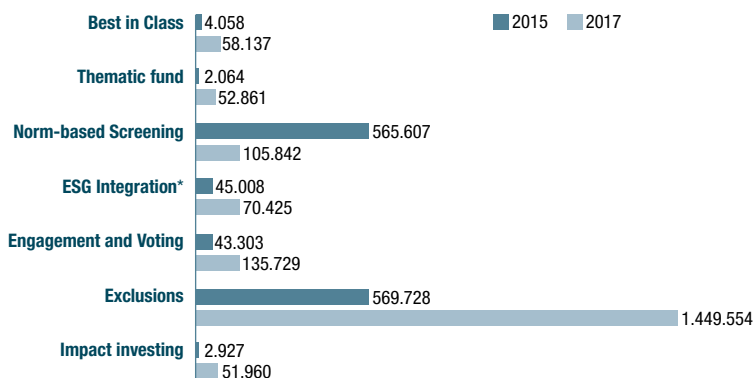
considerations relating to the UN SDGs²⁶ in investment strategies and choices.

In the period from 2015 to 2017 examined here, almost all strategies posted a significant growth²⁷ in the **Italian market** just like in Europe. In particular:

- **exclusions and engagement** are the most widespread strategies;
- **norm-based screening** still ranks third amongst the most widespread in Italy;
- **sustainability themed investments** grew more rapidly;
- **impact investing** confirms its strong growth.

The Eurosif study provides no data on total assets managed according to ESG criteria. As mentioned earlier, the SRI strategies monitored cut across asset classes and are not mutually exclusive, such that multiple strategies can apply to a given investment portfolio.

FIGURE 4. Overview of SRI strategies in the Italian market



Source: Italian Sustainable Investment Forum from Eurosif 2018, *European SRI Study 2018*: <https://bit.ly/2Yb3za2>; data in million Euros relating to assets managed according to SRI strategies.

*ESG integration consists in the explicit inclusion of environmental, social and governance factors in financial analysis. Notwithstanding a lack of a common European definition, Eurosif identified some criteria to measure the assets managed with this strategy, such as the introduction of formalized procedures to integrate sustainability issues, and the presence of ESG analysts.

26. In Italy the SDGs are promoted by Alleanza Italiana per lo Sviluppo Sostenibile (ASviS), a network of institutions and civil society organizations that aims to raise the awareness of the civil society, economic players and institutions on the importance of 2030 Agenda. For more information: <https://asvis.it/asvis-italian-alliance-for-sustainable-development> and Giovannini, Enrico 2018, *L'utopia sostenibile*, Roma-Bari: Laterza.

27. Norm-based screening is the only exception: this is related to the decrease in assets managed by exclusions, which are often adopted in combination with international conventions (alongside engagement); besides, such decrease might be due to poor knowledge of the SDGs by financial players at the time of the survey (until 2017).

1.2. ENCOURAGING MARKET GROWTH: DEFINITIONS AND COMMON CRITERIA NEEDED

Many emphasize the need to introduce **shared definitions and criteria** in order to develop the SRI market within a common framework, for the benefit of both (institutional and retail) investors and financial advisors. Indeed, investments can only be steered and protected if the industry is capable of defining common parameters and standards.

In the market survey on Italian retail investors carried out by Italian Sustainable Investment Forum and Doxa in 2017, 45% of respondents said that they are willing to invest in SRI products but at the same time they ask for more safeguards in relation to the products they invest in.

Clarity and transparency are key drivers for boosting retail investors confidence in financial players and instruments that qualify themselves as being “sustainable”. Knowledge of the investment products purchased is still limited: only 4% of retail investors believe they adequately know the scope of business of the companies in which their bank/insurer invests or howsoever connected to their investment products²⁸.

Also, according to a recent study conducted by UBS²⁹, 72% of high-net-worth investors³⁰ see confusion in the use of terms such as “SRI” or “ESG”. Less than 50% are fully familiar with concepts and definitions relating to sustainable investments.

Finally, the third edition of the study *Prodotti SRI: il coinvolgimento consulente-cliente*³¹, sponsored by ETicaNews and ANASF, highlights that most advisors are not satisfied with the information they receive on sustainable finance, with 63% believing it can be improved and 19% deeming it to be insufficient.

European institutions have identified a need for more clarity and transparency: both the final report of HLEG³² and the European Commission Action Plan point out the **lack of a common definition of sustainable investment** amongst the **main impediments to the development of the SRI market**: the introduction of a shared language on sustainable finance will be crucial to fill the gap between actual investments and those required for transitioning to a sustainable growth model.

28. Forum per la Finanza Sostenibile, Doxa 2017, *Il risparmiatore responsabile – Seconda Edizione*, p. 9: <https://bit.ly/2zre714>

29. UBS 2018, *UBS Investor Watch. Rendimenti di valore. Approfondimenti globali e italiani: Cosa pensano gli investitori/2018*, Volume 2. The report can be downloaded from the following link: <https://bit.ly/2p1TrTD>

30. Since 2012, UBS Investor Watch has been measuring and analyzing High Net Worth Investor confidence.

31. ETicaNews, ANASF 2018, *Prodotti SRI: il coinvolgimento consulente-cliente*, Atlante SRI 2018, Terza Edizione, pp. 4-5: <https://bit.ly/32X8SMC>

32. HLEG 2018, *Financing a sustainable European economy*, op. cit., pp. 15-19.

1.3. THE EUROPEAN UNION TAXONOMY ON ENVIRONMENTALLY SUSTAINABLE ACTIVITIES

The taxonomy is a classification of environmentally sustainable economic activities and is meant as guidance for investors and enterprises in view of transitioning to an economic growth with no adverse effects on the environment and in particular on climate.



As a reaction to the need for common criteria to define sustainable investments, the HLEG report and the European Commission Action Plan³³ propose the introduction of a taxonomy, i.e. of a **unified system** that clarifies the **activities that can be deemed to be sustainable** in environmental and social terms; this instrument could be gradually integrated in the laws of the European Union according to methods that are being defined. The goal is to increase market transparency and investor confidence, steering more investments towards sustainable projects.

For the time being, the European Commission proposal focuses on climate and the environment.

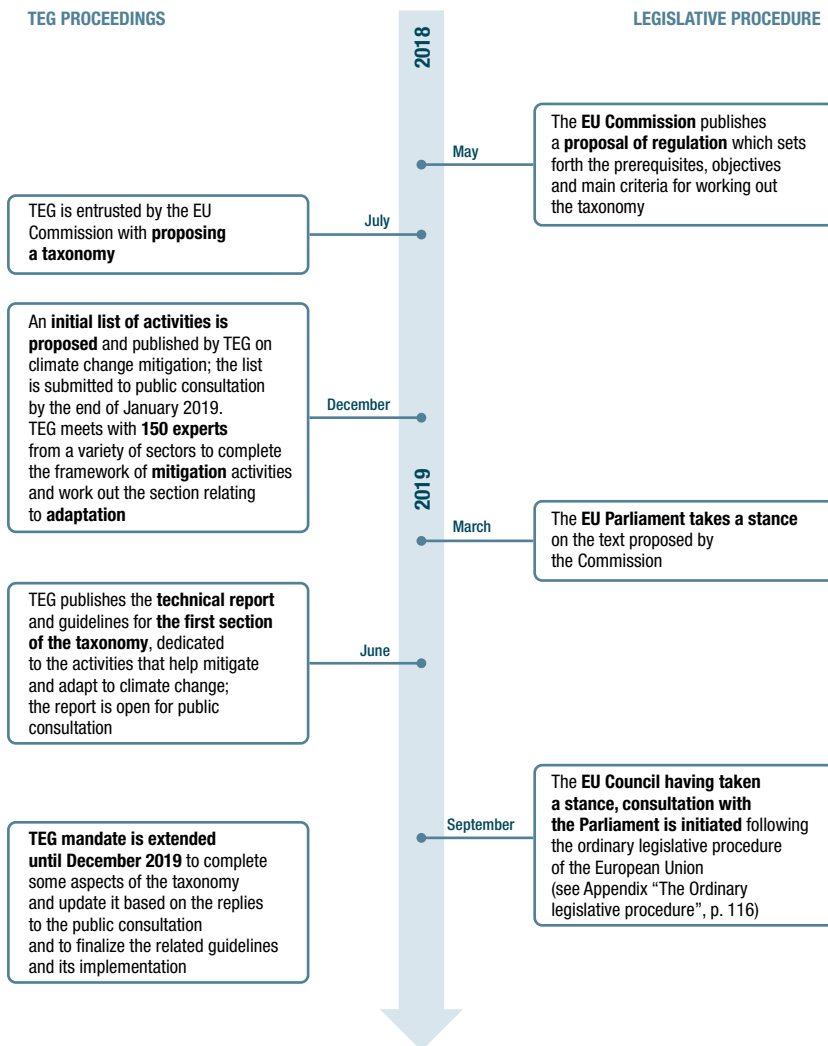
33. European Commission 2018, *Action Plan: Financing Sustainable Growth*, op. cit., pp. 4-5.

FIGURE 5. Development of the taxonomy

The following graph summarizes the main steps in the development of the taxonomy, highlighting the legislative process, on the one hand, and the work of the TEG, on the other.

TEG PROCEEDINGS

LEGISLATIVE PROCEDURE



At the end of the ordinary legislative procedure, the material developed by TEG becomes the basis for a delegated act (see Glossary, p. 110) by the Commission implementing the regulation

Source: Italian Sustainable Investment Forum; last update: September 26, 2019

The taxonomy comprises a **list of economic activities** and related **technical criteria that measure their environmental impact**.

The activities are selected based on the possibility to contribute towards achieving **six environmental objectives** identified by the European Commission³⁴:

1. climate change **mitigation**;
2. climate change **adaptation**;
3. sustainable use and protection of **water and marine resources**;
4. transition to a **circular economy, waste prevention and recycling**;
5. prevention and control of **pollution**;
6. protection of healthy **ecosystems**.

In order for an activity to qualify as “environmentally sustainable”, it is required to meet **four criteria**³⁵:

1. **substantially contribute** towards achieving at least one of the six environmental objectives;
2. **do not significantly harm** any of the environmental objectives;
3. be carried out in compliance with **minimum social safeguards** (e.g., those provided by the International Labour Organization – ILO agreements);
4. respect the **technical screening criteria** identified by TEG.

During its mandate, TEG focused on climate change and worked out **recommendations on mitigation and adaptation** (i.e., the top two objectives).

The reference criterion of the classification is the **NACE code**, that is the European nomenclature of economic activities; the procedure adopted to set up the scheme provides for the **selection of sectors, activities and technical criteria**. The latter define the quantitative and/or qualitative **requirements** based on which each activity:

- **help achieve at least one of the six environmental objectives** (“Substantial contribution”);
- **does no significant harm (“DNSH”)** to the other environmental objectives.

TEG chose to structure the classification based on economic activities rather than the type of investable companies so as to allow all organizations to communicate to the market the portion of their activities that help achieve environmental goals.

The criteria were established using the **technical and scientific expertise** of experts of each sector and **classification tools already used** in financial markets. The taxonomy takes account of the products **lifecycle** and is – to the extent possible – “**technology-neutral**”, that is to say not subject to significant alterations

34. European Commission 2018, *Proposal for a regulation on the establishment of a framework to facilitate sustainable investment*, May 24, 2018, art. 5: <https://bit.ly/2YCK9xG>

35. Ivi, art. 3.

with the technological evolution of the reference sectors. Furthermore, in order to ensure that the scheme is **dynamic** and **flexible**, the TEG has highlighted the requirements that might become more stringent at a later stage, like, for example, allowed CO₂ levels, which might trend down to zero emission.

The regulation proposed by the European Commission provides for the establishment of a **multilateral platform on sustainable finance**³⁶ formed by public sector representatives and private sector experts; this body will be tasked with assisting in the use of taxonomy and, if needed, update criteria.

The activities that contribute to climate change mitigation

“**Mitigation**” refers to the initiatives aimed to curb the impact of human activity on climate through the reduction and/or removal of GHG emissions. In view of achieving this goal, according to the TEG proposal the taxonomy includes:

- **activities that are already compatible with a zero-emission scenario in 2050** (e.g., zero-emission means of transport);
- **activities that help the transition to a zero-emission economy in 2050**, though not yet consistent with such scenario (e.g., low-emission power plants³⁷);
- **activities that enable those included under the two previous categories** (e.g., construction of wind turbines or installation of efficient boilers).

In view of achieving the goals above, TEG selected the sectors which:

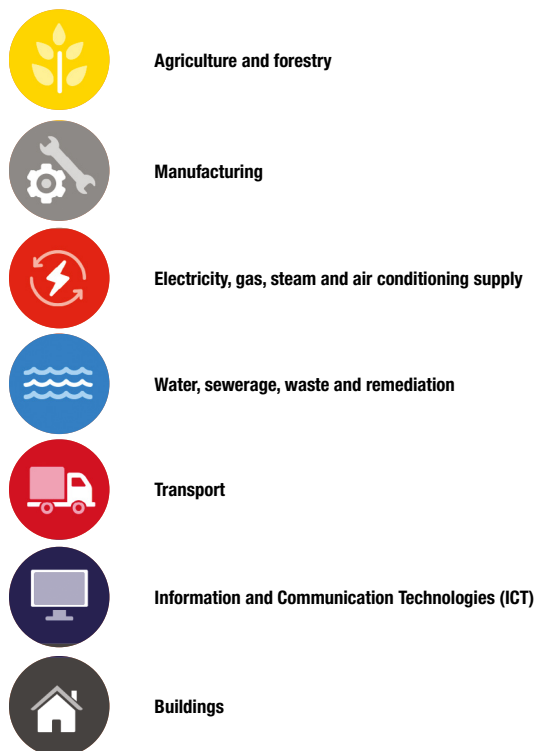
- have the highest levels of CO₂ emissions;
- can contribute towards reducing GHG emissions in other sectors.

36. Ivi, art. 15.

37. According to the proposal of the TEG, the taxonomy excludes the economic activities that stand in the way of achieving mitigation goals (e.g., the production of electricity from fossil fuels) including where they present goals set to reduce environmental impacts: indeed, such activities are not considered to be compatible with achieving the “zero emission” goal in 2050.

Seven sectors have been identified, as shown below:

FIGURE 6. Sectors that contribute towards mitigating climate change



Source: Italian Sustainable Investment Forum from TEG 2019, *Using the taxonomy*: <https://bit.ly/2GawIQD>

Within these sectors, **67 activities** have been selected: for each of them, TEG has identified the **technical screening criteria** to be used to determine the **quantitative thresholds** within which there is a contribution to the mitigation goals on a DNSH basis. For example, as regards the transport sector, interurban passenger rail transport help achieve the mitigation goal if trains are zero-emission or if they emit less than 50g of CO₂ per kilometer traveled by each passenger³⁸.

38. EU Technical Expert Group on Sustainable Finance 2019, *Taxonomy Technical Report*, June 2019, p. 329: <https://bit.ly/2MScqvr>

Activities that help adaptat to climate change

The second area of classification of the taxonomy relates to the goal of adaptation to climate change. By “**adaptation**” it is meant an improvement in the ability to foresee and tackle the adverse effects of climate change, considering present and/or future damage to economic activities, the environment and society³⁹.

The activities comprised in this area are closely **connected to the local territory** and vary depending on the type of climate effects and geographic, natural, economic and social contexts concerned.

TEG has structured this section of the taxonomy based on **guiding principles** for the selection of economic activities and **qualitative criteria** for defining requirements.

The guiding principles for identifying the economic activities that help adaptation are set out below:

1. **reduction of exposure to the physical risks** of the activity itself and/or of the environmental or socioeconomic context within which the economic activity takes place;
2. **absence of adverse impacts** on the resilience of other activities or other contexts;
3. **adaptation effects** that can be defined and measured.

Contribution to adaptation can be either:

1. by increasing the **resilience of the economic activity** through the adoption of measures that curb physical risks (e.g., as regards farming, by improving the soil's ability to retain water so as to limit the adverse consequences of draught);
2. by increasing the **ability of the economic activity to enhance the resilience of the environmental and socioeconomic context** within which the activity takes place (e.g., by developing satellite systems for monitoring climate and weather).

All of the sectors and economic activities have to improve resilience to climate change and can contribute towards improving the adaptation capability of the contexts within which they take place⁴⁰.

39. European Commission 2018, *Proposal for a regulation on the establishment of a framework to facilitate sustainable investment*, op. cit., art. 7.

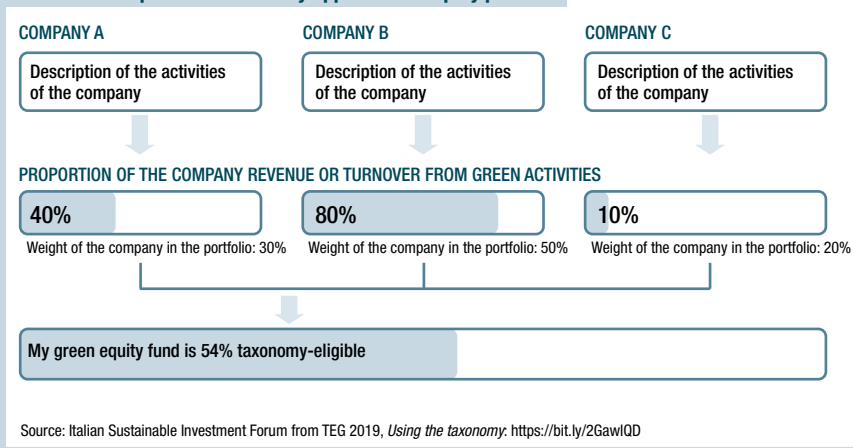
40. In order to align with the pre-requisites of the taxonomy, each economic activity that is relevant to adaptation must not stand in the way of achieving other environmental goals in other sectors. Hence, the TEG has identified an initial list of NACE macro-sectors that meet such requirements: 1) farming, forestry, fishing; 2) energy (electricity, gas, steam and air conditioning); 3) Information and Communication Technologies (ICT); 4) financial and insurance services; 5) scientific and technical activities; 6) supply of resources relating to water, sewage, waste and cleanup activities. See TEG 2019, *Taxonomy Technical Report*, op. cit., p. 37.

FIGURE 7. The taxonomy: guidelines

TO WHOM IS IT ADDRESSED?	WHAT IS IT FOR?	HOW DO YOU USE IT?
<p>Financial players⁴¹ that qualify as “environmentally sustainable” the financial products that they place on the market or purchase, such as:</p> <ul style="list-style-type: none"> • open-end funds; • alternative investment funds; • insurance products; • pension products and schemes; • portfolio management. 	<p>To disclose the environmental goals pursued by the financial products qualified as “sustainable”. The taxonomy is not binding; investors can also use other classification methodologies. The taxonomy can also be used for:</p> <ul style="list-style-type: none"> • developing new “green” products; • expressing investment preferences; • select the assets to invest in; • start a dialogue with investee companies on sustainability topics (engagement); • measure the environmental impact of a financial instrument. <p>The taxonomy can also be used by commercial banks for “green” mortgages and loans; by international investors as a reference point to measure the sustainability of economic activities in the markets; by companies to make investment decisions and to align with the classification in view of attracting new investments.</p>	<p>Every financial product intended to qualify as “sustainable” must include information on the percentage of investments in economic activities as defined in the taxonomy.</p> <p>There are five stages in the use of the taxonomy:</p> <ol style="list-style-type: none"> 1. identify the activities in which the product invests and which are included in the taxonomy; 2. verify contribution to at least one of the environmental objectives; 3. verify absence of adverse impacts on other objectives; 4. verify compliance with social minimum safeguards; 5. calculate the relative weight of the investments in the activities that are compatible with the taxonomy over total portfolio assets.

Source: Italian Sustainable Investment Forum from TEG 2019, *Using the taxonomy*: <https://bit.ly/2GawlQD>

FIGURE 8. Example of the taxonomy applied to an equity portfolio



41. Investment banks, insurance companies, asset managers, pension funds. Currently, use of the taxonomy by banks is voluntary as regards credit products such as mortgages and loans.



The banking industry position on the European Action plan

In the Action Plan for financing sustainable growth, published by the European Commission in March 2018, ABI represented to the European institutions, directly and through the positions of the European Banking Federation, its support to the transition to a sustainable economic model, also capable of adequately supporting the organizations that are not well positioned currently, so that they can proceed to transition from the environmental, climate, social and governance point of view.

The development of sustainable finance will be incisive and based on two preconditions:

- the **development of a regulatory environment** (overall, not just for the sector) **that encourages sustainable development** and that has clear standards to orient the economic activities of enterprises and financial flows;
- **investments in sustainable activities capable of generating return/remuneration.**

Usability of the taxonomy

ABI believes that the success and usability of the taxonomy will depend on the following aspects, with data availability being crucial:

A common language

ABI considers the taxonomy as a **common language** that might well be applied by all (financial and non-financial) market participants. However, it is important to draw a line **between voluntary and mandatory use**: it is deemed appropriate that, in general, the possible application of the taxonomy is on a voluntary basis, whereas it is mandatory to refer to it only for such financial products as are expressly marketed as being sustainable.

