



What the EU Action Plan means for Swiss financial market participants

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Introduction

Sustainable finance and the European Green Deal

A major transition to a more sustainable, low-carbon, resource-efficient circular economy is key for the long-term competitiveness of our economy.

This idea is also the foundation for the vision of the European Green Deal¹. When introducing the European Green Deal, European Commission President Ursula von der Leyen announced:

“

The European Green Deal is our new growth strategy – for a growth that gives back more than it takes away. It shows how to transform our way of living and working, of producing and consuming [...]

Ursula von der Leyen

European Commission President

The necessity to act, transform and proceed with implementing the transition to a climate neutral economy by 2050 requires unusual speed for policymakers; this rapid pace has not been seriously questioned even under very disruptive COVID-19 circumstances.

The large-scale transformation project requires financing not only from the public but also the private sector. Asset managers and owners play a vital role in raising funding for clean technologies and making the economy more resilient towards sustainability risks. In this context the European Commission released the action plan for financing sustainable growth on 7 March 2018 (“EU Action Plan”). The EU Action Plan encompasses far-reaching future regulation of sustainable finance.

This brochure summarizes the main legislative actions impacting asset managers in Europe, including Switzerland. We believe that implementing the regulations should not be perceived as a pure regulatory exercise. It also requires a strategic positioning of asset managers in

relation to the increasing importance and expectations of sustainability for various stakeholders (e.g. institutional clients or the “Fridays for Future” generation).

Swiss developments

Switzerland is a key global player in wealth and asset management, and it has also been a relevant ESG innovation driver in the past decades. The market study reports² of the Swiss Sustainable Finance Institute published together with the Center for Sustainable Finance & Private Wealth of the University of Zurich show double-digit growth in the use of ESG approaches in the last few years. This is caused by mainly institutional but also private investor demand. A large share of this market refers to products integrating ESG risk concepts, which may not qualify as sustainable investments according to the new conditions introduced by the EU Action Plan.

The Swiss Federal Council issued “Sustainability in Switzerland’s financial sector” in June 2020. This report was prepared by a

¹ www.ec.europa.eu/commission

² www.sustainablefinance.ch/en/swiss-sustainable-investment-market-study-2020



cross-departmental working group headed by the State Secretariat for International Finance (SIF), in close cooperation with the Federal Office for the Environment and other authorities. It highlights sustainable finance as a great opportunity for the Swiss financial center and recognizes the need for further efforts to safeguard the competitiveness of the Swiss financial center internationally. The aim is to make Switzerland a leading location for sustainable finance. Major relevant players, e.g., Swiss Bankers Association (SBA), Swiss Funds & Asset Management Association (SFAMA) and Swiss Insurance Association (SIA) as well as Swiss Sustainable Finance (SSF) and the Swiss Financial Market Authority (FINMA) have indicated that they welcome this goal. The question is how to achieve it given that the European regulator is pushing ESG business model enhancements that include:

- ▶ Applying sustainability risk integration on all financial products and into the whole risk governance
- ▶ Clearly carving out impact in a measurable way

- ▶ Providing transparency about the investment footprint along with clear expectations on active ownership and engagement

On the Swiss regulatory side, the focus is on the real economy and the potential effects of the proposed revision of the CO₂ Act. Furthermore, the referendum in November 2020 on the Responsible Business Initiative could have potential regulatory impacts for Swiss financial market participants in the areas of human and environmental rights abuses. The acceptance of the counterproposal of the Federal Council could influence future non-financial sustainability reporting duties of the Swiss entities above 500 FTE. Otherwise eyes are on FINMA who joined the Network for Greening the Financial System (NGFS) together with the Swiss National Bank (SNB) last year. This network of international central banks and supervisors is committed to better understanding and managing the financial risks of climate change. Many international regulators have communicated explicit expectations in this regard. For the time being FINMA has been less concrete but, in its Risk Monitor 2019, it identified

climate change as one of the most important long-term risks and will be influenced by the NGFS as a standard setter for regulatory authorities. The Federal Council's policy on a sustainable financial sector is based on the principle of the subsidiarity of state action and the primacy of market solutions. Guidance papers recently issued by the SBA, SFAMA and SSF in summer 2020 follow the tradition of providing non-binding standards. Therefore, there is a risk that not all market players will follow these basic recommendations and become sustainable finance latecomers when compared to their European peers. Digital business ideas developed in Switzerland will be key in order to position the country as an innovation hub and to take advantage of the opportunities presented by this positioning. Switzerland is well positioned to do so and may be able to grasp a share of the green FinTech market as it is home to a growing FinTech ecosystem with a long-standing history of wealth and asset management. Given the rapid pace of EU regulatory developments, ESG market players should not expect that leading today will necessarily mean leading tomorrow.