Simplicity

The more the taxonomy includes **simple, clear and unmistakable information** relating to the eco-friendliness of the economic activities evaluated by financial players, the more **the risk of “greenwashing” will be forestalled** and it will be possible to mobilize all players (banks and enterprises) with the required volumes and operating timing.

Operational aspects

Usability of the taxonomy will also depend on how it will be implemented, considering the **automation of processes and integration in IT systems**. Should sustainable finance remain a highly “manual” process, the number of sustainable transactions would not increase.

Mitigation and adaptation

We appreciate that the activities covered by the taxonomy are considered in light of both their contribution to mitigation (e.g., avoiding or reducing GHG emissions) and their contribution to adaptation to existing and foreseeable future climate changes (e.g., by enhancing the ability to adapt to draught, flooding, rising sea level, growing energy cost, etc.). In fact, **banks will likely face a higher financial risk if they fail to adapt their business to climate change** as compared to the risk linked to companies with poor measures in place to mitigate climate change.

Data Availability

It is **fundamental to have a “chain of consistent information”** enabling financial players to use the taxonomy to the extent that the data required is made available by companies. If the companies that are the customers of financial players are not capable to provide the data required by the taxonomy, the risk is there that environmentally sustainable sectors will be under-represented.

As of today, Non-Financial Disclosure is not enough to obtain the data required from Europe by banks – witness, amongst others, the new Communication of the European Commission *Guidelines on non-financial reporting: Supplement on reporting climate-related information*. Market incentives or the direct involvement of participants in financial markets with enterprises will play a critical role; still, one should bear in mind the variable quality of data and that high-quality, relevant and reliable data is expensive. The **availability of ESG data**, unless managed appropriately, **will clearly distort the competition between big business and SMEs**.

Trade associations are fundamental to support awareness raising and encourage a disclosure that companies can use to describe their sustainability profile, in a structured manner and in line with European standards. Supporting enterprises along this path means first and foremost help them enhance the value of the several existing best practices and mainstream them.

GREEN FINANCE FOR MARKET STABILITY: THE ROLE OF THE EUROPEAN CENTRAL BANK



The **European Central Bank** (ECB) has been committed for a long time to combat climate change within the framework of the activities which fall within its province, i.e., manage the monetary policy of the Euro Area and maintain price stability with the aim to encourage growth and integration.

The ECB action focuses on three main areas:

1. **banking supervision**, so as to enhance the ability of banks to manage climate risks;

2. **financial stability**, by measuring and assessing the impact of climate risks on the financial system;
3. **monetary policy**, with more focus on the green bond market as part of the purchase program.

In particular, the ECB Banking Supervision included climate change among the main sources of risk for the European banking system and highlighted the **adverse material impacts** that can arise from increasingly frequent and destructive extreme weather and from the **transition risks** of some productive sectors such as fossil fuels, energy-intensive sectors, utilities, transport and construction. This is why banks are required to adopt such measures as are adequate to manage their exposure to such sectors⁴².

Currently, the **lack of common definitions** and **scarcity of data and empirical evidence** are **hindering measurement of the impact of risks** on individual banks as well as on the banking system as a whole. For these reasons, the ECB has not yet adopted supervision requirements or guidelines relating to climate change; however, the relevant domestic authorities are collaborating with it to share knowledge and experience.

Since May 2018 the ECB has been a member of **Network for Greening the Financial System**, an international network of central banks and supervisory authorities aimed to encourage monitoring and management of climate risks and work out solutions to support the transition to a low-carbon economy⁴³.

Furthermore, the ECB representatives belong to **TEG** and are involved in the preparation of the taxonomy.

Also, the **Financial Stability Review** of May 2019 highlighted the importance of the taxonomy: the document includes a deep-dive on climate risks, with an analysis of the exposure of financial institutions and the possible impacts on market stability. The study maintains that *“creating a harmonised classification of environmentally sustainable activities is a priority for the European Commission”*⁴⁴.

42. European Central Bank, Banking Supervision 2019, *ECB Banking Supervision: Risk Assessment for 2019*, p. 5: <https://bit.ly/2ODI1TI>

43. For more information: <https://bit.ly/2QaSOmU>

44. Levels, Anouk and Melo, Ana Sofia 2019, *Box A - A taxonomy for sustainable financial activities*, in Giuzio, Margherita, Krusec, Dejan, Levels, Anouk, Melo, Ana Sofia, Mikkonen, Katri and Radulova, Petya 2019, *Climate change and financial stability*, European Central Bank, Financial Stability Review, May 2019: <https://bit.ly/2yEIdh6>



The EU's "green taxonomy" is the poster child of the Commission's Action Plan Financing Sustainable Growth, and **the most controversial of its current efforts**.

It is not expected to get political sign-off – i.e. be agreed by European Parliament and the Council of the European Union – until early 2020, having been subject to a tug of war between sides for more than a year already now.

The disagreements surrounding the taxonomy are numerous. Fundamentally, it will be a detailed list of legitimate "green" business activities that will help responsible investors know where to put their money, and companies know what's expected of them environmentally.

Its legal weight will be limited: the general expectation for the taxonomy at its inception was that it would be effective because, in a world of chaotic climate standards and commercial interests, it would be a trusted, EU-endorsed guide – a "go-to" for new market entrants and mainstream players, rather than the basis for any major rules.

The legislative proposal put forward by the Commission only targets product providers selling "green" funds in Europe; and even then, all they will have to do is state how their investments compare with the taxonomy. On a non-mandatory level, the plan is for the taxonomy to aid corporate engagement and voluntary reporting; and in future it may underpin new labels and guide any changes to capital requirements that may come about as part of the EU's agenda.

Still, there are **those who think it's too strict and others want it to be tougher**.

There's been fierce lobbying from some corners of European industry, nervous about potential taxonomy-based regulation that might limit their access to future finance. Others, including Germany at Council level, are understood to want the proposal watered down so it has no mandatory element at all. Others want it broadened to capture all product providers, arguing that as it currently stands, those providing ESG products are penalised with additional reporting requirements, while everyone else gets off scott-free.

On top of debate about the **scope of the legislation**, there are concerns about the scope of the taxonomy itself. The fact that political negotiations are ongoing, and therefore there is no official mandate for the taxonomy, hasn't deterred a bullish European Commission – aware both of the urgency of dealing with climate change and the sheer man-hours needed to create this kind of classification system. It has appointed a group of market participants and other specialists to help it develop the details, in anticipation of getting the green light from Parliament and Council without too many alterations to its original. Those experts (known as TEG) released an **outline of the taxonomy's guiding principles** in December 2018 – a binary approach in which activities were either green or not.

The **dramatic evolution** of those principles **in the six months that followed** reflects the pushback they received from the market. When TEG released its first draft of the taxonomy in June 2019, it was markedly different. As well as being more detailed – it currently outlines eligible activities, thresholds and KPIs (Key Performance Indicators) for 67 sectors

– it is no longer focused on the pure green. Instead, it includes **transition activities** that will support companies to move to 2°C but may still be pretty carbon intensive. Cement and steel feature, for example, in a bid to capture what a real economy would look like in transition, rather than create a niche investment universe of dark green activities.

This change has been largely welcomed by the market, but a number of NGOs are frustrated by the **lack of social considerations** in the current taxonomy. “Minimum safeguards” have been introduced to ensure that activities don’t harm basic human rights, but that’s it. Back in Parliament, there’s been conflict over whether there should be a social taxonomy too, rather than simply minimum social standards for green activities. A dramatic vote earlier in 2019 saw proposals to include such commitments slapped back.

Those revised proposals also included plans to develop a **“brown” taxonomy** – another major point of debate. Some investors and regulators believe that identifying activities that undermine the Paris Agreement would be more helpful, as these assets are arguably more clearly correlated with investment risk (making this information crucial for debt investors especially). The Commission has made it clear throughout the process, though, that it doesn’t want to “punish” companies and investors, so it has ignored calls for a brown dimension to the taxonomy. European Parliament also rejected the amendment.

But, as the legislative proposal continues to be at the center of political wrangling, and the contents of the taxonomy will be subject to many more revisions over coming months, there is still a lot to play for when it comes to this ground-breaking “dictionary” of sustainability.

2.

Communication of sustainability-related information (ESG disclosure)

Clear and uniform information as to how institutional investors integrate sustainability factors in their investment policies and processes is crucial to boost transparency and enhance ESG disclosure in the financial markets.

The first paragraph illustrates the main European regulatory measures and rules for transposition into the Italian laws that govern ESG disclosure. There follows a short analysis of the fragmented European and domestic scenario (see §2.1.); finally, a description is proposed of the main contents of the new Regulation of the European Commission (see §2.2.).

2.1. INVESTOR DISCLOSURE IN THE CURRENT EUROPEAN AND ITALIAN REGULATORY FRAMEWORK

In Europe, ESG disclosure by institutional investors is governed by two directives:

- EU Directive 2016/2341 on the activities and supervision of institutions for occupational retirement provision (**IORP II**⁴⁵);
- EU Directive 2017/828 on encouraging the long-term shareholder engagement (**Shareholder Rights – SRD II**⁴⁶).

IORP II (transposed in Italy by **Legislative Decree 147/2018**⁴⁷ in force since **February 1, 2019**⁴⁸) addresses social security players⁴⁹. The text of this norm highlights that **sustainability topics are important for investment policies and risk management** of pension funds. Therefore, these entities are **required to disclose**:

- **whether they consider ESG criteria** in their investment choices;
- **how they integrate them in risk management**.

In particular, it refers to ESG disclosure on:

- governance system;
- investment policies;

45. EU Directive 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORPs), December 14, 2016: <https://bit.ly/2EPnIAc>

46. EU Directive 2017/828 as regards the encouragement of long-term shareholder engagement, May 17, 2017: <https://bit.ly/2uu7X6q>

47. Legislative Decree 147/2018, Attuazione della Direttiva (UE) 2016/2341 relativa alle attività e alla vigilanza degli enti pensionistici aziendali o professionali, December 13, 2018: <https://bit.ly/2OI1MIU>

48. Italian rules on supplementary pensions were already more advanced compared to the requirements of IORP II on sustainability: indeed, the legislative decree that transposed the previous version of the directive required pension funds to disclose whether in their choices relating to funds management they considered ESG factors. See: Legislative Decree 252/2005, Provisions governing complementary pension funds, art. 6, 14: “*complementary pension funds are required to disclose in their annual report and summarize in their periodical memoranda to members if and how in the management of funds and in the exercise of the rights arising from ownership of portfolio securities they have considered social, ethical and environmental aspects*”. Mentioned in: Camilleri, Michaela 2018, “Le novità in materia ESG per i fondi pensione con il recepimento della IORP II”, *Ilpunto pensionielavoro.it*, November 5, 2018: <https://bit.ly/2Kedmpo>

49. More precisely, the directive addresses institution for occupational retirement provision (IORP). See EU Directive 2016/2341, art. 6.

- risk assessment and management;
- disclosure to existing and prospective members.

In the event that they do not adopt ESG criteria, they are required to **give reasons** according to the principle of “**comply or explain**”⁵⁰.

The **Shareholder Rights Directive II** aims to encourage a **long-term approach** and **more activism** by institutional investors in exercising their voting right in the stakes held in the capital of investee companies. The expected effect is that of fostering **dialogue between investors and issuers** on mid- to long-term corporate policies. This directive was transposed in Italy by **Legislative Decree 49/2019**⁵¹ in force since June 10, 2019 (its provisions apply from June 10, 2020).

IORP II AND SHAREHOLDER RIGHTS II: IMPACT AND OUTLOOK FOR PENSION FUNDS

STEFANIA LUZI, ECONOMICS AND FINANCE, MEFOP



European lawmakers have embarked on a course to strengthen the contribution of pension funds in favor of sustainable finance. Sustainability and the risks associated to environmental, social and governance (ESG) aspects will have to permeate the governance system and pension schemes as required by IORP II and Shareholder Rights (SRD II), in force from February 1, 2019 and June 10, 2020 respectively.

The decree that transposes **IORP II** refers to ESG aspects in relation to several factors ranging from the governance system to the investment policy, from risk management to information for existing and prospective members. Pension funds will be required to have a governance system capable of also ensuring the management of ESG risks which, just like other portfolio risks, can impact the value of investments. The ways in which the investment policy takes account of ESG factors must be reported in the investment policy, in the accounts as well as in the prospectus of pension services, besides being represented to prospective members before their registration. The integration of ESG criteria is however not yet mandatory.

SRD II modifies the pre-existing 2007/36/CE Directive so as to overcome the criticalities associated to the exercise of the voting right (insufficient commitment by institutional investors and active managers, poor transparency by advisors on voting, difficult and expensive voting process, etc.) and facilitate greater investor activism. The directive being modified refers to the

50. This principle is in line with Loi de Transition Énergétique pour la Croissance Verte (art. 173), passed in France in 2015, which requires institutional investors to measure and disclose their exposure to the risks linked to climate change on a comply or explain basis. For more information: Ecologique-solidaire.gouv.fr, *Loi de transition énergétique pour la croissance verte*, December 13, 2016: <https://bit.ly/2zHS1PA> (latest access on September 5, 2019)

51. Legislative Decree 49/2019, Attuazione della Direttiva 2017/828 per quanto riguarda l'incoraggiamento dell'impegno a lungo termine degli azionisti, May 10, 2019: <https://bit.ly/2yIv4wa>

“*exercise of some shareholder rights*”, whereas the new one refers to “***the encouragement of long-term shareholder engagement***” and outlines a clear shift in the concept of activism from a right that can be exercised to responsibility of pension funds as investors.

The main provisions of the decree are the following:

- **prepare, on a comply or explain basis, an engagement policy** on methods of implementation and related outcomes. Adequate reasons will have to be given for failure to comply. How should one read the comply or explain provision? Though compliance with the contents of the directive is voluntary, the “explain” option could expose the pension fund as investor, especially in the mid- to long-term period, to a reputational risk arising from the growing interests by stakeholders in ESG as increasingly shown by market surveys and consumer choices;
- the obligation to **disclose the alignment of the investment strategy** with the profile and duration of equity stocks and its contribution towards medium- to long-term return;
- **disclosure**, in case of contractual pension funds, **of the main elements of the agreement with the manager**, including: the presence of incentives to encourage alignment of the investment policy with the profile of equity stocks and allocation choices based on mid- to long-term results of companies; the time horizon for evaluating results; the portfolio turnover target; term of the agreement. Managers will be involved as well, who will be required to communicate to investors how their strategy agrees with the contents of the mandate conferred.

The voting right was already exercisable according to the reference regulatory framework but hard to put in practice due to the peculiarity of the Italian system, such as the obligation relating to contractual pension funds, poor awareness of ESG as well as inadequacy of the governance structures in tackling the complexity of the voting process. IORP II aims to enhance the governance of pension funds and includes ESG aspects amongst the risk factors to be evaluated and managed, as such it is paving the way for the requirements under SRD II. Without a doubt, should the entire system take initiatives, it would be easier to overcome said criticalities, share costs and be more influential, also as a result of the increase in assets under management.

The directives briefly described above apply to pension funds (contract-based, open and “pre-existent”⁵²). Even though Occupational Funds are not expressly mentioned amongst the addressees, being institutional investors and having a social function, they play a proactive role in relation to ESG issues, both in terms of portfolio management and in relation to investee companies.

52. Fondi pensione preesistenti (“pre-existent pension funds”) are pension plans that were already existing at the time the Legislative Decree 124/1993 - which for the first time established the second pillar of the Italian pension system - entered into force. Those pension plans were allowed to continue operating by way of derogation from the provisions of said Legislative Decree, *Editor’s Note*.

FIGURE 9. ESG criteria under IORP II

ARTICLE	TOPIC	PROVISION
19, b)	Investment rules	Pension funds can take into account the potential long-term impact of investment decisions on ESG factors , in line with the prudent person principle ⁵³ .
21	General requirements on governance	Pension funds must put in place an effective governance system that takes into account such ESG factors as are connected to investment activities.
25, 2, g)	Risk management	The risk management system covers the ESG risks linked to the investment portfolio and its management; pension funds are required to periodically report individual and aggregate risks to the administrative, management or audit body .
28	Own-risk assessment	Where they take account of ESG factors in their investment choices, every three years or whenever there is a significant change in the risk profile, pension funds are required to carry out an assessment of new or emerging risks , including those relating to climate change, the use of resources and the environment, social themes and the decrease in value of securities as a result of regulatory changes ⁵⁴ , and such assessments have to be adequately documented .
30	Statement of investment policy principles	Pension funds must communicate how their investment policy takes account of ESG factors ; such document has to be publicly accessible.
41	Information to be provided to prospective members	Pension funds are required to communicate to prospective members , before they become members, if and how their investment strategy takes account of ESG factors . In case of automatic membership, pension funds are required to communicate such information promptly thereafter.

Source: Italian Sustainable Investment Forum

53. The prudent person principle refers to the obligation of the investor to adopt adequate measures to identify, measure, monitor, control and manage effectively the risks of an investment asset by acting in the client's best interests.

54. For example, the write-down of securities linked to fossil fuels, due to a decline in investments in this sector as a result of the evolution of international, European and domestic regulations aimed to reduce CO₂ emissions (a.k.a. stranded asset).

IORP II and SRD II set out no obligation to integrate ESG factors. They merely provide that pension funds communicate if and how they do so. Pension funds **have not yet systematically adopted ESG criteria**⁵⁵ and **final investors are not receiving clear, complete and comparable information**.

Furthermore, as each Member State transposes them in its own way and market practices rely on domestic and often sector-specific commercial standards and rationale⁵⁶, the scenario looks fragmented.

HLEG recommends to:

- **clarify the duties of institutional investors** relating to the inclusion of risks connected to ESG aspects in the assessment and management of financial risks;
- **improve disclosure** to final investors⁵⁷.

The European Commission has undertaken to propose regulations aimed to ***“clarify institutional investors’ and asset managers’ duties in relation to sustainability considerations”***⁵⁸.

2.2. THE NEW EUROPEAN REGULATION ON ESG DISCLOSURE

On May 24, 2018 the European Commission published a **legislative proposal** covering institutional investors and financial advisors with the aim of laying down **clear, common rules on the obligations of transparency on the integration of sustainability risks** in investment processes and advice.

55. For example, the HLEG final report mentioned the 2017 Mercer's European Asset Allocation Report, which found that as little as 5% of European Union pension funds take account of sustainability risks in managing investment portfolios. As for the Italian market, a study carried out by Italian Sustainable Investment Forum and Mefop in collaboration with MondoInstitutional found that in 2018 over half of the plans monitored (27 out of 42) did not apply any sustainable investment strategy. See Forum per la Finanza Sostenibile 2018, *Le politiche d'investimento sostenibile e responsabile degli investitori previdenziali – Quarta Edizione*: <https://bit.ly/2YyYB9Q>

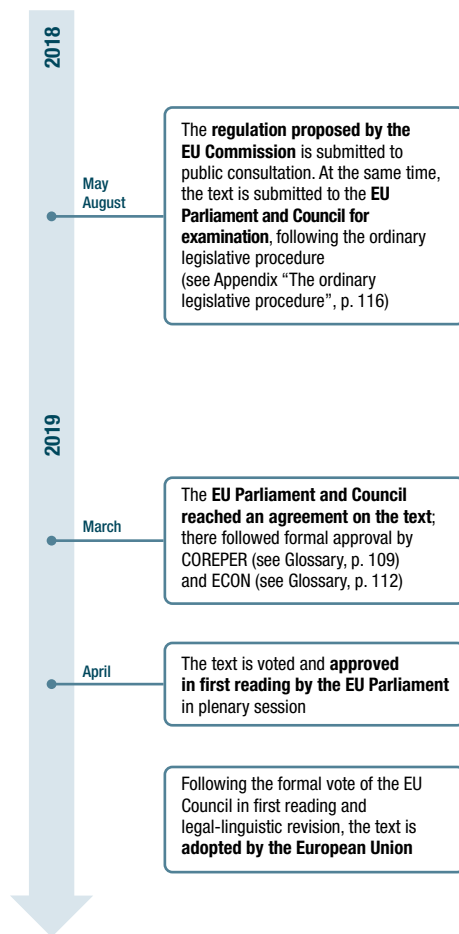
56. For example, a working document of the European Commission for Italy, mentions the Charter of Sustainable and Responsible Investment signed by ABI, ANIA, Assogestioni and FeBAF in 2012. See European Commission 2018, *Commission Staff Working Document, Impact Assessment*, SWD(2018) 264 final, May 24, 2018, p. 153: <https://bit.ly/2ytOnsG>

57. HLEG 2018, *Financing a sustainable European economy*, op. cit., pp. 20-23.

58. European Commission 2018, *Action Plan: Financing Sustainable Growth*, op. cit., pp. 9-10.

FIGURE 10. New European regulation on ESG disclosure: the legislative process

The following chart summarizes the main steps in the legislative process for the approval of the new regulation on ESG disclosure.



Source: Italian Sustainable Investment Forum⁵⁹

59. See: [Europarl.europa.eu](https://europarl.europa.eu), *Disclosures relating to sustainable investments and sustainability risks/after 2018-05*, Legislative train schedule: <https://bit.ly/32WquZ0> (latest access on September 2, 2019). To view the replies to the public consultation on the legislative proposal of the European Commission see relevant page on the website of the European Commission: <https://bit.ly/2YBrMcl>

The new provisions⁶⁰ are based on three principles⁶¹:

1. more **disclosure on sustainability to markets**, so as to combat greenwashing⁶²;
2. **regulatory neutrality**, which provides for the applicability of provisions by all market players involved⁶³;
3. **equal conditions among sectors**, to ensure even application to the different financial products concerned⁶⁴.

The text of the regulation approved by the European Parliament and the Council of the European Union addresses “**financial markets participants**” (including insurance undertakings, asset managers and pension funds⁶⁵) and **financial advisors**, with the provisions that apply to pension funds being an amendment to IORP II.

The text indicates **the ways** in which financial market participants are required to **disclose to final investors** how they integrate sustainability factors in their activities; also, it requires disclosure of the **possible adverse impacts of investments on sustainability goals** (e.g., activities that pollute the waters or destroy biodiversity).

Under the regulation, investors and advisors are required to **publish and update on websites** disclosure of:

- policies to **integrate ESG risks** in investment processes;
- policies to **evaluate the potential adverse impacts on sustainability** arising from investment processes (where investors decide to not consider these impacts, they are required to give reasons on a comply or explain basis);
- alignment of **remuneration policies** with sustainability risks.

Pre-contractual disclosure to provide information on:

- **integration of ESG risks** in investment processes;
- potential **adverse impacts of investment processes on sustainability**;
- potential **impacts of ESG risks on product return**.

60. In the following analysis of the contents of the regulations, reference is made to the text approved in first reading by the European Parliament: European Parliament 2019, *Legislative resolution on the proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341*, April 18, 2019: <https://bit.ly/2pKYWGM>

61. European Commission 2019, *Capital Markets Union: Commission welcomes agreement on sustainable investment disclosure rules*, Press Release, March 7, 2019: <https://bit.ly/2nWUZ1n>

62. Greenwashing refers to marketing strategies aimed to disseminate groundless or misleading statements on the sustainability characteristics of products, services or corporate practices.

63. The regulation provides that the three European supervisory authorities (EBA, EIOPA and ESMA – see Glossary, pp. 111-113), and in particular their joint committee, strengthen the convergence and harmonization of disclosure in all of the sectors concerned.

64. In particular, the regulation governs the following financial services sectors: investment funds; insurance-linked investment products; private and occupational pensions; management of individual portfolios; insurance and investment advice. See European Commission 2019, *Capital Markets Union: Commission welcomes agreement on sustainable investment disclosure rules*, op. cit.

65. European Parliament 2019, *Legislative resolution on the proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341*, op. cit., art. 2, a).

Besides, **pre-contractual disclosure** and **periodical communications** relating to **products referred to as pursuing environmental and/or social goals** must state:

- how such goals are pursued;
- to what extent benchmarks, if any, align with them and how they differ from other non-ESG ones;
- which are the overall impacts of the product on sustainability topics.

The definition of “sustainable investment”

Importantly, the regulation defines sustainable investments⁶⁶ as **investments in economic activities that contribute towards achieving an environmental⁶⁷ and/or social⁶⁸ objective** on condition that:

- **they do no significant harm to any of the environmental or social objectives;**
- **the enterprises that benefit from such investments comply with good governance practices**, in particular as regards the strength of management structures, relations with personnel, remuneration policies and tax compliance.

The integration of ESG criteria in the fiduciary duty: an open issue

The text of the regulation that governs disclosure on sustainable investments and risks for sustainability is a **trade-off between the initial proposal of the European Commission and the position of the European Parliament and the Council** of the European Union (see Glossary, p. 113 and p. 109). An analysis of the evolution of the text of the regulation makes it possible to capture the different positions of European institutions on some themes that are a matter of debate amongst financial players.

For example, the original text provided that the **European Commission** had the power to issue **delegated acts** (see Glossary, p. 110) **to add integration of ESG risks to the notion of fiduciary duty⁶⁹ within the framework of IORP II**. Article 10 of the proposal provided that:

The Commission is empowered to adopt, by means of delegated acts in accordance with Article 60a, measures ensuring that: a) the “prudent person” rule with respect to the consideration of environmental, social and governance risks is taken into account; b) environmental, social and governance factors in internal investment decisions and risk management processes are included.

66. Ivi, art. 2, o).

67. The environmental objective is measured using key resource efficiency indicators of: use of energy, use of renewables, use of raw materials and water and use of soil, waste production, GHGs emissions, impact on biodiversity and on the circular economy.

68. In particular, the investments that help combat inequality, promote social cohesion, social integration and industrial relations as well as investments in human capital or in economically or socially less favored communities.

69. The fiduciary duty is the obligation for the investor to act in the client's best interests.

This proposal was strongly opposed by pension funds associations and in particular PensionsEurope (the European association) and ABA (the German association), which claimed the right to more discretion for pension funds in evaluating the interest of members, including in relation to the specific features of domestic markets. As a result, Article 10 of the proposed regulation has been deleted⁷⁰.

The integration of ESG criteria in the fiduciary duty is an open issue that needs to be further debated by the parties involved.

Integration of ESG criteria in the stress tests of pension funds

A turnaround in the integration of sustainability-related considerations in the activity of European pension funds has been the introduction of ESG criteria in EIOPA biennial stress tests (see Glossary, p. 112).

On April 2, 2019, **the supervisory authority clarified which information it will consider in order to evaluate the capital strength of pension funds** and in general their ability to tackle possible risk scenarios. Qualitative and quantitative information is required⁷¹. As regards the former, pension funds will have to clarify if and to what extent they reduce their exposure to ESG risks and contribute towards mitigating sustainability risks in the community in which they operate. The quantitative data to be provided comprise a classification of investments based on the economic activities financed, making it possible to measure the level of CO₂ emissions of investment portfolios.

70. Rust, Susanna 2018, "EU Council scraps IORP II delegated acts from green finance proposal", *IPE.com*, December 20, 2018: <https://bit.ly/32WV5pi>

71. EIOPA 2019, *2019 IORP Stress Test Specifications*, March 29, 2019, p. 7: <https://bit.ly/2XmEWpE>



Etica Sgr is an asset management company that is 100% sustainable and responsible. It was established in 2000 based on the belief that integrating ESG (environmental, social and governance) criteria in investment choices creates long-term value. The track record of Etica Sgr has shown over the years that it is possible to derive financial value, i.e. risk-adjusted returns, and at the same time have a positive impact on society and the environment.

Several studies have shown that sustainable and responsible investment is capable of generating **competitive performances** compared to the market. Besides, in periods of strong volatility, it allows to **mitigate financial risk** as the ESG analysis of assets enables the manager to have more complete control of risks and helps select those that are most sustainable in the long run.

Sustainable investing will be increasingly indispensable for the Planet, as the European Commission stated in its Action Plan that sets out the actions to be taken so that the financial system embarks on an increasingly sustainable path and fulfills its role of supporting the economy.

Etica Sgr's Rischio ESG

Rischio ESG (ESG Risk) is a proprietary methodology designed by Etica Sgr. Rischio ESG is a statistic and predictive tool that calculates the risk arising from ESG-related issues that impact the performance of stocks in a mutual fund.

Every security in the portfolio of Etica Sgr funds is assigned an ESG score. This score is higher for the securities of companies and countries that do well on this front. Securities thus fall in classes of Rischio ESG. Given this distribution, the ESG Risk is lower when the best performing securities (in ESG terms) are concentrated in the classes with a higher score.

This metrics has shown a strong statistical correlation between Rischio ESG and the traditional financial risk represented by non-diversified VaR (Value-at-Risk), which consists in the potential loss on an investee in a given timeframe.

This **statistical correlation** applies to both sectors and countries. A fund with a higher VaR also has a higher Rischio ESG and a fund with a low Rischio ESG features a low VaR.

A twofold focus: on financial risk and on ESG risk alike

An evaluation of ESG risk factors through a stress analysis and VaR enables to estimate the weighting of the ESG component alone, typically ranging between 5% and 10% of the overall risk, which Etica Sgr believes is quite good.

It is also possible to calculate the **overall risk saving** of the actual investment of the fund as compared to the hypothetical allocation to the highest tenable risk and to the reference market. Consider vector (R), with three components: financial risk is in terms of **VaR**, **Rischio ESG** and **Relative VaR**. The figure shows a triangle with three coordinates (Figure 1): the one corresponding to the actual allocation of the **Etica Azionario Fund**

(blue) is in two larger risk triangles, i.e. **Tactical Value Limit** (orange) and **Strategic Value Limit** (grey).

Having regard to the latter, the risk saving (i.e., the difference compared to the fund's R norm) is around 60%.

Figure 1

Risk triangle

Coordinate 1: VaR

Coordinate 2: R_ESG (ESG Risk)

Coordinate 3: RelVaR (Relative VaR)

Euclidean distance Equity

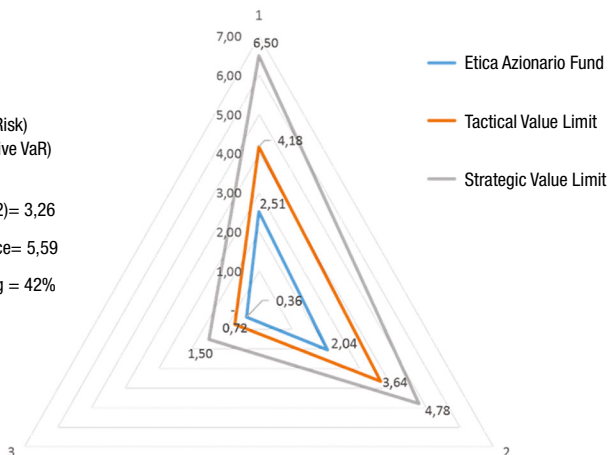
$$= (d1^2 + d2^2 + d3^2)^{1/2} = 3,26$$

Maximum Euclidean distance = 5,59

Delta = 2,33, i.e. risk saving = 42%

Distance M = 8,21

i.e. risk saving = 60%



One can therefore conclude that the measurements of Rischio ESG are an additional tool available to investors and that it is likely to become increasingly important in the choice of investments.

A new type of efficient frontier

The importance of considering ESG variables in the analysis and evaluation of a portfolio clearly emerges from a **new type of efficient frontier** that links portfolio return and overall risk, that Etica Sgr refers to as “holistic”, which includes traditional and non-financial (ESG) variables.

Chart 1

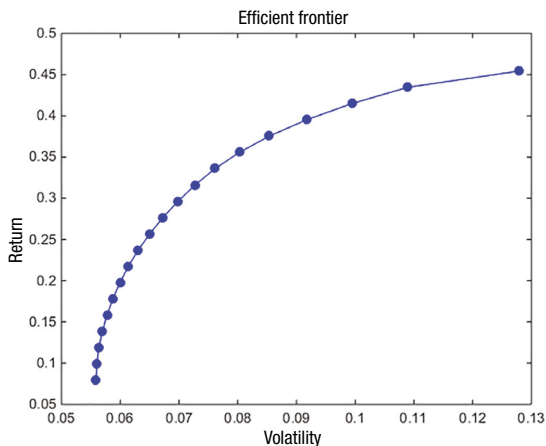
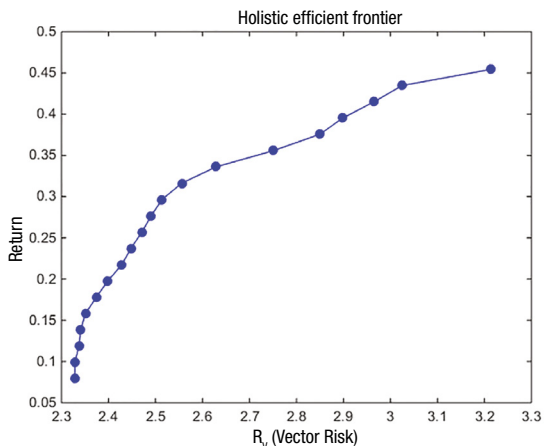


Chart 2



Source: Etica Sgr – Elaborated by the Risk Management team

Chart 1 shows what we would typically refer to as a “traditional” efficient frontier, i.e. with portfolios broken down by return-volatility ratio. Chart 2 shows a new efficient frontier, with the vector risk module on the X axis, i.e., the holistic vision of risk R_v (which considers VaR, Relative VaR versus the Investible Universe of Etica Sgr and the ESG Risk).

While this shows that the efficient frontier essentially applies in terms of trend and shape of the curve, if we also consider Rischio ESG (and RelVaR) the shape of the frontier changes to the extent that, ignoring this, one would overestimate the expected return based on the same risk, with bitter surprises being possible.

The calculation of Rischio ESG is the first step towards the integration of financial and ESG risk and provides investors with a **holistic vision of the overall riskiness** of their investment.

2.3. CORPORATE ESG DISCLOSURE: NEW GUIDELINES FOR NON-FINANCIAL REPORTING

On June 18, 2019 the European Commission updated the **guidelines for corporates on reporting climate-related information to investors**⁷². This non-binding guidance is in addition to the guidelines attached to the Directive 2014/95 on Non-Financial Reporting (NFRD⁷³). The NFRD currently applies to approximately 6,000 listed companies, banks and insurance companies. These non-binding guidelines aim to provide investors with clearer and more complete information on the effects of climate change on corporates as well as on the impacts of corporate activities on climate⁷⁴.

THE NEW NON-BINDING GUIDELINES SUPPLEMENTING THE NON-FINANCIAL REPORTING DIRECTIVE

SARA LOVISOLO, GROUP SUSTAINABILITY MANAGER, LONDON STOCK EXCHANGE GROUP
AND MEMBER OF TEG



The new Non-Binding Guidelines (NBGs) published by the European Commission in June 2019 are currently the only tool with which the **European Union expressly supplements its regulatory framework and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)** – the reporting standard set by the Financial Stability Board, led by Mark Carney, as a response by the financial sector to the Paris Agreement on climate.

What the TEG did by offering to the European Commission the recommendations on which the new NBGs are mainly based, was far from banal. The approach of the Non-Financial Reporting Directive (NFRD) approved in 2014, ahead of the Paris Agreement, is essentially modeled on the UN Guiding Principles on Business and Human Rights, as shown by the importance attached to corporate policies, due diligence and results in the methods of reporting. Accordingly, also the impacts that the company has on the environment, society, employees, human rights and corruption are considered to be material for understanding the position of the reporting entity. The TCFD has a

72. European Commission 2019, *Communication from the Commission – Guidelines on non-financial reporting: Supplement on reporting climate-related information*, June 20, 2019: <https://bit.ly/339gDOU>

73. EU Directive 2014/95 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, October 22, 2014: <https://bit.ly/2DV0hA6>

74. The guidelines are based on the work carried out by the TEG, which in January published a report and submitted it to public consultation, receiving 70 replies. The European Commission considered both the TEG report and the replies to the consultation in preparing the final document.

completely opposite vision in that it focuses on mitigating and anticipating the impacts that the response to climate change (transition risks) and climate change itself (physical risks) might have on the financial system.

Hence the decision to include in the NBGs the **notion of “double materiality”** so as to expressly state the principle set by the NFRD whereby also the impacts outside the accounting scope of corporate activities (referred to as “non-financial”) are relevant for the purpose of evaluating an investment decision. Having first established the principle of (double) materiality, the Commission was later able to submit a list of indicators without having to further qualify them (whereas in the TEG report they fell into Type I, II and III based on the level of exposure of the organization to climate risks).

Indicators or KPIs are perhaps the single most-awaited element of the NBGs for stakeholders as well as the most innovative ones as compared to the TCFD. They provide precise guidelines on the disclosure of GHG emissions, including Scope 3 emissions⁷⁵, set targets for the reduction of emissions and exposure to physical climate-related risks. Specific indicators for banks and insurance companies go beyond the examples provided by TCFD so as to generate a material flow of information for data users. The latter – as part of the Action Plan on Financing Sustainable Growth (Action Plan) – have taken on board new entities including ESAs (European Supervisory Authorities – EBA, EIOPA and ESMA – see Glossary, pp. 111-113) which are now tasked with integrating sustainability in their supervisory activities. ESMA, EBA and EIOPA need data to be monitored and interpreted and it is fundamental that this data is comparable.

Amongst the novelties introduced by the NBGs there is also the indication to **publish information** relating to “green” activities or, to be more precise, **activities aligned with the taxonomy** proposed by the Commission. The companies exposed to the activities under the taxonomy through products or services that significantly contribute to at least one of the six environmental objectives listed in the proposed regulation are invited to disclose sales and investments associated to these activities. Availability of economic data such as sales and investments is necessary for banks and investors to be able to translate the taxonomy into investment decisions.

The NBGs should not be considered on a stand-alone basis. The improvement in the quality of sustainability reporting in Europe has always been considered by stakeholders as a **pre-requisite to implement other measures of the Action Plan**. Besides the new task of the ESAs mentioned above, alongside the taxonomy, the regulation on sustainability disclosure in the financial sector approved in March 2019 will require

75. The “Scopes” (proposed by the Greenhouse Gas Protocol) represent one of the most widespread ways to classify CO₂ emissions. Scope 1 comprises the emission from sources owned or controlled by the company; Scope 2 includes the emissions linked to the energy purchased by the company, in the first place for the purposes of electricity consumption; finally, Scope 3 comprises all emissions linked to the company’s activity outside Scope 1 and Scope 2 (e.g., emissions relating to employee mobility, to the supply chain, to the use of the goods manufactured, etc.). For more information: <https://ghgprotocol.org/>

to make available sustainability data on invested assets so that investors can meet the requirement of integrating ESG in their investment decisions as well as in their governance and risks management system.

The NBGs add several elements of novelty that can potentially enhance the quality of sustainability reporting in Europe with contents – including precise reference to global standards – that confirm European leadership in sustainability. So, what next?

There's a question that TEG members frequently get, i.e. whether the NBGs will remain voluntary (as is the case with TCFD recommendations) or will be made mandatory. Other stakeholders suggest a complete make-over of the Accounting Directive due to the limited amount of time available to respond to the climate emergency, as voiced by the IPCC. Other stakeholders point out that it is only since 2018 that European companies have been reporting based on NFRD and that further changes, given the limited evidence available, would eventually bring about inefficiency and confusion.

Considering the work done on the several measures of the Action Plan, one has the impression that they cannot be evaluated individually. Whether the Action Plan will succeed, i.e. whether it is capable of mobilizing the resources of the financial sector to hit the targets of the Paris Agreement and achieve the Sustainable Development Goals, will depend on the quality of the implementation of the actions carried out and the interaction of all market players in a clear context and with a clear business case for all of the players involved.

EFRA¹ ACTIVITIES ON CLIMATE-RELATED REPORTING:

THE PROJECT TASK FORCE ON CLIMATE-RELATED REPORTING OF THE EUROPEAN LAB

ANDREA GASPERINI, HEAD OF SUSTAINABILITY AND ESG OBSERVATORY,

AIAF (ASSOCIAZIONE ITALIANA PER L'ANALISI FINANZIARIA – ITALIAN ASSOCIATION
FOR FINANCIAL ANALYSIS)

ELENA FLOR, HEAD OF CORPORATE SOCIAL RESPONSIBILITY, INTESA SANPAOLO GROUP



To accurately measure climate risks, companies and investors need complete, consistent, reliable, comparable and clear data. Thanks to the European Non-Financial Reporting Directive (NFRD), EU companies already have a head start, but we need to go further. This is why the European Commission in March 2018 asked **EFRA¹** (European Financial Reporting Advisory Group) to launch the **European Lab**, as part of Action Plan Financing Sustainable Growth. It will **help identify and spread best reporting practices**, which is an important step in creating a more sustainable financial sector. In September 2018, EFRA¹ General Assembly approved the establishment of the European Corporate Reporting Lab (the “European Lab@EFRA¹”) with the objective to stimulate innovations in the field of corporate reporting in Europe by identifying

and sharing good reporting practices. The European Lab@EFRAG serves the European public interest⁷⁶.

It is envisioned that the initial focus of the European Lab will be **on sustainability related reporting**. Nonetheless, topics related to corporate reporting that are not directly addressed within the European Commission Action Plan or that are not related to sustainability or Environmental, Social and Governance (ESG) factors could be potential topics for the European Lab.

In February 2019 in Brussels, EFRAG announced that the European Lab Steering Group has appointed 23 members, chair Michele Lacroix, of the Project Task Force for its **first project on climate-related reporting** (the “PTF on Climate-related Reporting”), selected from a high number of applicants from a broad range of stakeholder groups and national backgrounds⁷⁷. The appointed members have practical experience and expertise in climate-related reporting from companies of different sizes, users (analysts and investors), the accountancy profession, civil society, academia and other constituencies.

Members from Italy are Elena Flor (Head of Corporate Social Responsibility in Intesa Sanpaolo Group), Andrea Gasperini (Head of Sustainability and ESG Observatory in AIAF) and Giulia Genuardi (Head of Sustainability Planning and Performance Management in Enel).