EU Action Plan

Overview

The EU Action Plan is based on 10 recommendations from the High-Level Expert Group on Sustainable Finance, composed of policy leaders from the finance sector, civil society and academia. The measures stemming from the EU Action Plan are, to date, the broadest and most comprehensive regulatory initiatives developed in the area of sustainable finance. The EU Action Plan lays out a roadmap for future work in the area of sustainable finance and sets the first key deadlines for March 2021. The 10 key action points were used to formulate 22 objectives, which in turn have informed 28 legislative and non-legislative initiatives.

The ultimate aims of the EU Action Plan are to reorient capital flows towards a more sustainable economy, foster long-termism and manage the increasing importance of sustainability risks as outlined in 10 key action points:



Reorienting capital flows towards a more sustainable economy

1. Establishing an EU classification system for sustainable activities (see Taxonomy)
2. Creating standards and labels for green financial products
3. Fostering investment in sustainable projects
4. Incorporating sustainability when providing financial advice (see amendments to MiFID II and IDD)
5. Developing sustainability benchmark

Mainstreaming sustainability into risk management

6. Better integrating sustainability in ratings and market research
7. Clarifying institutional investors' and asset managers' duties (see Disclosure Regulation and amendments to UCITS/AIFMD)
8. Incorporating sustainability in prudential requirements

Fostering transparency and long-termism

9. Strengthening sustainability disclosure and accounting rule-making
10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

The EU is the first regulator to establish a taxonomy but will not be the last. Other regulators are currently investigating how best to leverage the work that has been done on the EU Taxonomy. Therefore, the NGFS is working towards coordinating globally consistent taxonomies.

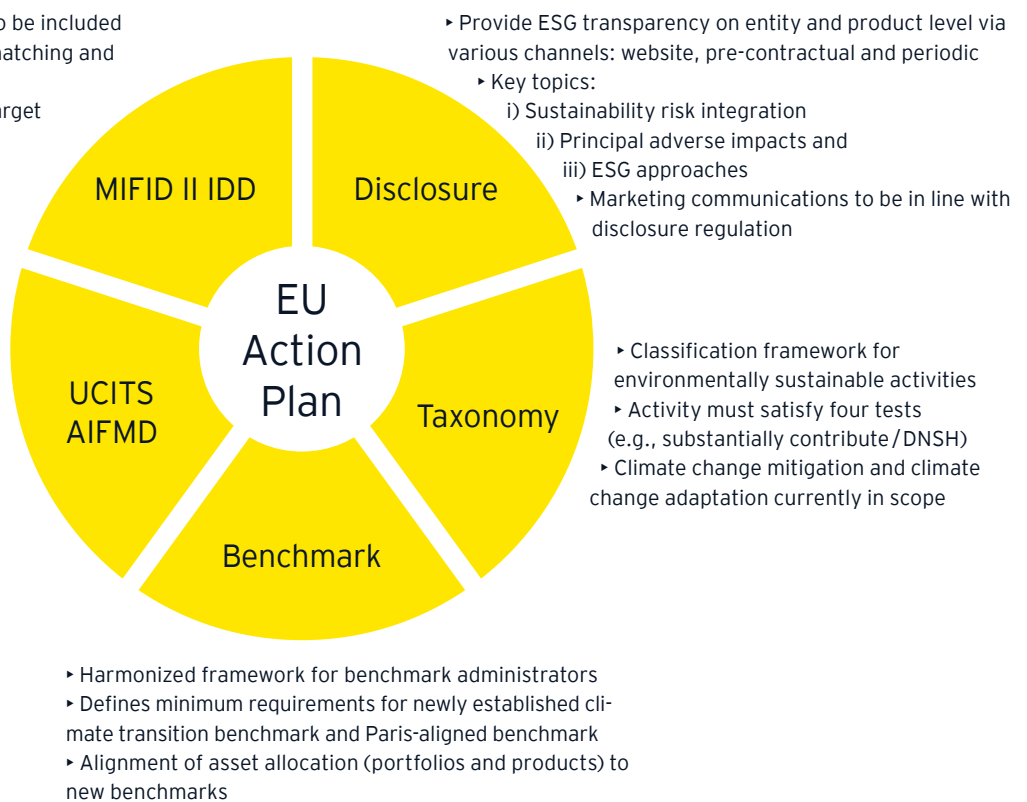
EU Action Plan

Legislative initiatives

The main legislative proposals refer to two new regulations (Taxonomy Regulation, Disclosure Regulation) and various existing regulations to be amended (e.g., MiFID II, IDD, UCITS, AIFMD, Benchmark Regulation). The core legislative proposals are summarized below and will be further described in section 3.