The primary focus of the PTF is on the **Task Force on Climate-related Financial Disclosures (TCFD) recommendations** of the Financial Stability Board with consideration of the European Commission’s Non-Binding Guidelines (NBGs) on climate-related information, updated in 2019 following the proposals of the Technical Expert Group (TEG) on Sustainable Finance of the European Commission with regard to climate-related disclosures and on sectors that are most affected by climate risk. **The project addresses good reporting practices** of both the financial impact of climate risk on companies as well as the impact of companies on the environment. Topics to be addressed include scenario analysis, the link of climate risk and risk reporting, and metrics and targets that inform on the impact of climate risk and opportunities across the value chain of companies.

The work of the European Lab complements and contributes to the practical application of the NFRD requirements, the updated NBGs and the TCFD recommendations. The European Lab focuses on identifying innovative and good reporting practices and not on providing normative guidance.

The NFRD requires the consideration of double materiality with climate change risk having outside in (financial materiality) and inside out impacts (environmental and social materiality). Hence, in addition to reporting companies, the primary audience

76. For more information: <https://bit.ly/2KVwhoT>

77. For more information: <https://bit.ly/2IVNNRH>

when considering financial materiality will be investors, while the primary audience, when considering environmental and social materiality, will be stakeholders including consumers, civil society and employees.

Dialogue with users and preparers of corporate reporting information is an important step of the European Lab PTF to ensure good practices that both facilitates preparers' tasks and serves users' needs. During the fourth quarter 2019, the PTF will issue a draft report for public consultation. Before the issuance of the draft report and to ensure practical insights of stakeholders are reflected in the draft report, during the months of September and October, the PTF will engage in dialogue with users, preparers and other stakeholders of climate-related reporting information. Target deadline for final report is December 2019.

3.

European climate benchmarks



The third legislative proposal put forward by the European Commission focuses on new sustainability benchmarks.

A “benchmark” is an index used as **objective reference parameter to compare the performance of a portfolio or a financial instrument to that of the market**. Typically, benchmarks are built using the weighted averages of the market value of a basket of stocks or debt instruments.

Benchmarks are the starting point for investors to **evaluate the risk and return of funds**: as they impact demand, they play a fundamental role in the pricing of financial instruments.

Amongst other functions, a benchmark **communicates the typical risk of the market** in which the portfolio invests⁷⁸: this information derives from an analysis of the composition and methods for constructing the benchmark or market indices of which it is comprised.

In structuring their investment strategy, investors can use benchmarks as a reference to assign management mandates and purchase products, be they passive (ETF⁷⁹) or active (mutual funds). Given their indirect but incisive impact in terms of steering capital, benchmarks are **strategic for transitioning to a sustainable economy**.

Chapter 3 focuses on the role of benchmarks in fostering the transition to low-carbon activities, with a view to aligning the European economy to the Paris Agreement. The first paragraph (see §3.1.) illustrates the main characteristics of the European market of sustainability benchmarks and points out the criticalities and possible areas of development identified by the European Commission; the second paragraph analyzes the main contents of the TEG proposal concerning climate benchmarks (see §3.2.).

3.1. SUSTAINABILITY BENCHMARKS: MAIN TOOLS

Current Regulatory Framework

According to the HLEG recommendations and the European Commission Action Plan, **more transparency** and a clear direction are needed such that investors can select benchmarks in line with long-term investment strategies and pursue a positive environmental and social impact.

78. See: Borsaitaliana.it, *Benchmark*, Financial Glossary: <https://bit.ly/2ynlq1Q>

79. ETFs (Exchange Traded Funds) are investment funds traded on the Stock Exchange as equities: their function is to replicate the benchmark according to passive investment strategies.

The current benchmark regulatory framework is based on:

- **IOSCO Principles for Financial Benchmarks**, developed in 2013⁸⁰;
- European Union **Benchmark Regulation**, published in 2016⁸¹.

Both set out to achieve the following goals:

- improve **controls on the benchmark creation process**, in particular to ensure that directors avoid conflicts of interest or adequately manage them;
- improve the **quality of data and methodologies** used by index providers;
- ensure that the **data** provided is **subject to adequate controls** so as to avoid conflicts of interest;
- **protect consumers and investors** by means of greater transparency and adequate indemnity rights in case of fraudulent behavior of managers.

As will be noted, currently there is no hint to the consideration of ESG criteria in the procedure to create benchmarks.

Sustainable benchmarks

The benchmarks currently available and that define themselves as being “sustainable” are comprised of assets selected according to the **issuers’ ESG performance** based on a variety of SRI strategies (see §1.1.):

- exclusion of individual issuers or entire sectors deemed to be controversial (**exclusions**);
- selection of the best issuers in a category or asset class (**best in class**);
- focus on one or more sustainability topics (**thematic indices**).

The significant **heterogeneity of the methodologies used** for the creation of ESG benchmarks and concerns as to the **transparency of processes** have impacted their reliability. In fact, with demand on the rise, **it has become necessary to provide standards relating to selection criteria, type of data and methodologies used to weigh the various financial instruments** of the benchmarks.

80. OICV-IOSCO 2013, *Principles for Financial Benchmarks*, Final Report: <https://bit.ly/2oda2lb>

81. EU Regulation 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) 596/2014, June 8, 2016: <https://bit.ly/2KLU1M0>

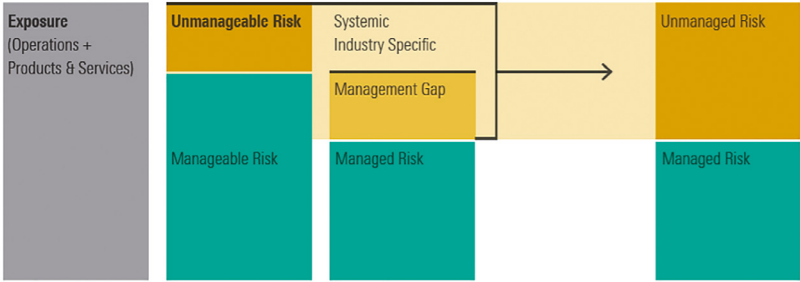


Investors are increasingly interested in knowing the risk arising from any polluting emissions they may have in their portfolio. Global warming impacts not only the daily life of individuals but also the economy, businesses and financial markets. Some describe it as a “long-term trend”, others as a “systemic hazard”, others as a “material financial risk”: whatever the definition, all (from large portfolio managers to pension funds) are increasingly pressurized to seriously take it into consideration. It's not just about measuring the carbon footprint of a portfolio: the current level of emissions can be the beginning, not the end. It is crucial for investors to understand **to what extent a company is vulnerable to the transition to a low-CO₂ emissions economy**. The shift to cleaner energy sources started right after the 2015 Paris Agreement on climate (COP21), despite the aversion of the American President Donald Trump. Besides, the Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) in 2017 provided enterprises with guidelines for more transparency on these themes. In the same year, a group of investors launched the Climate Action 100+ initiative to urge the largest “polluters” to take practical action to reduce emissions. Finally, the signatories of the Montreal Carbon Pledge, sponsored by the Principles for Responsible Investment (PRI), undertook to measure and disclose the carbon footprint of their equity portfolios on an annual basis. In Europe, regulations require increasingly more transparency on these themes.

“Carbon” risk in a portfolio

Analysis and evaluation methodologies evolve thanks to the **availability of a growing amount of data**. Indeed, at present it is possible to calculate the overall portfolio risk arising from polluting emissions. While fossil fuels are undoubtedly the most highly exposed sector, they are not the only ones having to tackle the issues related to the transition to a cleaner economy: estimates say that **the so-called “Carbon risk” concerns half of the capitalization of the world stock exchanges**. According to the definition of Sustainalytics, a company specializing in the analysis of the sustainability of companies worldwide, it can be described as *“the risk for the economic value of an enterprise arising from the shift to a low-emission production system”*. In order to assess it, it is necessary to first consider the total exposure to carbon and subsequently the percentages of the latter which are managed or which, instead, are not yet or cannot be managed. Therefore, the **risk** is *“the **unmanaged carbon exposure** remaining after taking account of the actions taken to mitigate it”* (see chart below).

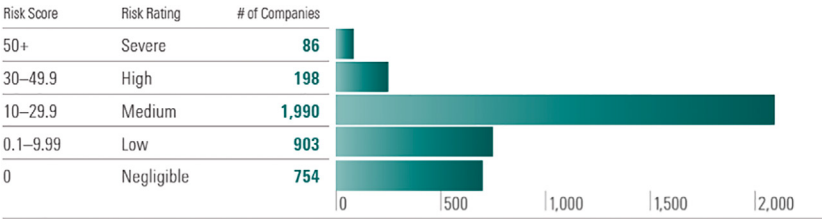
Carbon risk model developed by Sustainalytics



Source: Sustainalytics

Based on this analysis, it is possible to define five categories of carbon risk (from “severe” to “negligible”) and thus classify the companies based on their risk score, as in the table below.

Sustainalytics Carbon risk rating



Source: Sustainalytics; data as of November 30, 2018

Morningstar aggregated this by portfolio so as to assess the Carbon risk of a fund or of an Exchange Traded Fund (ETF) such that the manager can make strategic decisions on how to curb it (ranging from the selection of the stocks to be included or excluded to the engagement practices with investees so as to push them towards green productive systems). Not only that, though. Indeed, this also enables to understand to what extent and how this type of risk impacts performance.

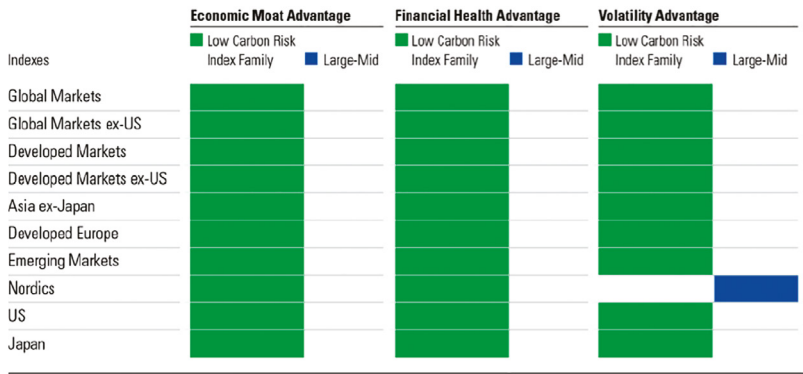
Low-Carbon risk indices

Based on the same model, it is possible to construct **reference baskets for the investors that are interested in mitigating Carbon risk** or have “low-pollution” portfolios. Importantly, in this regard, it is possible to **maintain an adequate diversification across geographies and sectors** so as to narrow the gap with the reference market. For example, the Morningstar Low-Carbon risk family of indices takes the traditional parent index as starting point, which, amongst other things, has the advantage of maintaining

the comparability between the two types of products. This universe excludes severe-risk securities and includes those with the best Carbon risk score, so as to have a selection of those best positioned for a transition towards a clean economy.

As compared to traditional, cap-based ones, **from 2012 to the end of 2018 these indices overperformed in all of the main geographies and were less volatile.** Even more significantly, **low-carbon baskets comprise companies with a higher competitive advantage** (a.k.a. “Economic moat”) **and healthier accounts.** In other words, their earnings are better protected from the danger that competitors take market shares and are less likely to face financial stress.

Strengths of Morningstar Low-Carbon risk indices versus traditional ones



Source: Sustainalytics; data as of December 31, 2018

3.2. THE NEW EUROPEAN REGULATION ON CLIMATE BENCHMARKS: EU CLIMATE TRANSITION BENCHMARK & EU PARIS-ALIGNED BENCHMARK

A climate benchmark is a **reference parameter** for investments that selects and weighs assets with a view to pursuing, besides financial targets, also specific goals relating to the **reduction of GHG emissions** and **transitioning to a low-carbon economy**.



A climate benchmark can be used as:

- a reference index for passive investment strategies⁸²;
- to compare the performance of the investments to be used as part of strategies aimed to reduce GHG emissions;
- a tool for engaging with investees and/or investible companies;
- to define the investible universe of a fund and the mid-to-long term investment policies⁸³.

On the back of HLEG considerations on the criticalities in terms of transparency and harmonization of sustainability benchmarks, the European Commission **Action Plan** proposed to take action on two fronts:

- develop a **new European benchmark to reduce CO₂ emissions**, so as to **harmonize** heterogeneous methodologies and indicators⁸⁴;
- introduce **new disclosure requirements** for existing benchmarks, so as to **clarify the methodologies** used to integrate ESG criteria.

On May 24, 2018 the European Commission proposed a **regulation**⁸⁵; at the end of the consultations under the ordinary legislative procedure (see Appendix “The ordinary legislative procedure”, p. 116); on February 25, 2019, the Parliament and the Council of the European Union reached a political agreement on a text that has been adopted by the Parliament in plenary session⁸⁶.

82. Passive Exchange Traded Funds (ETFs), for example, replicate the performance of the benchmark according to a passive strategy.

83. EU Technical Expert Group on Sustainable Finance 2019, *Report on benchmarks*, TEG interim report, June 2019, p. 8: <https://bit.ly/2WQIZjd>

84. See Action 5 in European Commission 2018, *Action Plan: Financing Sustainable Growth*, op. cit., p. 8.

85. European Commission 2018, *Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks*, May 24, 2018: <https://bit.ly/2yl7mWA>

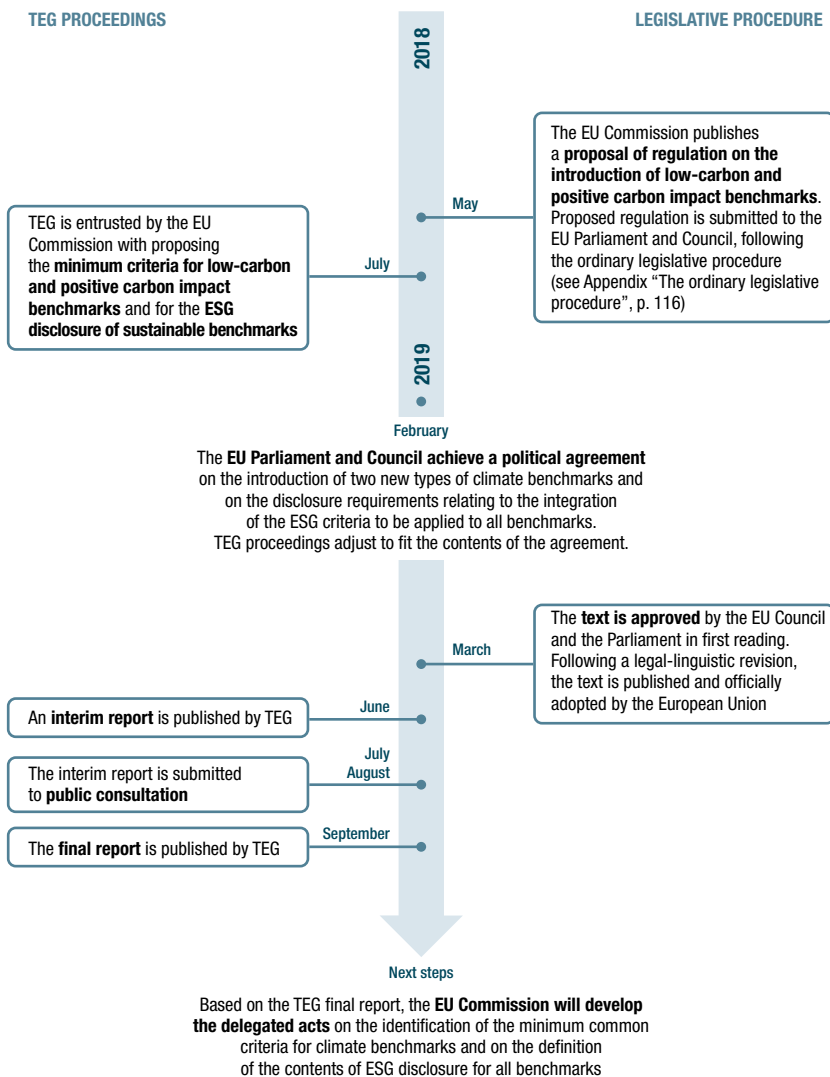
86. European Parliament 2019, *Low carbon benchmarks and positive carbon impact benchmarks*, *European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks*, March 26, 2019: <https://bit.ly/2pz5Miv>. During the drafting of this handbook, the lexicon of the text was being revised in view of its publication in the Official Journal.

FIGURE 11. Climate benchmarks development process

The following chart summarizes the main steps in the development of climate benchmarks, highlighting the legislative process, on the one hand, and the work of the TEG, on the other.

TEG PROCEEDINGS

LEGISLATIVE PROCEDURE



Source: Italian Sustainable Investment Forum, last update: September 30, 2019⁸⁷

87. See: [Europarl.europa.eu](https://europarl.europa.eu), *Low-carbon benchmarks and positive carbon impact benchmarks/2018-05*, Deeper and fairer internal market with a strengthened industrial base / financial services, Legislative train schedule: <https://bit.ly/2GzMCPa> (latest access on September 2, 2019).

The normative act provides for the introduction of minimum criteria for the definition of **climate benchmarks**.

There are two types of climate benchmarks: **Climate Transition Benchmarks** and **Paris-aligned Benchmarks**.

- **EU Climate Transition Benchmarks** select securities based on the companies' GHG emission reduction targets so that the portfolio sits on a **trajectory of decarbonization** and progressive alignment with the Paris Agreement targets; the trajectory must be measurable, science-based and time-bound to reduce carbon emissions.
- **EU Paris-aligned Benchmarks** select securities so that the portfolio's emissions level **is consistent with a scenario compatible with the Paris Agreement**, i.e. curbing the increase of average global temperatures to 1.5°.

Climate benchmarks can be used by investors to achieve two goals:

1. adopt strategies enabling to **protect portfolios from climate transition risks**;
2. **identify investment opportunities** linked to energy transition.

The second key measure of the regulation applies to **all types of benchmarks** (except currency and interest rate ones⁸⁸) and requires that index providers:

- clarify if and how **the methodology used to design the benchmark reflects ESG factors**⁸⁹;
- declare **if and to what extent** the benchmark pursues the goal of **reducing emissions** and **alignment with the Paris Agreement**⁹⁰.

From the European Commission proposal to the final regulation

The final version of the regulation marks a significant evolution compared to the initial text drafted by the European Commission.

The original proposal concerned two types of benchmarks:

- **Low-Carbon Benchmarks** with decarbonization compared to traditional indices through the selection of securities associated to a lower level of CO₂ emissions;
- **Positive Carbon Impact Benchmarks**, with a selection of securities in which avoided emissions exceed the CO₂ emitted⁹¹. The latter type of benchmarks is in line with the target of curbing global warming to within 1.5°.

The climate benchmarks referred to in the final version of the regulation differ from

88. Because underlying assets have no impact on climate change.

89. If the index does not pursue ESG goals, the provider is required to disclose this.

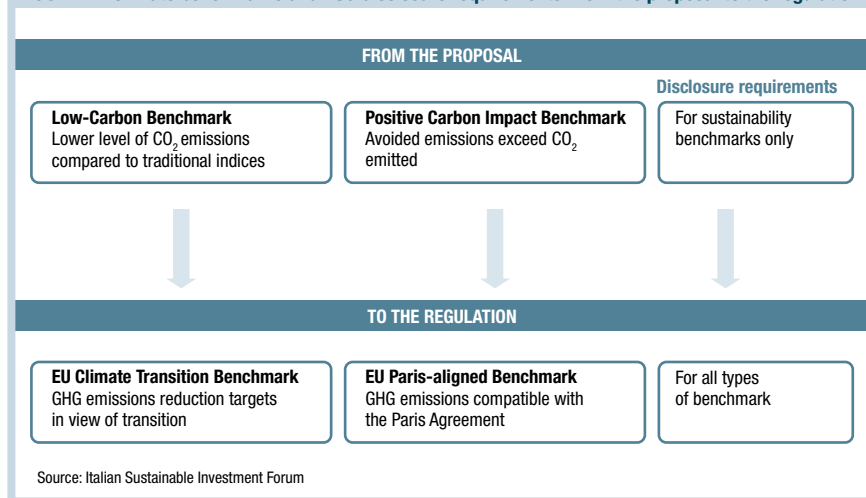
90. By December 31, 2021.

91. European Commission 2018, *Proposal for a regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks*, op.cit., art. 1, 1.

Low-Carbon and Positive Carbon Impact benchmarks in terms of **timing** in that they have a **forward-looking approach** aimed to **anticipate the evolution of markets** towards a reduction of emissions and a progressive alignment to +1.5° scenarios. For example, the portfolios compatible with the Climate Transition Benchmark are not yet decarbonized, but have identified precise targets in terms of emissions reduction. Instead, the indices mentioned in the initial proposal of the European Commission merely reflected the current market positioning relating to GHG emissions.

The second major novelty concerns **ESG disclosure requirements**: under the initial proposal, they applied solely to sustainability benchmarks⁹², whereas under the final text all types of benchmarks are required to disclose information on ESG aspects. One of the reasons why European institutions made this choice is the need to not penalize ESG benchmark providers by imposing additional disclosure requirements⁹³.

FIGURE 12. Climate benchmarks and ESG disclosure requirements: from the proposal to the regulation



92. Ivi, art. 1, 2.

93. EU Technical Expert Group on Sustainable Finance 2019, *Report on benchmarks*, TEG final report, September 2019, p. 14: <https://bit.ly/2nPMQvg>

The TEG recommendations:

minimum criteria for the construction of climate benchmarks

In the report published in September 2019, the TEG set out the **minimum criteria that a benchmark must meet in order for it to qualify as Climate Transition or Paris-aligned**. As mentioned earlier, the two types of benchmarks differ in terms of how demanding their environmental goals are, with Paris-aligned ones having more stringent minimum criteria compared to Climate Transition ones.

The criteria proposed include:

- **less carbon intensity compared to traditional benchmarks or to the reference investible universe** (with a reduction of 30% for Climate Transition benchmarks and 50% for Paris-aligned ones);
- adequate **exposure to those economic sectors that have a high impact on climate** (to avoid decarbonization by shifting investments from high-impact to low-impact assets);
- **yearly reduction of the emissions level by at least 7%⁹⁴** so as to be on a trajectory in line with (or more ambitious than) the +1.5° scenario; where a benchmark fails to hit this target for two years in a row, it loses its climate certification.

The TEG recommendations:

ESG disclosure requirements for all benchmarks

In order to probe deeper into the theme of sustainability disclosure, which, as mentioned, applies across all benchmarks, the TEG has taken a variety of approaches depending on the **asset classes**. Set out below is the disclosure required from all benchmarks under the TEG proposal:

- consolidated ESG rating;
- ESG rating of the ten assets with the highest weighting;
- percentage of assets breaching the Global Compact⁹⁵;
- percentage of assets that are signatories to international standards and agreements (above all for sovereign bonds⁹⁶).

Significantly, also specific **social indicators** (e.g., percentage of assets related to controversial business such as weapons and tobacco) and **governance indicators** (e.g., diversity and independence of Boards of Directors) are included.

94. Ivi, p. 9.

95. The Global Compact is a UN initiative aimed to encourage global companies to adopt sustainability and CSR policies. The action is based on ten principles grouped in four thematic areas: Human Rights, Employment, Environment, Fight against Corruption. For more information: www.unglobalcompact.org

96. TEG 2019, *Report on benchmarks*, TEG final report, op. cit., p. 18.

4.

European green bond certification



Green bonds are debt securities associated to the funding of projects that have a beneficial impact on the environment. Renewable energies, sustainable waste and water management, the protection of biodiversity and energy efficiency are amongst the sectors concerned.

Green bonds are an opportunity to **increase the availability of the capital required for the transition to a more sustainable economy** and, in some cases, they make it possible to drive down the cost of debt for the projects that have a beneficial impact on the environment⁹⁷. Therefore, the development of this financial instrument is crucial to achieve the targets of the Action Plan, in line with the international commitments undertaken by the European Union.

Following after a short analysis of the size, characteristics and potential and criticalities of the green bond market (see §4.1. and §4.2.) the chapter describes the TEG's European Green Bond Standard proposal (see §4.3.); finally, some of the main certifications for sustainable products currently used and being developed in European markets are presented (see §4.4.).

4.1. GREEN BONDS: DEFINITION AND MARKET CHARACTERISTICS

The green bond market: globally, in Europe and in Italy

Globally, the first green bond, the Climate Awareness Bond, was launched in 2007 by the European Investment Bank (EIB – see Glossary, p. 112). In 2008 the World Bank issued its first green bond. In recent years, the market was extended to include the securities issued by companies, municipalities, regions, States⁹⁸ and State agencies.

The **green bond market is steadily growing** according to the latest data published by the Climate Bonds Initiative (CBI) – the world's leading organization for promoting and monitoring the sector – in 2018 green bonds were issued worth overall \$167.6 billion. Issues from 2007 to the end of 2018 added together totaled a record \$521 billion⁹⁹.

In the European market, the cumulative value of green bonds since 2007 attained \$190 billion at the end of 2018: this being the best result on a regional level. With 193 issuers (accounting for one third of the total across the world) **Europe leads the way in the green bond market**¹⁰⁰.

97. See: Investiresponsabilmente.it, *Glossario*: <https://bit.ly/2MX7vph>

98. The first sovereign issuer was Poland in December 2016, followed in 2017 by France, the Fiji Islands and Nigeria. In the course of 2018 Belgium and Lithuania set a foothold in the green bonds market; in February 2018 Indonesia issued the first sukuk green, a bond under the Islamic law for funding projects that have a beneficial impact on the environment. In June 2018, the largest issuer was France, with a market share of approximately 2/3 of total volumes. For more information: Forum per la Finanza Sostenibile 2018, *Investimento sostenibile nelle aree emergenti*, pp. 37-41: <https://bit.ly/2Kokikk>

99. Climate Bonds Initiative 2019, *Green Bonds – The State of the Market 2018*, p. 2: <https://bit.ly/2HpgjUn>

100. Ivi, p. 5.

As regards **Italy**, at the end of 2018 it **ranked sixth in Europe** in terms of green bond issues, with a total volume slightly less than \$10 billion¹⁰¹. According to Bloomberg's data, in the first half of 2019 new issues totaled over €4 billion, up 120% over 2018, when €2 billion¹⁰² worth of new products were launched. The main issuers are non-financial companies, especially multiutilities like Enel, Terna and ERG.

FIGURE 13. Green bonds issued in Italy (2014-2019)

	ISSUER	VALUE (million Euros)	USE OF PROCEEDS
2014	Enna Energia	3,2 ¹⁰³	Renewable energies
	Hera	500	Renewable energies Enhance energy efficiency Upgrade waste treatment and purification Boost recycling
2016	Alperia	100	Renewable energies (hydroelectric power plants)
	Alperia	125 ¹⁰⁴	
	Alperia	150	
2017	Enel	1250	Development, construction and repowering of renewable energy generation plants Development of transmission and distribution networks Implementation of smart grid and smart metering ¹⁰⁵
	Intesa Sanpaolo	500	Renewable energies Energy efficiency
	Iren	500	Energy efficiency Renewable energies Enhance the efficiency of waste management and recycling Water purification
	Ferrovie dello Stato Italiane	600	Renewal of public transport rolling stock (new regional and high-speed trains)
2018	Enel	1250	Development, construction and repowering of renewable energy generation plants Development of transmission and distribution networks Implementation of smart grid and smart metering
	Terna	750	Production of renewable energies Reduction of CO ₂ emissions Reduction of soil exploitation and of the impact on the earth's biodiversity

101. Climate Bonds Initiative 2018, *Green Bonds – A key tool for financial centre competitiveness: Lessons from Europe*, p. 2: <https://bit.ly/2KNcQR8>

102. Bloomberg data mentioned in Monti, Mara 2019, "Il fenomeno green bond: crescita del 120% sul 2018", *lsole24ore.com*, July 23, 2019: <https://bit.ly/2JP4rvT>

103. Mini green bond.

104. Fully subscribed by Cassa Depositi e Prestiti.

105. Systems for remote reading and management of electricity, gas and water meters.

	ISSUER	VALUE (million Euros)	USE OF PROCEEDS
2018	Iren	500	Energy efficiency Renewable energies Enhance the efficiency of waste management and recycling Water purification E-mobility
2019	Enel	1000	Renewable energies Construction, management and operation of smart metering Sustainable mobility Smart lighting ¹⁰⁶ Energy efficiency
	Terna	250	Production of renewable energies Reduction of CO ₂ emissions
	Terna	500	Reduction of soil exploitation and of the impact on the earth's biodiversity
	Pagano & Ascolillo – Public Lighting ¹⁰⁷	17,3	Energy efficiency (LED public lighting in Campania)
	Snam ¹⁰⁸	500	Renewable energies (distribution of biomethane) Energy efficiency Better environmental impact of corporate activities
	UBI Banca	500	Renewable energies (solar and wind)
	ERG	500	Production of renewable energies (solar and wind)
	Ferrovie dello Stato Italiane	700	Purchase of new trains, electric locomotives, last-generation cars for goods transportation (energy efficiency and reduction of GHG emissions)
	Hera	500	Energy efficiency Circular economy and sustainable waste management Water infrastructures
	A2A	400	Circular economy Decarbonization of the energy system, development of renewable energies and energy efficiency Water and waste treatment Sustainable mobility Grid upgrade
	Tozzi Green	198 ¹⁰⁹	Electrification of rural areas in Peru with PV plants
Source: Italian Sustainable Investment Forum, last update: August 6, 2019			

The Green Bond Principles

Currently there is no shared and regulated definition of green bonds, even though market players have identified a number of common guidelines.

The **Green Bond Principles** (GBP) of the International Capital Market Association

106. Innovative technical solution providing for the use of remote-controlled and managed LED lighting fixtures. This technology allows to reduce the consumption of electricity by approximately 65%, improve the quality of lighting and the effectiveness of facility management thanks to a longer life cycle of the equipment and less use of labor.

107. Infrastructural green bond.

108. The bond was referred to as "Climate action bond".

109. The issue was in dollars, for a value of \$222 million. See Tozzi Green 2019, *Tozzi green places its first green bond for US\$222 mln*, Press Release, July 22, 2019: <https://bit.ly/2GM3baY>

(ICMA) are at present the most widespread international standard. Still, it should be highlighted that ICMA does not itself issue a certificate of conformity of the bond to GBPs, it being up to the issuer to attach an auto-certification to the prospectus. GBPs cover four main areas¹¹⁰:

1. Use of revenues

The distinctive feature of green bonds is the use of earnings to fund projects that have a positive environmental impact, which should be adequately described in the bond documentation.

2. Project evaluation and selection

Green bond issuers should state:

- if the project is eligible for green bond;
- selection criteria used;
- environmental sustainability targets.

Furthermore, GBPs encourage a high level of transparency and recommend that the project evaluation and selection process adopted by the issuer be subject to independent audit.

3. Management of revenues

The net revenues of green bonds should be deposited on a dedicated account, transferred to a specific portfolio or in any case traced by the issuer. Besides, the issuer should communicate to investors how it intends to use the revenues for the time being unused in the projects.

4. Disclosure

The issuers should disclose and update on a regular basis the data relating to the use of revenues, including a list of the projects in which the resources are being used, a short description of the same and a breakdown of the sums allocated as well as of expected impacts.

MAIN FEATURES OF THE INTESA SANPAOLO GREEN BOND

FRANCESCA LOLLI, RELATIONS WITH SOCIALLY RESPONSIBLE INVESTORS AND CLIMATE CHANGE,
INTESA SANPAOLO



Intesa Sanpaolo was the **first Italian bank to issue a green bond**. In June 2017 it successfully placed a €500 million green bond, with orders in the region of €2 billion. The issue is aligned with the Green Bond Framework of Intesa Sanpaolo, prepared on

110. Forum per la Finanza Sostenibile 2016, *Finanza sostenibile e cambiamento climatico*, pp. 80-81: <https://bit.ly/2gGMSS2>

the basis of the Green Bond Principles published by the International Capital Market Association (ICMA). Alignment of the framework with these principles has been verified by an independent ESG research and analysis firm; the bond has also obtained the highest score (GB1 Excellent) in Moody's Green Assessment.

The projects funded by the bond must belong to the following categories:

- infrastructures for the production and transmission of energy from **renewable sources** (solar PV, wind, biomass and hydroelectric);
- investments in less energy intensive infrastructures or processes and to boost **energy efficiency**;
- construction of **new buildings or renovation of existing real estate** according to the **best environmental standards**.

The funds raised through the green bond have been used to finance or refinance the projects dedicated to renewable energies and energy efficiency and which fully meet the eligibility criteria under the Green Bond Principles.

The projects have been selected by a dedicated working group (including the Treasury and Corporate Social Responsibility functions as well as the Energy Desk of Mediocredito Italiano) which, besides identifying the projects to be included in the green bond, has set up and updated the “**Green Bond Register**”, i.e. the document that sets out all of the specifications of the projects financed including category, amount, description and expected environmental benefits.

As is the rule for this type of issues, the bank also undertook to draw up the annual **Green Bond Report**, which was certified by an independent company and then published on the bank's website. In June 2019, Intesa Sanpaolo published the second Green Bond Report, providing an update on the projects in the portfolio and reporting the environmental benefits measured at May 31, 2019.

At the same date, **the proceeds of the Green Bond financed 75 projects**, 61.3% of which relating to refinancing (approximately €307 million), and 38.7% were fresh funds (approximately €193 million), agreed between June 28, 2017 and May 31, 2019. 64% of proceeds was allocated to PV, 12.6% to wind, 9.3% to hydroelectric, 12.5% to bioenergy and 1.6% to energy efficiency.

In terms of environmental impact, these projects generated an annual production of energy from renewable sources of 978,265 MW, energy savings totaling 27,697 MWh and CO₂ emissions savings of 353,911 tons. These figures comprise the new projects included during the last year in the Green Bond Register to replace 13 projects, worth approximately €90 million, that had been included at the time of issue, but with prepayment of the related loans.

Upon inception, the bond's cost was in line with that of a typical public senior issue of Intesa Sanpaolo of the same duration, though on the secondary market it overperformed, on average, the other Senior outstanding bonds of Intesa Sanpaolo with the same maturity. The placement was part of the Bank's broader strategy and growing focus on the environment, on the wake of a number of green finance initiatives, the development of innovative products and services, the reduction of CO₂ emissions as well as support to

several top-notch domestic and international initiatives to study climate change and analyze the related financial impact. Amongst these, mention should be made of the uptake by Intesa Sanpaolo with the recommendations of the TCFD (Task Force on Climate-related Financial Disclosures) and participation in the second phase of the pilot study for the banking sector sponsored by UNEP FI concerning a scenario analysis of a number of sectors exposed to the effects of climate change. As a result of its commitment to the environment, Intesa Sanpaolo has received several awards and has been included in authoritative sustainability indices (e.g. Dow Jones Sustainability Index and the “A List” of the Carbon Disclosure Project).

THE COMMITMENT OF THE ITALIAN STOCK EXCHANGE FOR A SUSTAINABLE MARKET

ENRICO SOBACCHI, LISTING AND PRODUCTS DEVELOPMENT MANAGER, FIXED INCOME MARKETS,
BORSA ITALIANA - LSEG



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Borsa Italiana (the Italian Stock Exchange) actively encourages the definition of disclosure standards capable of boosting the development of “sustainable markets”. Besides being a member of the UN-supported Sustainable Stock Exchanges Initiative aimed to support the transition to a low-environmental-impact economy, it participates, through the London Stock Exchange Group, in the Climate Bonds Initiative – Fixed income partner of the Italian Stock Exchange since 2018 – and is one of the observers of the Green Bonds Principles of the International Capital Market Association (ICMA). The London Stock Exchange Group is also a signatory of the Paris Pledge for Action.

Over the course of the years, Borsa Italiana undertook to raise the awareness of issuers on the need to provide markets with more exhaustive disclosure on their ESG policies since it found that in the decision-making processes of investors such policies are increasingly significant. Also, it has made available to the market a number of tools to better identify and analyze the world of sustainable finance such as:

- a. **Indices and analyses;**
- b. **Guidance to ESG reporting for listed companies;**
- c. **Segment of green and/or social bonds traded** on MOT and ExtraMOT markets.

Having regard to the latter initiative, starting from March 13, 2017, Borsa Italiana decided to offer institutional and retail investors alike the possibility to identify the instruments whose proceeds are used to fund projects that have specific environmental (green bonds) and/or social (social bonds) benefits or impacts. To be identified, they first have to be certified by an independent body and renew the certification of the use of proceeds at least annually, until they have been entirely allocated.

This segment is not a new **market**. Rather, it **cuts across all debt markets** of Borsa Italiana and covers all types of transactions and issuers, ranging from government entities

to banking and supranational issuers, corporate large caps through to unlisted SMEs which are the backbone of the domestic economy. The willingness to **include also small issues and companies**, alongside the need to provide investors with adequate disclosure both upfront and throughout the investment process has been crucial to determine admission criteria in line with international practices and the needs of all stakeholders. In promoting ESG good practices, Borsa Italiana focuses on the needs of all its clients and resolutely pursues the goal of establishing standards for the entire market by taking account, to the extent possible, of the different issuers and their distinctive features. **Applying the same standards to large caps and SMEs may entail the risk of making these instruments hardly affordable for the latter**, depriving them of a great opportunity in terms of “sustainable growth” and broadening the investor portfolio. Borsa Italiana believes that sustainable growth as well as the integration and development of ESG policies in corporate business models are crucial for companies to present themselves, and not only their instruments, as being sustainable. To this end, in defining the standards, it is necessary to take account and enhance the value of the distinctive features of issuers.

As of July 2019, **83 green and social bonds are included in the Fixed Income list of Borsa Italiana worth over €73 billion**. There are 18 issuers in the “sustainable” segment, including corporate, supranational, government and banking issuers. Witness the fact that ESG themes and green and/or social issues are of interest not only for large listed issuers but also for SMEs that are the industrial backbone of our country, four unlisted SMEs have already issued “mini” green bonds certified on ExtraMOT PRO with a total of €26.3 million raised.

Finally, Borsa Italiana is aware of the importance of climate-aligned bonds, i.e. those issued by companies operating in the sectors that support the transition to a low-environmental-impact economy. The latter, though not included amongst green and social bonds, can be identified by the ExtraMOT PRO sector of the issuer.

4.2. MARKET DEVELOPMENT: CONSTRAINTS AND OPPORTUNITIES

The HLEG final report highlighted that the European green bond market has not yet tapped its full potential and currently accounts for a **relatively small proportion of the total bonds** outstanding¹¹¹. Mission 2020 calculated that in order to hit the targets of the Paris Agreement, more capital needs be invested in green bonds to reach at least \$800-900 billion by 2020, i.e. over ten times total issues in 2016¹¹².

According to market players, amongst other, the following hampers market development:

- **little clarity** as to the economic **sectors eligible for funding**;
- little clarity about **economic benefits for issuers**.

Having regard to the latter issue, this chapter already mentioned earlier the lower cost of debt potentially associated to green bonds, as high demand allows for lower interest rates in some cases. However, green bonds imply at the same time **higher charges for the issuer** for disclosure and external audit. Indeed, companies are required to introduce complex procedures that may entail additional costs, thus eroding the economic benefits of green bonds.

As European institutions are increasingly willing to support the development of the green bond market, the debate is rife among issuers and investors as to the need to **introduce simplified and standardized issuance procedures** alongside **shared and detailed definitions**.

While listed green bonds are, as such, already subject to transparency and disclosure requirements under current European regulations, unlisted bonds are subject to less stringent regulations, such as CONSOB¹¹³ supervision as to whether proper and transparent information is disclosed.

For this reason, **HLEG** proposed to identify a **Green Bond Standard (GBS)** starting from existing good practices, with a view to clarifying controversial aspects such as the definition of “green” project that can be financed by the bond, measurement of the impact of actions, consistency of the validation and external audit processes.

In **Action 2 of the Action Plan**, the European Commission refers to HLEG guidance and is committed to establish standards and labels for sustainable financial products including green bonds.

111. In the last quarter of 2018, “green”, “social” and “sustainability” bonds accounted for 10% of the bonds issued by European issuers. See: EU Technical Expert Group on Sustainable Finance 2019, *Report on EU Green Bond Standard*, June 2019, p. 17: <https://bit.ly/2KXIPzh>

112. Mission 2020 2017, 2020: *The Climate Turning Point*, p. 18: <https://bit.ly/2z9VZUx>

113. CONSOB (Commissione Nazionale per le Società e la Borsa) is the public authority responsible for regulating the Italian financial markets. For more information: www.consob.it

4.3. EU GREEN BOND STANDARD

The **EU Green Bond Standard (GBS)** is a system of **criteria for the issuance of green bonds, common across Europe**; thanks to the introduction of such standard, it will be possible to grant the “EU Green Bond” certification to any type of listed or unlisted bond or debt instrument issued by a European or international issuer that provides evidence of compliance with GBS¹¹⁴.



In view of implementing Action 2 of the Action Plan, the European Commission entrusted TEG with drafting **recommendations for the development of a Green Bond Standard (EU GBS)**.

On June 18, 2019¹¹⁵ **TEG published a report** setting forth the key principles and structure of GBS; recommendations to support the development of the green bonds market; the expected impact of GBS against the targets of the Action Plan.

The standard proposed by TEG is **voluntary** and draws inspiration from existing criteria and **good practices**, such as the Green Bond Principles – GBP (see §4.1.).

The GBS rests on **four principles**:

- 1. alignment with the taxonomy of environmentally sustainable activities** (see §1.3.), for the identification of projects and activities eligible for funding;
- 2. publication of a “Green Bond Framework” (GBF)**, i.e. a document in which the issuers states its willingness to bring the green bond in line with GBS; compliance of the bond’s funding plan with the environmental goals of the European Union; highlights as to the use of proceeds, investment processes and disclosure;
- 3. production of reporting** on the use of proceeds and actual environmental impact¹¹⁶;
- 4. verification by an external verifier** of compliance of the Green Bond Framework and allocation of proceeds¹¹⁷.

114. EU Technical Expert Group on Sustainable Finance 2019, *Report on EU Green Bond Standard – Overview*: <https://bit.ly/32ivzup>

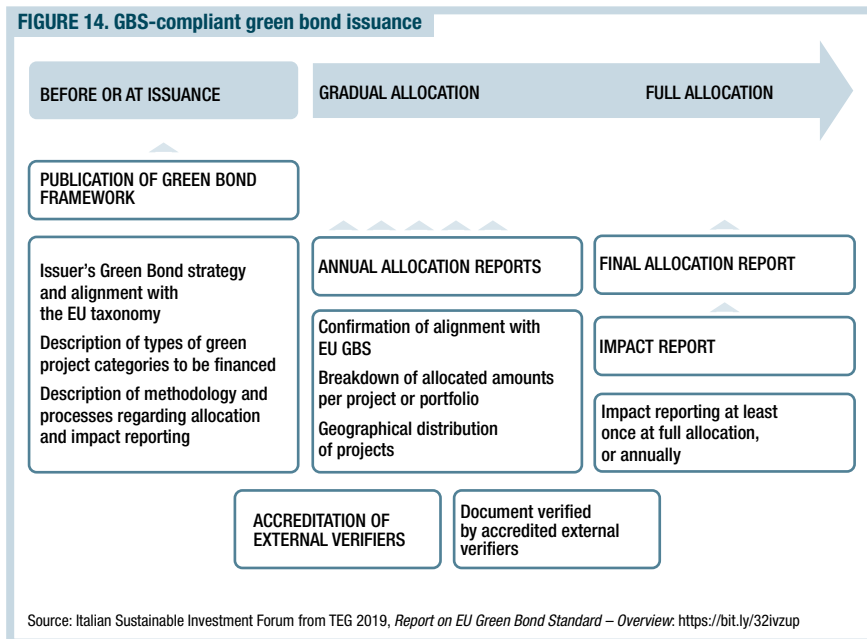
115. The TEG final report was preceded by an interim version, published on March 6, 2019 and submitted to public consultation; approximately one hundred market players provided feedback. The TEG has taken into account the observations received and other in-house analyses to work out the final document. As compared to the interim report, the final version has added one paragraph on the expected impact of GBS on the market of sustainable finance and green bonds; also, the TEG has developed a template for onboarding with GBS, has reduced the number of recommendations and has specified its characteristics and scope of application. To view the interim report: <https://bit.ly/2TCYx6u>

116. To be published every year until completion of the allocation of proceeds and in subsequent years, in case of significant changes.

117. Attached as an annex, the TEG proposes a draft template to be submitted to the issuers that want to disclose alignment with GBS. See TEG 2019, *Report on EU Green Bond Standard*, op. cit., Annex 2, p. 62.

Besides, TEG suggests that independent verifiers be subject to a **formal onboarding and supervision procedure**¹¹⁸ to be developed and initiated by the European Securities and Markets Authority – ESMA (see Glossary, p. 113).

FIGURE 14. GBS-compliant green bond issuance



TEG recommended that the **Commission, Member States governments and market players** encourage a wider acceptance of GBS through measures that act on both the demand and supply of green investments.

In particular, TEG:

- encouraged **institutional investors** to refer to GBS for defining investment strategies in relation to green bonds;
- invited the **European Commission** to introduce **disclosure obligations** for all green bonds in compliance with the new ESG disclosure regulation (see §2.2.);
- encouraged the European system of **central banks** and the Network for Greening the Financial System to prefer the green bonds that comply with the standard in their programs for the purchase of green bonds;
- recommended that the **European Commission and Member States**

118. The TEG proposes to establish an interim onboarding regime for up to three years; this initiative might be led by market players. See: TEG 2019, *Report on EU Green Bond Standard*, op.cit., p. 41.

introduce **incentives** to encourage the progressive alignment of the European green bond market to the standard¹¹⁹;

- pointed out the importance of **including GBS in eco-labels for financial products** (i.e., environmental sustainability certifications for retail financial products – see §4.4.).

Finally, TEG believes that a wider acceptance of GBS will **have a beneficial impact** on the implementation of the Action Plan in terms of greater **transparency and consistency** of the green bond market and **more investments** in projects, which, in turn will be good for the environment.

Next steps

The European Commission will review TEG recommendations and decide if and how to take account of them. In this regard, TEG recommends that the European Commission does not introduce normative acts for at least three years so as to monitor and evaluate market reactions to the introduction of the standard¹²⁰.

4.4. OTHER EUROPEAN SRI PRODUCT CERTIFICATIONS

Financial products certifications enhance the transparency and recognizability of stocks by investors. As regards in particular sustainability certifications, a significant European experience is the **European SRI Transparency Code** by Eurosif for sustainable retail funds (see Box “European SRI Transparency Code”, p. 86).

Furthermore, the European Union is considering extending ecolabels (i.e., environmental sustainability certifications for consumables to retail financial products (see Box “EU Ecolabel for financial products”, p. 87). ESG requirements also apply to the new pan-European personal pension products (see Box “Integrating ESG criteria in PEPPs”, p. 89).

On a domestic level, initiatives have been taken in many countries by financial centers, trade associations or organizations specializing in financial products certifications; these initiatives provide for minimum requirements to be met, in line with international standards, and require an audit by an independent body. ESG labels cover approximately 500 financial products out of over 60,000 funds in the European market. Currently **France** is the only country in which the government has established and supports two public certifications: the SRI Label





119. For example, the TEG proposes that governments provide for subsidies allowing issuers to offset the internal audit fees, as happens in China, Hong Kong and Singapore; see: TEG 2019, *Report on EU Green Bond Standard*, op. cit., pp. 42-43.

120. This assessment could be performed with the support of the EU Platform on Sustainable Finance, already in charge of monitoring the use of - and update - the taxonomy of environmentally sustainable activities (see §1.3.).

for responsible investments and the Greenfin label for investment funds focusing on environmental topics.

As for asset classes, the majority of existing certifications are for **domestic equity and bond funds qualifying as UCITS** (Undertakings for Collective Investment in Transferable Securities), or harmonized¹²¹ funds which are regulated by Directive 2009/65. At present, only the Umweltzeichen (Austria) and Greenfin (France) labels can certify real estate funds. Furthermore, the Greenfin label applies to venture capital and funds relating to infrastructure during inception.

FIGURE 15. Sustainability certifications in Europe






ESG	LABEL	GOVERNANCE	GRANTED BY	TYPE	ANNUAL COST
	 SRI Label France	Independent stakeholder committee supported by the Ministry of Finance	Onboarded certification bodies	SRI investment process	Fee that also covers audit and promotion costs
	 FNG Siegel Austria, Germany, Switzerland	Expert committee led by FNG ¹²²	GNG (FNG certification body) & University of Hamburg	Exclusions	€3500
	 LuxFLAG ESG Luxembourg	LuxFLAG ¹²³	LuxFLAG	SRI investment process	€3000
	 Febelfin QS Belgium	Febelfin ¹²⁴	External certification body	Quality standard for thematic investments and exclusions	-

121. Harmonized funds are open funds which, in line with EU directives on UCITS can be marketed in the European Union under a mutual recognition regime. The funds are subject to the Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), July 13, 2009: <https://bit.ly/2Mmmiu7>

122. Sustainable Investment Forum (German-speaking countries).

123. Independent certification agency for the financial sector in Luxembourg.

124. Belgian federation for the financial sector.

	LABEL	GOVERNANCE	GRANTED BY	TYPE	ANNUAL COST
ESG	 Umweltzeichen Austria	Austrian Ministry for the Environment	Ministry	Exclusions	Variable yearly fee
	 Nordic Swan Ecolabel Nordics	Nordic Ecolabelling Board ¹²⁵ mandate by Nordic governments	Nordic Swan	Exclusions and disclosure of environmental impacts	€3000 + fixed charge
GREEN	 LuxFLAG Environment Luxembourg	LuxFLAG	LuxFLAG	Thematic investments, ESG integration, exclusions	€3000
	 LuxFLAG Climate Finance Luxembourg	LuxFLAG	LuxFLAG	Thematic investments, ESG integration, exclusions	€3000
	 Greenfin Label France	Independent stakeholder committee chaired by the Ministry for the Ecological and Fair Transition	Certification bodies	Thematic investments, ESG integration, exclusions	Depending on the auditor

Source: Italian Sustainable Investment Forum from Novethic 2019, *Overview of European sustainable finance labels*: <https://bit.ly/2Yn9wEv>

EUROPEAN SRI TRANSPARENCY CODE



The European SRI Transparency Code, initiated by Eurosif in 2008, applies to **retail investment funds** and covers multiple asset classes across the spectrum from equities to bonds.

In 2018 the Transparency Code had approximately **800 registered funds**.

125. Nordic Ecolabel is a voluntary label established by the Nordic Council of Ministers in 1989, available for approximately 60 categories of retail products. The “financial products” category was introduced in 2017.

The Code was established to **enable managers to disclose to investors their approach to SRI** using a simple and comparable format. The signatories undertake to **disclose accurate, relevant and up-to-date information** on the integration of ESG criteria in fund management policies, in view of greater transparency for stakeholders and clients in particular.

In practice, the Transparency Code is comprised of a number of commitments undertaken by signatories relating to the obligation to disclose information on a number of topics, including:

- adoption of ESG criteria in the analysis of corporate (and Government) bonds;
- fund management process;
- ESG controls and disclosure.

After three updates, on February 19, 2018 Eurosif and the domestic SIFs (Sustainable Investment Forums) published a new version of the Transparency Code to reflect the latest developments on the SRI market, in line with the latest recommendations in Europe on sustainable finance: i.e., the Loi de Transition Énergétique pour la Croissance Verte (Art. 173); the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board and the recommendations of the final report of HLEG¹²⁶.

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EU ECOLABEL FOR FINANCIAL PRODUCTS

LUCIA ALESSI AND ELISA OSSOLA, EUROPEAN COMMISSION - JOINT RESEARCH CENTRE



The adoption of the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development mark a historical international commitment to the objective of a more sustainable economy and society. The EU is fully committed to reaching the EU 2030 climate and energy targets and to mainstream sustainable development into EU policies.

In this context, the Commission published an Action Plan on financing sustainable growth on 8 March 2018. It puts forwards ten actions whose main objectives are the following:

1. Reorienting capital flows towards sustainable investment;
2. Mainstreaming sustainability into risk management;
3. Fostering transparency and long-termism in financial and economic activity.

With reference to aims 1 and 2, the European Commission has set out a **strategy including the establishment of an EU classification system for sustainable activities** (i.e., an “EU Taxonomy”), and the creation of standards and labels for green financial products.

126. For more information: <http://www.eurosif.org/transparency-code/>

With respect to this latter action, it has been decided to apply the EU Ecolabel Regulation to financial products.

The EU Ecolabel is a voluntary award scheme intended to **promote products with a reduced environmental impact and to provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products**. The EU Ecolabel criteria can be particularly useful for retail investors who have preferences in relation to the environmental sustainability of the activities funded by their money. Therefore, the scope of the Ecolabel includes specific retail investment and insurance products. For example, investment funds (UCITS) would be included in the Ecolabel scope as their shares are also offered to retail investors.

In order to assess whether a particular financial product, e.g. an investment fund, is Ecolabel eligible, one needs to evaluate the following:

- to what extent the **underlying assets are linked to environmentally sustainable economic activities**;
- whether **the overall portfolio is sufficiently green to be awarded with the label**.

Green investment is generally associated with the financing of activities that provide environmental benefits such as a reduction in greenhouse gas and air pollutant emissions. Financial products or investments can therefore be labelled as green based on the greenness of the underlying projects or activities that are financed. The Ecolabel for financial products relies on the EU Taxonomy for the definition of which economic activities can be defined green. In the context of the Ecolabel, investment in particular activities may be excluded based on social and ethical aspects.

Furthermore, to ensure consistency and complementarity across the various relevant EU initiatives, the definition of the criteria for the EU Ecolabel for financial products also considers the **development of an EU Green Bond Standard**. Green bonds finance or re-finance in part or in full new and/or existing eligible green projects. The EU Green Bond Standard defines green activities in line with the EU Taxonomy.

With respect to the work plan, the development process for the Ecolabel for financial products started in autumn 2018 and is expected to last 2 years overall. A preliminary report and a technical report with scope and criteria proposals were presented at the first meeting with stakeholders in April 2019¹²⁷. A second meeting is planned to discuss stakeholder feedback on the working documents.

127. Relevant documents are available here: <https://bit.ly/2HCQcIW>



On July 26, 2019 the **PEPP (Pan-European Personal Pension Product)¹²⁸** **Regulation** was published on the Official Journal of the European Union.

PEPPs are a form of **supplementary pension for individual retail investors**, i.e. they can be subscribed by individuals (be they self-employed or hired by an employer, students and unemployed) in view of saving for retirement.

They feature **common standards** (e.g. on transparency requirements and investment rules) and a “**passport**” that allows **distribution to all of the Countries of the European Union**.

PEPPs are **transferable** inside the European Union: in other words, if the subscriber changes his/her place of residence within the European Union, (s)he can either continue to save using the same product or transfer the amounts to a new PEPP in the new place of residence without having to first sell them.

PEPPs can be issued by insurance companies, banks, asset managers, investment companies and corporate and occupational pension funds; EIOPA (see Glossary, p. 112) verifies that products meet the requirements to be PEPP-certified and authorizes distribution in the European Union; besides, the Authority fills out the central register of all PEPPs.

The regulation refers to sustainability themes in various parts of the text: **PEPP providers will have to be encouraged to integrate ESG factors in their investment choices and risk management**; they will also have to disclose such information to EIOPA, relevant authorities and retail investors.

In particular:

- the **KIID¹²⁹** must disclose the return of investments in relation to ESG factors (where available);
- the **prospectus** must illustrate the investment policy relating to ESG factors and indicate how to find additional information;
- **throughout the term of the agreement, retail investors** must be promptly informed as to how the investment policy takes account of ESG factors.

128. EU Regulation 2019/1238 on a pan-European Personal Pension Product (PEPP), June 20, 2019: <https://bit.ly/2nYbj1T>

129. The KIID (Key Investor Information Document) is a two-page document that summarizes the key characteristics of an open-end mutual fund. The KIID has 4 parts: a) investment purpose and policy; b) risk-return profile; c) costs; d) historical performances. It was introduced with the entry into force, starting from January 1, 2018, of the European Regulation on PRIIPs (Packaged Retail and Insurance-based Investment Products).



5. Integrating ESG in investment advice

The **HLEG** final report recognizes the **central role of investment advice in leading and steering investors towards SRI products**. For this reason, the expert group expressly recommended that the European Commission and the European Securities and Markets Authority (ESMA – see Glossary, p. 113) take legislative action: **it is necessary for financial advisors to take account of retail investors' ESG preferences** as early as at the time of profiling the client with the questionnaire introduced with MiFID EU Directive (see Glossary, p. 111).

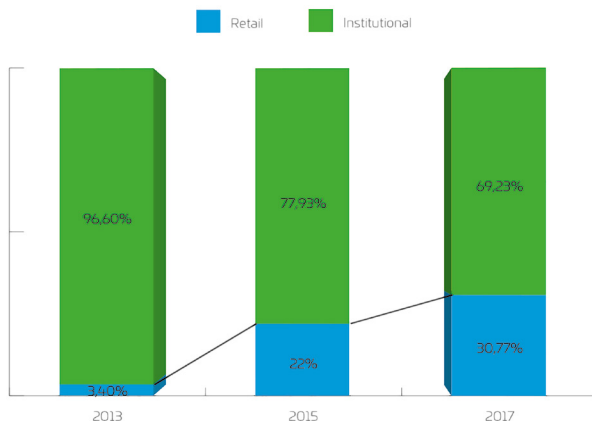
The latest market research data also show that retail investors are increasingly interested in investing in SRI products: thus, **greater involvement of financial advisors and sales networks** in sustainability topics appears to be crucial to speed up the development of SRI.

This chapter analyzes the growing interest of retail investors in SRI and the important role of financial advisors in assisting clients with sustainable investment choices (see §5.1.) and then focuses on the action taken by the European Commission to integrate ESG criteria in investment advice (see §5.2.)

5.1. RETAIL INVESTORS AND FINANCIAL ADVISORS

The **European SRI Study 2018** highlights the growth of investments that integrate ESG factors. The proportion of retail investors was up from 3.4% in 2013 to 30.8% in 2017, confirming the **growing awareness of retail investors of the importance of ESG themes**.

FIGURE 16. Growth of the retail SRI market in Europe



Source: Eurosif 2018, *European SRI Study 2018*: <https://bit.ly/2Yb3za2>

Research conducted in 2017 by Natixis Investment Managers¹³⁰ with 8,300 interviewees in 26 countries found that over 70% of retail investors consider ESG goals in their investment choices.

This finding is consistent with a study conducted in the same year by Vigeo Eiris¹³¹ which shows that 72% of French retail investors would like integration of ESG in asset management to become mandatory.

The market survey conducted by Italian Sustainable Investment Forum and Doxa in 2017¹³² found that there are **more investors choosing the products proposed** by their bank or financial advisor and fewer investors who make fully independent investment choices¹³³. The tendency to rely on expert advice is in line with the growing confidence in financial advisors (up by 17% against 2013). 58% of retail investors without SRI products reported that they never invested in these products because the latter have never been proposed to them¹³⁴.

In light of the rapid growth recorded by the retail segment of sustainable finance in recent years, now the challenge is to provide sufficient information and reassure those who are interested but still skeptical: for example, by **making commercial and communication policies more incisive, clearer, more transparent** and **better able to meet** the needs of retail investors, also by including financial education notions¹³⁵.

5.2. ESG CRITERIA IN INVESTMENT ADVICE

Action 4 of the Action Plan provides that sustainability be integrated in investment advice by verifying client preferences on **ESG topics when assessing product suitability**¹³⁶.

Between May and June 2018, the European Commission started a **public consultation**¹³⁷ to delve into the positions of players as to the possibility to **modify MiFID II and IDD** – on financial and insurance products respectively (see Glossary, pp. 110-111) – with a view to integrating ESG in investment advice.

On January 4, 2019¹³⁸ the European Commission published two **draft rules**

130. Natixis Investment Managers 2017, *Trust, transparency and the quest for clarity*, p. 6: <https://www.im.natixis.com>

131. Vigeo Eiris, FIR 2017, *The French and SRI: results of the 8th national survey*: <https://bit.ly/2KiNkkV>

132. Forum per la Finanza Sostenibile, Doxa 2017, *Il risparmiatore responsabile*, op. cit.

133. The comparison refers to the previous edition of the study, of 2013, that can be viewed at the following link: <https://bit.ly/2ZLTEvi>

134. Forum per la Finanza Sostenibile, Doxa 2017, *Il risparmiatore responsabile*, op. cit., p. 18.

135. Ivi, p. 6.

136. European Commission 2018, *Action Plan: Financing Sustainable Growth*, op. cit., pp. 7-8.

137. To view the replies: <https://bit.ly/2YmZzH1>

to amend MiFID II¹³⁹ delegated regulation and IDD¹⁴⁰ regulation: the new rules must be adopted following after the approval of the regulation on ESG disclosure (see §2.2.). The abide-by deadline set by the European Commission is meant to give time to the players willing to comply with the new provisions.

ESG CRITERIA IN INVESTMENT ADVICE: THE POINT OF VIEW OF FINANCIAL ADVISORS

SONIA CICCOLELLA AND MATTIA SUARDI, RESEARCH DEPARTMENT OF ANASF



The Action Plan for financing sustainable growth, published by the European Commission on March 8, 2018, is the starting point to escalate to institutions the integration of ESG criteria in the activity of those financial advisors that are authorized to offer investment products outside their offices to retail investors. While the Plan recognizes the central role of investment advisors in redirecting the financial system towards sustainability, it points out that *“Investors’ and beneficiaries’ preferences as regards sustainability are often not sufficiently taken into account when advice is given”*. This gap can be filled through two interlinked actions aimed to prepare a regulatory framework that integrates ESG criteria in investment advice and knowingly defining the role that financial advisors can play in this regard.

Having regard to the first action line, on **January 4, 2019 the Commission published the proposed regulation** which, added to MiFID II, will integrate ESG considerations in investment advice¹⁴¹ in particular in relation to the gathering of the information required to define the investor profile and thus have basic information to evaluate the suitability of the financial services and instruments proposed. As regards **investor profiling**, the proposed regulation provides for an enhancement of the information set (in line with MiFID II¹⁴²) through the **identification of ESG preferences, if any, by adding specific questions to the suitability evaluation questionnaire**. This novelty, in turn, will make it necessary, in view of future implementation of the new regulation, for the players to brainstorm and

138. European Commission 2019, *Commission publishes draft rules to ensure investment firms and insurance distributors consider sustainability topics when advising clients*, Press Release, January 4, 2019: <https://bit.ly/2LTIRIJ>

139. European Commission 2019, *Commission delegated regulation amending Delegated Regulation EU 2017/565 as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice and portfolio management* (draft), January 4, 2019: <https://bit.ly/2OzbME9>

140. European Commission 2019, *Commission delegated regulation amending Regulation EU 2017/2359 as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice for insurance-based investment products* (draft), January 4, 2019: <https://bit.ly/315X7BE>

141. See European Commission 2019, *Commission delegated regulation amending Delegated Regulation (EU) 2017/565*, op. cit. Similar considerations apply, again in the field of investment services under MiFID II, for portfolio management and the distribution of insurance investment products under IDD.

142. I.e., gathering of information about client's knowledge and expertise, financial situation and investment objectives.

understand the number and depth of the questions as well as the topics referred to in the “ESG questions” in MiFID II questionnaires. Another operational aspect is when to collect investors’ ESG preferences: the proposed EU regulation (see point 6) provides a major clarification in relation to this as it specifies that, in order to avoid a mismatch, intermediaries and **financial advisors will have to first evaluate the client’s investment objectives and then follow up with questions on the potential ESG preferences**. These preferences will have to be taken into account in the investment advice report which, as required by MiFID II, has to be delivered to retail investors in order to illustrate the contents of the advice given and explain why the investment recommendation is deemed to be adequate for the specified investor profile.

A closer look at the role of financial advisors shows that individual professionals can contribute to all of the stages of the investment advice process. During **client profiling**, by means of the MiFID II questionnaire, the financial advisor will fulfil the sensitive function of **collecting the investor’s ESG preferences, if any**, and, in this stage (s)he will have to focus in particular on their **integration with the investment objectives so identified**. The financial advisor will also be called upon to add practical contents to the forecast (see relevant item in the proposed EU regulation) based on which it is required to explain to clients how their ESG preferences are taken into consideration in the process of selecting the individual financial instruments recommended. It is equally important to bear in mind that the financial advisor, being a direct point of contact for the investor, is in a privileged position in terms of **capturing any changes in the characteristics and needs of the client**, including attitudes to ESG themes. Suffice it to think of an investor who over time develops a “sustainability awareness”, showing a particular sensitivity to themes such as climate change, renewable energies or sustainable buildings.

The role, as outlined above, of financial advisors relative to the integration of ESG criteria in investment advice needs to be developed and its value needs to be enhanced, especially if one considers that financial advisors themselves acknowledge that there is vast room for improvement. According to the data of the monthly observatory on a sample of financial advisors who are members of ANASF¹⁴³, only approximately 54% of respondents reported having at least good knowledge of SRI products, with this percentage going down to 45% and 42% respectively in relation to knowledge of ESG criteria and the related performance indices. This evidence confirms the need to develop the role of financial advisors as part of sustainable investments through **targeted occupational training and refresher courses** (either set up by the investment house itself or offered by third parties).

In conclusion, while sustainable investments have become a fully-fledged reality in the financial industry and are acknowledged off-the-record by the European Union institutions, sustainable finance should also be disseminated through the two courses of

143. Real Trend ANASF monthly observatory, set up jointly with ETicaNews October 22-30, 2018.

action identified earlier, i.e.: 1) integrate ESG criteria in the MiFID II provisions on advisory services, and 2) work on the role of financial advisors in raising the awareness of citizens on ESG topics and encourage informed and responsible investment decisions capable of taking into account the attitude of individual retail investors.

In July 2018, the European Commission asked **ESMA** and **EIOPA** (see Glossary, pp. 112-113) to provide expert advice on the inclusion of ESG criteria in investment advice on financial and insurance products¹⁴⁴.

On April 30, 2019, ESMA published and sent to the European Commission its advice¹⁴⁵ on the changes to MiFID II¹⁴⁶.

In general, ESMA believes it is important for ESG factors to be integrated with a **principles-based approach** rather than a prescriptive one as the latter might hamper product innovation and generate inconsistencies in the regulatory framework. Also, ESMA deems it necessary to have an operative **clear, complete and binding taxonomy of sustainable activities** before all other reforms on ESG topics enter into force. The new provisions will have to take into account the **principle of proportionality** so as not to penalize some players due to their size; also, all the stakeholders concerned will have to have time to comply with the new provisions.

The ESMA opinion then moves on to focus on two areas: **organizational requirements** and “**product governance**”, i.e. the set of obligations for producers and distributors of the financial products.

As for organizational requirements, ESMA focuses on: verification of the knowledge and competence of advisors relating to sustainability; integration of ESG criteria in risk management processes (taking account of the scarcity of reliable information); drafting of adequate measures to detect any **conflicts of interest** that may arise from the distribution of SRI products (e.g., misselling; in this case, sustainability is exploited as a way to drive investors to purchase of more expensive products). As to product governance, ESMA recommends integrating ESG criteria in the activity of producers and distributors; in particular, the latter will have to take them into account when analyzing needs, characteristics and goals of the reference market, in the periodical assessment of the consistency of products with client needs and in the verification of the changes in the attitudes and opinions of clients.

144. In particular, the request for a technical opinion as to possible delegated legislation in connection with MiFID II, IDD, UCITS (on open-ended funds) AIFMD (on alternative funds), Solvency II (on the activity of insurers).

145. ESMA 2019, *ESMA's technical advice to the European Commission on integrating sustainability risks and factors in MiFID II*, Final Report, April 30, 2019: <https://bit.ly/2WjHoNm>

146. On the same date, ESMA also published technical advice on the integration of ESG criteria in UCITS Directive on open-ended funds and AIFMD Directive on alternative funds. For more information: <https://bit.ly/2vAvGSG>



The supply of sustainable insurance-linked investment products or ESG products has increasingly grown and starts to be considered no longer as a niche market. In order to further boost their development, the European Commission recently adopted several measures aimed to put ESG considerations “*at the heart of the financial system to support the transformation of Europe’s economy into a greener, more resilient and circular system*”¹⁴⁷. In particular, the Commission presented, as part of the Action Plan for financing sustainable growth, some legislative proposals aimed to integrate ESG considerations into the services provided to clients by investment houses and distributors of insurance-linked investment products¹⁴⁸. As regards insurance companies, changes have been proposed to the delegated EU Regulation 2017/2359 so as to include ESG factors among the information to be collected for profiling clients and verifying if the product offered is suitable to meet their needs. The Commission, in July 2018, asked EIOPA to give advice to support the integration of ESG factors in the regulations on insurance (Solvency II and IDD) and the related implementation rules. On May 3, 2019, following after the consultation, the European supervisory authority disclosed its technical advice to the Commission¹⁴⁹.

In particular, as regards **Solvency II**, several **changes** are proposed to be made **to the delegated EU Regulation 2015/35**. EIOPA technical advice considers first the possibility to **integrate the so-called “prudent person principle”** and provides that as part of the assessment of security, quality, liquidity and profitability of the portfolio, also the above-mentioned “sustainability risks” should be taken into account and that companies should take into consideration **the long-term impact of ESG factors on investments** and refer, where relevant, to **preferences of the insured and of the beneficiary in relation to ESG**. The Authority points out the potential increase in costs for financial intermediaries and distribution networks as a result of such approach, especially due to the current lack of adequate expertise in the processing and use of relevant information, data and instruments, with a growing need to collect such information from third parties. As to **conflicts of interest**, EIOPA’s position is in line with ESMA’s proposal in relation to MIFID II: i.e., the addition of a new recital to the delegated EU Regulation 2017/2359 requiring companies to also evaluate the conflicts arising from consideration of ESG factors in distribution; furthermore, it should be provided that, amongst the factors to be considered when identifying the types of conflicts that can arise in the distribution of insurance products, also those arising from the clients’ ESG goals should be included, if relevant.

147. European Commission 2018, *Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment*, op. cit.

148. EIOPA 2018, *7th Consumer trends*: <https://bit.ly/2UYpq2J>

149. EIOPA 2019, *EIOPA submits advice on Sustainable Finance to the European Commission*, Press Release, May 3, 2019: <https://bit.ly/2T036VI>

According to the Authority, one can expect ESG to be analyzed and evaluated also by **compliance and internal audit functions**, as these are responsible for monitoring and for the adequacy of the risk management policies and procedures.

EIOPA also considers product governance and proposes to include ESG principles in the relevant set of rules. To this end, it proposes to include specific reference to **ESG factors in the rules that govern the determination and revision**, by insurance companies with the support of distributors, **of the product's target market**. When identifying the ESG preferences used for defining a given product, companies can refer to the taxonomy being prepared by the Commission. In the meantime, however, existing market models can be used.

The European Commission, based on the Authority's technical advice, will finalize the changes to the regulation for implementing MIFID and IDD. According to the schedule for implementing the Action Plan, the final text of the new regulations should be approved and enter into force by the end of 2019 and be applied starting from 2020.

In September 2019 IVASS¹⁵⁰ started a public consultation on the draft regulation.

150. IVASS is the insurance supervisory authority. For more information: <https://www.ivass.it/>

6.

Italian market outlook



6.1. GENERAL REMARKS

The measures proposed by the European Commission meet two widespread needs of the SRI market, which are necessary for it to grow:

- **transparency;**
- identification of **common criteria for defining sustainable investments.**

It is important for these criteria to take account of the **specificity of domestic markets** and of the **needs of individual categories** of financial organizations, in terms of both activity and size.

Such measures aim to align financial markets with the Paris Agreement. While Italian players acknowledge them, some technical and quantitative aspects need be clarified such as the **scientific definition of the probability and implications of reference scenarios relating to the environment and human activities, the risks and opportunities associated with the transition process, relevant indicators for financial activities**, etc. It is widely held that climate change is a risk to the stability of markets, but the time horizon of and precisely how such risk manifests itself are as yet to be clarified.

A turnaround for the market was the position adopted by the Bank of Italy, which mentioned the materiality of climate risk as the reason for its decision to integrate ESG criteria in the strategy for managing a portion of assets¹⁵¹.

It will be crucial to give markets **more information on the financial implications of climate risks based on scientific data and evidence**: only then can the measures proposed by the Action Plan be fully implemented by players and become the “new normal”.

As such, it is important to define the **relevance of ESG criteria in terms of risks as well as opportunities**: in this regard, the approach of the European Commission to updating the guidelines for companies¹⁵² (see §2.3.) is significant. To this end it will be useful to strengthen and encourage the dissemination of **academic studies and market research** that highlight the benefits of SRI investments in terms of both returns and risk reduction¹⁵³.

151. “In Europe, the expected effects of climate change impact above all southern countries like Italy. These changes raise new risks for the real economy and for the stability of the financial sector. [...] The effects of climate change on the real economy can propagate to the financial sector through different channels. [...] Where the scale of these effects becomes significant, the stability of the financial system itself could be impacted”. From *Sviluppo sostenibile e rischi climatici: il ruolo delle banche centrali*, speech delivered by Ignazio Visco (Governor of the Bank of Italy) at the opening conference of the 2019 Festival of Sustainable Development (Rome), May 21, 2019: <https://bit.ly/2wtiMq8>

152. European Commission 2019, *Guidelines on non-financial reporting*, op. cit.

153. See for example: Becchetti, Leonardo, Ciciretti, Rocco, Dalo, Ambrogio and Herzel, Stefano 2014, *Socially Responsible and Conventional Investment Funds: Performance Comparison and the Global Financial Crisis*, CEIS Università di Roma “Tor Vergata”: <https://bit.ly/2KLtWzg>; Eccles, Robert G., Ioannou, Ioannis and Serafeim, George 2011, *The Impact of Corporate Sustainability on Organizational Processes and Performance*, Harvard Business School: <https://hbs.me/2lDqVzU>; Clark, Gordon, Finer, Andreas and Vieh, Michael 2015, *From the stockholder to the stakeholder, How Sustainability can drive financial outperformance*, University of Oxford, Arabesque Partners, Smith School of Enterprise and the Environment, March 2015: <https://bit.ly/2BJ2sEL>; Friede, Gunnar, Busch, Timo, and Bassen, Alexander 2015, “ESG and financial performance: aggregated evidence from more than 2000 empirical studies”, *Journal of Sustainable Finance & Investment*, Vol. 5, n. 4, pp. 210-233: <https://bit.ly/2MJelFm>

Credit risk should also be considered, besides sustainable investment. Indeed, it is necessary for ESG criteria to be extended to lending; this aspect is particularly important for most of Italian banks, due to their propensity to finance Small and Medium Enterprises (SMEs).

Along the same lines, having regard to the **evaluation of insurance risks**, ESG factors are as yet not sufficiently considered even though 80% of the losses in the sector in 2018 was caused by extreme weather¹⁵⁴.

For the time being, banks and insurance companies do not have sufficient data and metrics to adequately evaluate the risk levels associated to sustainability: in the future it will therefore be crucial to do more research in these areas.

In relation to the measures proposed by Action Plan, it is very important to clarify to markets which rules will become **binding** and which will remain **voluntary for players**.

In both cases, it is important to:

- ensure **applicability of the measures**, through greater involvement of market players;
- **clearly determine the scope of application of the rules** (to whom and in which areas) and the mandates of supervisory bodies;
- define an **appropriate timeline** for the entry into force of each rule, some of which being preliminary to others (e.g., the taxonomy is the foundation for other measures);
- define **adequate transition periods** for players to comply without distorting the market;
- optimize the **trade-off between clarity of rules and the risk of disincentives** for players (it is important to avoid over-regulation and over-bureaucratization and ensure that the new rules encourage the adoption of sustainable investment practices);
- ensure that **the timing of the legislative process does not slow down the dynamics of the SRI market** which has long **shown its interest in embedding sustainability criteria** in investment policies and strategies, in Europe and Italy alike;
- ensure **flexibility of measures** such that they can be commonly and steadily used by multiple players, adapting to the innovations of the market and absorbing technological developments.

It is crucial to pay more attention to **governance**: in order to achieve a full and real market transition, sustainability should not cover financial products alone; rather, it should permeate the entire corporate structure and not just in the financial sector.

This topic is addressed by the section of the guidelines on climate disclosure,

154. European Central Bank (sundry authors) 2019, *Climate change and financial stability*, op. cit.

which analyzes the theme of policies and due diligence¹⁵⁵: relating to the risks and opportunities associated to climate change, the European Commission recommends that companies describe the Board of Directors' oversight and the role of evaluation and management of the executive team. Also, the requirements proposed by TEG for benchmark sustainability disclosure are not limited to the environment but also include social and governance themes like Board independence and diversity – with regard to equities – and corruption, political stability and rule of law in relation to the analysis of government bonds.

Another key aspect is the **measurement of the impact of sustainability on financial performance**: it is fundamental to harmonize metrics among companies (through the identification of strategic KPIs for all sectors) and between companies and investors.

In this area, it seems appropriate to introduce a **reporting** system in line with:

- the sustainability requirements of companies, i.e. effective disclosure of their ESG activities to the markets;
- investors' expectations, i.e., know the impacts of ESG on corporate business and related financial risks/opportunities.

As part of future technical deep-dives and of regulatory developments it will be important to focus more on **SMEs**, including as entities to which the provisions apply (e.g., guidelines for climate disclosure) in order to safeguard the needs of financial players that deal with SMEs as investors or lenders.

Besides, it is crucial to encourage more resolutely a **long-term approach by investors and companies**: an obstacle to integrating ESG criteria in investment strategies – especially by asset managers – is often the time mismatch between the mid- to long-term effects of SRI investments and the needs of investors which often want to see positive returns in the short term. As such, it is important for all of the stakeholders involved in the investment chain to share the same sustainability criteria¹⁵⁶.

Finally, one should bear in mind that the action of the European institutions aims to **encourage a widespread uptake of sustainability as a new common denominator of financial markets**: as such, it is important for the new classifications, standards and certifications to not aim to create “green” niches, but rather apply across financial industry to broadly attest the sustainability of governance policies, investment strategies as well as products and services. At the same time, it is necessary to adopt appropriate clauses that protect from the risks connected to a dilution of the quality of criteria and strict application of the same: in other words, one should prevent the taxonomy and other instruments from being used also for products or entities which in fact are not sustainable.

155. European Commission 2019, *Guidelines on non-financial reporting*, op.cit.

156. It will be interesting to see the technical advice required by the European Commission from supervisory authorities (EBA, EIOPA, ESMA – see Glossary, pp. 111-113) on the possible pressures by financial markets for the adoption of a short-term horizon by companies. For more information: <https://bit.ly/2yLp6dG>

6.2. SPECIFIC REMARKS

The taxonomy

One of the key characteristics of the taxonomy is its **approach to definition and classification**: a common language, especially for green finance, is being demanded by investors at large for greater market transparency and is necessary in order to boost the investments in sustainable projects.

Still, most players agree on demanding **more clarifications on the level of completeness and reliability of the data** underlying technical criteria. Besides, it is necessary to elaborate more on the **competences and mandate of the Platform on Sustainable Finance**, the body in charge of supervising the applicability and update of technical criteria.

More focus is also needed on the **quality and effectiveness of the information** available to the players that will use the taxonomy to classify their portfolios: such information, in fact, mostly comes from the statements **provided by companies** and is often considered insufficient or inadequate to meet the needs for analysis of investors. The new guidelines attached to the directive on non-financial disclosure are a useful tool to fix these criticalities.

Since the taxonomy is the foundation of many of the measures proposed by the Action Plan, it is important to **define an appropriate timeline to prioritize the conclusion of the regulatory and technical process for this instrument**. The technical details of the other measures should be defined following the timeline of such process (consultation between the Parliament and the Council of the European Union – see Appendix “The ordinary legislative procedure”, p. 116), so as to optimize the timing, procedures and costs of compliance and not originate legal risks for financial players.

The taxonomy has a technical content; at the same time, it implies a number of **delicate political and economic choices by governments**, on which it is necessary to reach a consensus both domestically and especially in Europe to avoid arbitrage among the different domestic legislations, the objective being to avoid a double-standard reform process, with the Commission and the European institutions being proactive and the domestic governments and financial players being more conservative or viceversa. Complex as this process undoubtedly is, it is nonetheless necessary and it is **crucial to move on fast** but also **allow for adequate time to reach a consensus** on all levels.

Financial players generally appreciate the **transition-centered approach** that allows the taxonomy to promote the economic activities that are already compatible with the Paris Agreement scenarios while, at the same time, incentivizing a lower

environmental impact in high-emission sectors. This rationale has two strengths: in the first place, it tends to include all of the economic activities that are necessary for the functioning of economic and manufacturing systems and in the second place it could facilitate the **“right transition”**, thus contributing towards mitigating and absorbing the potential social tensions that arise from the progressive decline of some sectors.

One of the most debated aspects is the **need to create a taxonomy for social and governance themes**, which will have to be integrated with the taxonomy of environmental activities. Indeed, social themes are also linked to environmental- and climate-related issues: for example, the consequences of stranded assets¹⁵⁷ have an impact in terms of jobs and the local community. Even though the parties did not reach a consensus on the proposal during the parliamentary discussion, it is important for the consultations between the Parliament and the Council of the European Union to also cover the option of extending the scope of the taxonomy to social themes. This position is supported by several trade associations, such as Insurance Europe¹⁵⁸.

It is undoubtedly complex to identify common criteria in an area that can refer to sets of values that differ depending on the geographical and cultural context of individual players: however, far from being an obstacle, this should act as a stimulus to improve the quality of the social variable, that is inherent to SRI. This is also evidenced by the evolution over the years of sustainable and responsible investments.

Another controversial point is whether or not a **mandatory regime** will apply to the taxonomy-based disclosure. At present, the TEG proposal requires that the players that qualify an investment as being environmentally sustainable disclose information on whether and how they have used the criteria set by the taxonomy for such evaluation¹⁵⁹; at the same time, they can refer to and describe alternative methodologies. The theme will have to be further discussed as part of the dialogue between European institutions.

In the event that the consultation ends in favor of the non-mandatory nature of the disclosure according to the European taxonomy, this tool might lose its power as single and common reference for the market, thus diluting any and all differences compared to other classifications currently used. Furthermore, this would complicate the implementation of the measures which may refer to the taxonomy, as the new rules for ESG disclosure which have been approved by the institutions of the European Union (see §2.2.).

157. The expression “stranded asset” is commonly used to refer to the reserves of fossil fuels that cannot be used due to changes in international and domestic laws aimed to limit CO₂ emissions and, in general, the transition to alternative energy sources; as a result, the stocks linked to such reserves are written down in the market, with adverse financial repercussions on the companies of that sector.

158. Insurance Europe 2018, *Insurance Europe comments on the European Commission proposal for a regulation on the establishment of a framework to facilitate sustainable investment*, Position Paper: <https://bit.ly/33hPNF3>

159. TEG 2019, *Using the taxonomy*, op. cit., p. 3.

Sustainability disclosure

In relation to the new regulations on the ESG disclosure requirements for institutional investors, it is worth highlighting the **complexity** for European institutions in **establishing common rules** in the varied and diversified sector of institutional investors, with the risk of distorting the market and originating new risks for some categories or for the players of some countries. Indeed, each category and each domestic market has its specific characteristics, depending on their activities and social and economic context.

The legislative decrees currently in force which transposes IORP II and the Shareholder Rights Directive II into Italian law show to what extent lawmakers and authorities are very much focused on the importance of **ESG themes in the activities of institutional investors**.

As it seems, the texts effectively interpret the convergence of sustainable finance and supplementary pensions, as shown in particular by two aspects:

- the **long-term perspective** of the role and mission of pension funds and as well as of SRI investors;
- the **social sustainability of the role of pension funds**, linked to their responsibility to ensure adequate pensions to workers.

Still, under the legislative decrees currently in force, institutional investors (insurance companies, pension funds and asset managers) need **greater consistency between European and domestic provisions**.

Besides, it seems appropriate to analyze and study **possible solutions to the complexity for Italian pension funds of applying the Shareholder Rights Directive II**: due to the peculiarity of the domestic system, the voting right is rarely exercised and the role of responsible investor mostly translates in delegating the manager.

Over the last two years, the growth of the engagement strategy across Europe and Italy has shown more propensity by institutional investors to influence the sustainability policies of investee companies. Therefore, it is important to encourage **more activism by pension funds as part of this engagement**, mainly in light of their ability to move large volumes of assets.

Green bonds

The Italian market is turning out to be highly receptive to the widespread use of sustainable bonds, in particular green bonds. As part of this, the initiative of the Green Bond Standard (GBS) is conducive to increased market transparency and increased cross-border financial flows.

At the same time, one should **take account of the features of the Italian market** so as to not disincentivize issuance by certain categories of issuers.

For example, the GBS requirement that a third party reports on the use of proceeds might be exceedingly burdensome for a SME (currently, the dedicated

market of the Italian Stock Exchange based on ICMA standards provides for an annual report by the issuer).

Besides, it is crucial to build a **system of adequate incentives to encourage companies** to issue green bonds, in relation to the real environmental impact of the project.

Also, some **public institutions** – like the Ministry of Economy and Finance and regional authorities – **could be major issuers** due to their propensity to invest in the needs and in the emergencies that directly impact the territory (e.g. reforestation and forest maintenance subsequent to extreme weather, so as to both restore damaged areas and support the companies engaged in the social and economic restructuring of the territory).

As suggested by TEG in a dedicated section of the report, the relevant institutions might work out a **set of incentives** for the issuance of green bonds. Interestingly, the TEG proposed to implement the best practice currently in place in a number of Asian markets (e.g., Hong Kong), where the contractual charges relating to the external verifiers are covered by the government¹⁶⁰.

Another proposal could be the introduction of a lower tax rate of green bonds to possibly bring it in line with government bonds; likewise, also the study of a standard for social bonds could be a significant initiative.

Equally important will be the developments of the **working group focusing on the extension of the Ecolabel to retail financial products** led by the European Commission (to be more precise, by DG FISMA (Direction for Financial Stability, Financial Service and the Capital Markets Union) and by some units of the Joint Research Centre (which deals with growth and innovation for DG Environment), in collaboration with the main stakeholders¹⁶¹.

Integrating ESG criteria in investment advice

Importantly, ESG topics will have to be adopted by investment advisors through the **integration** of existing regulations: a stratification of rules would generate too much complexity and accordingly too little clarity. Besides, it would be important to start **simplifying existing regulations**, especially as regards the relationship between first and second tier regulations.

Adequate **training of financial, insurance and pension advisors** will be key:

- in order to coach those clients who lack the knowledge or sensitivity and provide in-depth knowledge to the clients who already know and are sensitive to ESG and who wish to dig deeper with the support of financial advisors;
- in order to be more proactive in proposing ESG products;
- in order to assist clients in filling out the profiling questionnaire with ESG criteria;

160. TEG 2019, *Report on EU Green Bond Standard*, op. cit., p. 43.

161. For a focus on this, see Box "EU Ecolabel for Financial Products", p. 87.

- in order to be able to find the appropriate combination of investment objectives and clients' ESG preferences.

To this end, it might be useful **to introduce ESG competences in training courses** for onboarding advisors.

Finally, it might be useful to **lower taxes** on SRI products for both issuers and investors. These incentives will have to ensure symmetry and balance in the market activities of financial players.

Appendix



APPENDIX

I. THE EUROPEAN UNION AND SUSTAINABLE FINANCE – GLOSSARY

A

Action Plan: Financing Sustainable Growth (European Commission)

Published on March 8, 2018, it illustrates the measures that the European Commission intends to take to steer the capital market towards a sustainable and inclusive development model, in line with the commitments undertaken as part of the Paris Agreement on climate.

These measures aim to:

- steer capital flows towards sustainable investments;
- manage more effectively the financial risks that arise out of climate change, resource consumption, environmental blight and social inequalities;
- improve transparency and encourage a long-term approach of economic and financial activities.

C

Capital Markets Union

It is a project of the European Commission to mobilize capitals in Europe by providing increased support to companies, the goal being that of making more capital and sources of funds available to European companies, including SMEs. The proposal was made in July 2014 by the then President of the European Commission, Jean-Claude Juncker; in 2015 the Commission developed an Action Plan for a Capital Markets Union so as to create a single capital market comprising all of the 28 Member States by the end of 2019.

COREPER – Committee of permanent representatives

It is responsible for setting up the proceedings of the Council of the European Union. In particular, it prepares the dossiers to be transacted by the Council (proposals and bills submitted by the Commission). It is comprised of the representatives of member countries qualifying as ambassadors to the European Union.

Council of the European Union

The Council of the European Union is the main decision-making body of the European Union alongside the Parliament.

The Council has no permanent members and holds ten different types of meetings depending on the sector discussed. Within the Council, the ministers of the governments of each member country meet to discuss, modify and

adopt the laws and coordinate policies.

The main tasks of the Council are: negotiate and adopt the laws of the Union; coordinate the policies of member countries; work out foreign and security policies; sign agreements between the European Union and the other countries or international organizations and approve the annual accounts together with the Parliament.

Its offices are in Brussels.

Official website: <https://www.consilium.europa.eu/it/>

D

Delegated acts

Issued by the European Commission, to update a set of rules in order to reflect the developments of the sector regulated thereby. The European Commission is delegated via the legislative act that sets out its objectives, contents, scope and timeline. The power of the Commission is limited as follows:

- the delegated act cannot modify the essential elements of the regulation;
- the Parliament and the Council can revoke the delegation or raise objections in relation to the delegated act.

Directive

It is a legislative act that establishes an objective that all of the Member States of the European Union must achieve; individual member countries define how such objectives must be achieved and they do so through domestic regulations.

IDD (Insurance Distribution Directive)

Directive 2016/97 – Transposed in Italy with Legislative Decree 68/2018

This Directive regulates the distribution of insurance products by intermediaries and insurance companies. Like MiFID II, IDD aims to increase transparency and protection for those who buy insurance investment products: it makes more stringent the obligations of integrity of those who wish to promote a product; simplifies and standardizes information for investors.

IORP II (Institutions for Occupational Retirement Provision Directive)

Directive 2016/2341 – Transposed in Italy by Legislative Decree 147/2018

This Directive applies to company or professional pension funds, which are required to disclose whether they integrate ESG criteria in their investment choices and how they integrate such criteria in risk management systems. In particular, it refers to the integration of ESG in: governance; investment policies; risk assessment and management; disclosure to existing and prospective members.

In the event that pension funds do not adopt ESG criteria, they are nonetheless required to give reasons on a “comply or explain” basis.

MiFID II (Markets in Financial Instruments Directive)

Directive 2014/65 – Transposed in Italy by Legislative 129/2017

MiFID II entered into force on January 3, 2018 to update the previous version (MiFID). It governs European financial markets and services with a view to increasing investor protection and improving the efficiency, resiliency and transparency of financial markets. Its main focus is on the relationship between financial players and clients, emphasizing product transparency and governance, i.e. the obligations of the providers and distributors of financial products.

Non-Financial Disclosure (Directive)

Directive 2014/95 – Transposed in Italy by Legislative Decree 254/2016

Under this Directive, companies are required to disclose information on:

- policies adopted and achievements in relation to environmental and social matters;
- personnel, respect of human rights and (active and passive) fight against corruption.

The companies that do not have in place specific policies in one or more of the areas mentioned by the directive are required to give reasons on a “comply or explain” basis.

The directive covers large corporations and corporations of public interest, with a headcount of at least 5,000 employees (e.g., listed companies, banks, insurance companies).

Shareholder Rights II (Directive on encouraging long-term shareholders engagement)

Directive 2017/828 – Transposed in Italy by Legislative Decree 49/2019

The Shareholder Rights II Directive entered into force on June 10, 2019 and modified the previous version of the regulation: the revised version sets forth a new approach by the European Union to the corporate governance of listed companies. It mainly aims to encourage the long-term engagement of shareholders and requires transparency and disclosure as to how investees are monitored in terms of ESG.

E

EBA – European Banking Authority

The European Banking Authority is one of the three European supervisory authorities established in 2011 in order to protect the stability of the European financial system.

It is tasked with supervising the European Union banking sector, helping establish and implement a single set of regulatory and supervisory rules for all member countries. The goal is to create a single efficient, transparent and stable market for the banking products of the European Union. Amongst other things, the EBA is tasked with protecting depositors, investors and consumers; ensure the transparency of financial markets and products; strengthen international coordination of supervision in order to ensure a harmonized application of prudential rules and equal conditions; act as mediator in the controversies among multiple countries.

Official website: <https://eba.europa.eu/>

ECON – Economic and Monetary Affairs Commission

It is one of the permanent commissions of the European Parliament. It deals with issues relating the economic and monetary policies of the European Union; it has authority on the free circulation of capitals and payments and on issues relating to the international monetary and financial system. It takes action on issues relating to competition rules and State or public aids, tax provisions, regulations and supervision of services, financial institutions and markets, including financial disclosure, audit of accounts, corporate governance and other corporate law issues specific to financial services.

EIB – European Investment Bank

This is the credit institution of the European Union, responsible for funding those projects that help achieve the political goals of the Union, both domestically and beyond the borders of the Member States, by supporting the economy, adding jobs and encouraging equality.

Currently, the EIB is the main issuer of green bonds, with €23.5 billion raised at December 31, 2018. It is headquartered in Luxembourg.

Official website: <https://www.eib.org>

EIOPA – European Insurance and Occupational Pensions Authority

The European Insurance and Occupational Pensions Authority is one of the three European authorities for financial supervision established in 2011 in order to protect the stability of the European financial system.

It supervises the activity of insurers, reinsurers and insurance brokers as well as company and occupational pension funds by dealing with issues related to governance, audit of accounts and financial disclosure.

Besides ensuring the stability of the financial system and assessing the risks of the above-mentioned areas, EIOPA supervises the transparency of financial markets and (insurance and pension) products and ensures the protection of the insured, members and beneficiaries of pension schemes.

Official website: <https://eiopa.europa.eu/>

ESMA – European Securities and Markets Authority

The European Securities and Markets Authority is one of the three European financial supervision authorities established in 2011 in view of protecting the stability of the European financial system.

It is tasked with protecting investors and promoting the stability and orderly functioning of the financial markets.

ESMA pursues such objectives through four activities:

1. assessment of risks for investors, markets and financial stability;
2. creation of a single set of rules for European financial markets;
3. promotion of standardized supervision rules;
4. direct supervision of credit rating agencies and trade repository.

Official website: <https://www.esma.europa.eu/>

European Commission

The European Commission is the executive body of the European Union and is politically independent from Member States. It is tasked, amongst other things, with developing and translating the general political objectives of the Union into policies and initiatives; allocate funds; ensure compliance with the European laws and represent the Union in international relations.

The Commission is comprised of 28 commissioners (one for each member country) chaired by a President.

Its offices are in Brussels.

Official website: <https://ec.europa.eu/>

European Parliament

The European Parliament is the legislative body of the European Union.

The Members of Parliament are elected by European citizens every five years in proportion to the population of each country. Within the European Parliament, though, parliamentary groups are organized based on the political party they belong to rather than nationality.

The Parliament has three main functions:

- legislative (in collaboration with the Council), whereby it passes the laws of the European Union, decides on international agreements and new members;
- supervision, whereby it exercises democratic control on all Community institutions (e.g., it elects the president of the Commission, approves the accounts, reviews citizens' petitions, discusses monetary policy with the ECB);
- accounts (in collaboration with the Council), whereby it has the power to decide on the annual accounts of the European Union in their entirety.

The proceedings of the Parliament fall in two main phases: 1) parliamentary commissions work out a draft relating to their position on the legislative

proposals; 2) drafts are voted in the plenary session and are the official proceedings of the Parliament.

It seats in Brussels, Strasbourg and Luxembourg.

Official website: <http://www.europarl.europa.eu/>

Eurosif – European Sustainable Investment Forum

European organization that encourages the sustainability on financial markets. It is a tier-two association, which federates national Sustainable Investment Forums (SIFs) and other entities interested in integrating sustainability criteria in investments. One of the main activities of Eurosif is the development of the European SRI Study, the biennial piece of research on sustainable finance in Europe, conducted in collaboration with national SIFs.

Official website: <http://www.eurosif.org/>

H

HLEG – High-Level Expert Group on Sustainable Finance

Set up by the European Commission in December 2016 with the task of developing guidelines for sustainable finance in Europe. The working group was comprised of representatives of the financial industry, the academia and the civil society, alongside observers from European institutions and international bodies.

In January 2018, the HLEG published a report with recommendations for the European Commission, as part of the drafting of the Action Plan on sustainable finance.

O

Opinion

This is a non-binding tool enabling European institutions to express their position without imposing any legal obligation.

R

Recommendation

Through recommendations, which are not binding, European institutions disclose their position and issue guidance without imposing legally binding obligations.

Regulation

Regulations are binding and each and every one of their components applies to the members of the European Union.

TEG – EU Technical Expert Group on Sustainable Finance

It was established by the European Commission in order to support the latter in the implementation of the Action Plan for financing sustainable growth, by studying in depth:

- the taxonomy of environmentally sustainable economic activities;
- how to improve the guidelines on climate change disclosure by banks, insurers and other big business;
- common criteria for the construction of low-carbon benchmarks and positive carbon impact and ESG disclosure requirements for all benchmarks;
- the Green Bond Standard.

TEG members come from the civil society, the academia and finance as well as from European and international public bodies.

II. THE ORDINARY LEGISLATIVE PROCEDURE OF THE EUROPEAN UNION

The ordinary legislative procedure is the process whereby the European Union laws are passed. It involves the Commission, the Parliament and the Council. It is governed by Article 294 of the Treaty on the Functioning of the European Union (TFUE).

The process is initiated when the **Commission** submits a proposal and sends it to the Parliament and to the Council; whereupon, a chain of four phases starts:

Phase 1 – first reading

The **Parliament** drafts its position on the proposal, in which it can propose amendments, and sends it to the Council. Where the Council accepts it, it is adopted; where the **Council** intends to propose further amendments, it adopts its position and sends it to the Parliament.

Phase 2 – second reading

Where, within six months, the **Parliament**:

- approves the Council's proposal or fails to do so, the act is adopted (based on a text that matches the position of the Council during the first reading);
- rejects the Council's position, the proposal is not adopted;
- proposes amendments through a second draft and sends it to the Council.

Within three months, the Council may:

- approve all of the amendments, in which case the act is adopted;
- fail to approve all of the amendments, in which case within six weeks a conciliation Committee is convened.

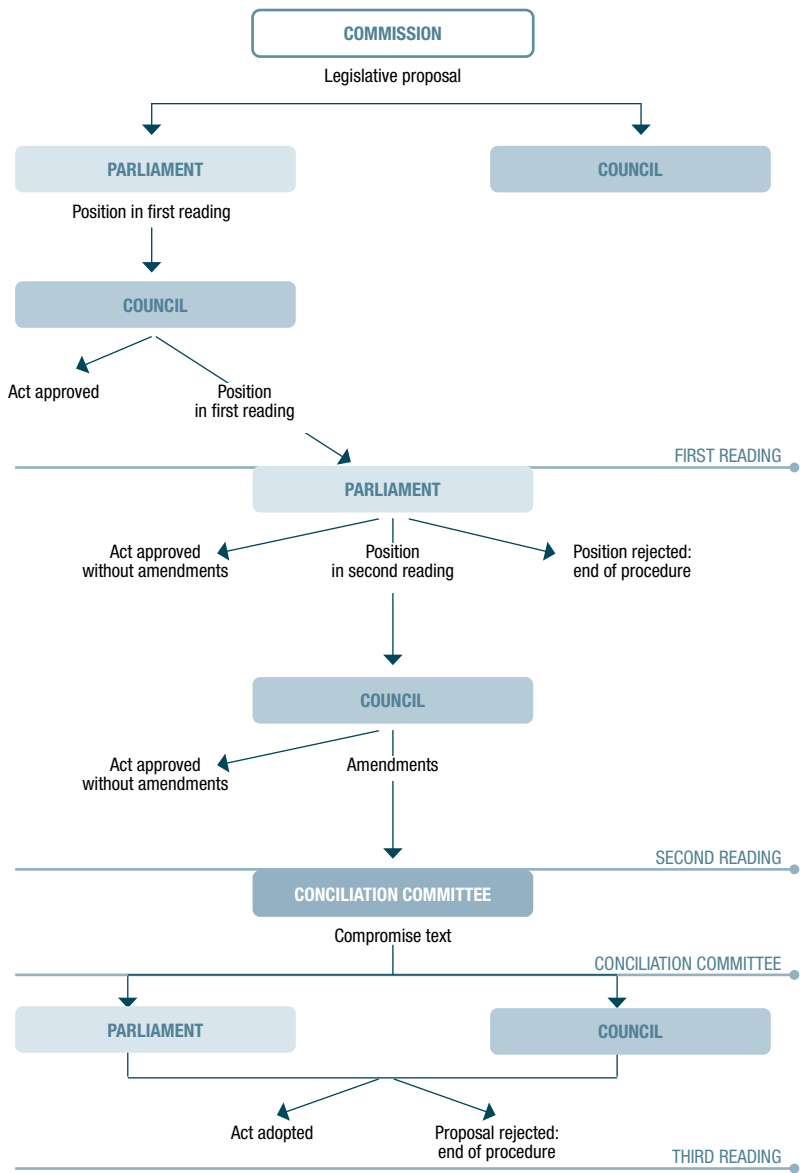
Phase 3 – conciliation

The **Conciliation committee**, comprised of the members of the Council and of the Parliament, is tasked with drafting a compromise text within six weeks of the date in which it was called upon to do it; where it fails to agree on the draft by this deadline, it is not adopted.

Phase 4 – third reading

In the event that the Committee drafts the compromise text, the **Parliament** and the **Council** have six weeks to approve it: where both are in favor, it is adopted; failing the approval of either, it is not adopted and this ends the procedure¹⁶².

FIGURE 17. The ordinary legislative procedure of the European Union



Source: Italian Sustainable Investment Forum

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Forum per la Finanza Sostenibile

ITALIAN SUSTAINABLE INVESTMENT FORUM

The Italian Sustainable Investment Forum (ItaSIF) is a not for profit association founded in 2001. Its membership base is multi-stakeholder: its

members are financial actors and other organizations interested in the environmental and social impacts of financial activities.

ItaSIF mission is to promote the awareness and the strategies linked to sustainable investments, with the aim to encourage the integration of environmental, social and governance criteria into financial products and processes.

ItaSIF activities are divided into three main areas: research, projects and advocacy.

Within these sectors ItaSIF:

- runs research and education activities and facilitates working groups to promote best practice and contribute to the analysis and growth of sustainable investments;
- informs and advises the financial community, the media and society as a whole, on sustainable finance through the organisation of communication campaigns, conferences, seminars and cultural events;
- engages with Italian and European institutions to encourage the implementation of a regulatory framework promoting sustainable investments.

Since 2012, ItaSIF has organized the Italian SRI Week, one of the leading initiatives in Italy on sustainable and responsible investment.

ItaSIF is a member of Eurosif, the association for the promotion of sustainable investment in the European market.



Associazione
Bancaria
Italiana

ABI

The Italian Banking Association - ABI - is a voluntary non-profit organization. Its purpose is to represent, defend and promote

the interests of its member banks and financial intermediaries. It works, in this framework, for the development of the awareness in society and within the banking and financial system of the social and behavioral values that follow from entrepreneurial principles and from the formation of open and competitive markets. Specifically, ABI undertakes initiatives for the orderly, stable and efficient growth of the banking and financial system, in a competitive outlook consistent with Italian and European Union law.



ASSOGESTIONI

associazione del risparmio gestito

ASSOGESTIONI

Assogestioni is the representative association of the Italian investment management industry. The association's

main purpose is to foster the growth of the investment management industry in Italy by contributing to the strengthening of the regulatory framework and the efficiency of financial markets.

Assogestioni is committed to encouraging sustainable investing. Indeed, the Italian investment management industry acknowledges the importance of integrating environmental, social and governance issues into financial institutions' business processes and investment decisions and works towards the transition to a more sustainable and low carbon economy.

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