- ▶ Client's sustainability preferences to be included in advisory processes (onboarding, matching and reporting)
- ▶ Product governance - definition of target markets with regard to sustainability preferences

- ▶ Incorporation of sustainability risks into the investment process and overall risk governance
- ▶ Perform ESG/climate-risk scenario analysis to take into account future ESG/climate-related risks



The legislative initiatives summarized in this brochure are not exhaustive. Further initiatives such as the amendment of the Capital Requirements Directive, Solvency II and Institutions for Occupational Retirement Provision Directive II are due. The European Commission also committed to review the Non-Financial Reporting Directive (NFRD) as part of its strategy to strengthen the foundations for sustainable investment. Therefore, in February 2020, it launched a public consultation on the review of the NFRD which is relevant for both large financial and non-financial undertakings.

Non-legislative initiatives

One of the main non-legislative initiatives relates to the EU Green Bond Standard. In June 2019, the EU Technical Expert Group on Sustainable Finance (TEG) published its report and proposed the creation of a voluntary EU Green Bond Standard to enhance the effectiveness, transparency, comparability and credibility of the green bond market and to encourage market participants to issue and invest in EU Green Bonds. Further, in March 2020, the TEG published a usability guide for the EU Green Bond Standard. This led the European Commission to

explore the possibility of a legislative initiative for an EU Green Bond Standard in relation to its renewed sustainable finance strategy.

Another relevant initiative is the EU Ecolabel for Financial Products. The European Commission envisaged a voluntary EU-wide labeling scheme for sustainable financial products in order to avoid the use of multiple, overlapping or contradictory labeling practices within the EU. The Ecolabel will define the minimum environmental performance criteria of a product

group in order to qualify for the label and pursues the goal of recognizing the best environmentally performing financial products. It will be based on and build upon the EU Ecolabel Regulation 66/2010 requirements.

Other non-legislative initiatives (non-exhaustive) include the TEG Taxonomy Technical Report, the ESMA Final Report: Suitability Requirements, and the TEG Report on Benchmarks.

Relevance for Swiss entities

While the legal initiatives of the EU Action Plan relate directly to entities in the EU, they also have an indirect impact on entities outside of the EU, especially those wishing to manufacture or sell financial products to EU clients. None of the EU Action Plan regulations provide for harmonized third-country access, and various activity triggers apply. Swiss asset managers should be careful when promoting ESG under the new strict marketing regime in Europe.

Essentially, the EU Action Plan applies to all EEA-based financial market participants and financial advisors. Typically, funds are introduced in the EEA market before they are repatriated to Switzerland. In such situations the EU Action Plan also applies directly. In other set-ups the direct exposure of Swiss entities depends on triggers like the management of EEA funds and the active distribution of financial products in the EEA.

Depending on an institution's ESG ambitions, their clients' expectations or their regulatory obligations, there may also be indirect impacts. Finally, it must be considered that, with the EU Action Plan, the EU acts as a global industry standard setter whether or not these standards become mandatory in Switzerland.



Key legislative initiatives

Providing ESG transparency (Disclosure Regulation)

Background and developments

The EU Regulation on sustainability related disclosures in the financial services sector (Disclosure Regulation or SFDR) entered into force in December 2019. As certain key provisions have to be implemented by 10 March 2021, these should be tackled first in any current EU Action Plan projects. The Disclosure Regulation is supplemented with further details in regulatory technical standards (RTS) that have been developed by the three European Supervisory Authorities (ESAs), i.e., the EBA, EIOPA and ESMA. In April 2020, the ESAs issued a consultation regarding their proposed draft RTS about content, methodologies and presentation of disclosures. The consultation ran until 1 September 2020, leaving little time to implement the provisions once they are finalized. There remains the possibility of “no-action letters” for the regulators to avoid enforcement of provisions from day one; however, as there is no official confirmation that this will be the case,

the running projects will need to work against this deadline.

Main requirements

The Disclosure Regulation contains ESG-specific transparency requirements to be disclosed to (potential) investors via various channels, i.e. website, pre-contractual documents (e.g. prospectus), periodic reports. The transparency requirements contain disclosure obligations on an entity and product level and apply to entities manufacturing financial products (Financial Market Participants) or providing investment or insurance advice (Financial Advisors). Financial Market Participants include fund managers, insurance-based investment product providers, pension product providers and institutions providing portfolio management (discretionary mandates) so, broadly speaking, any type of asset manager.

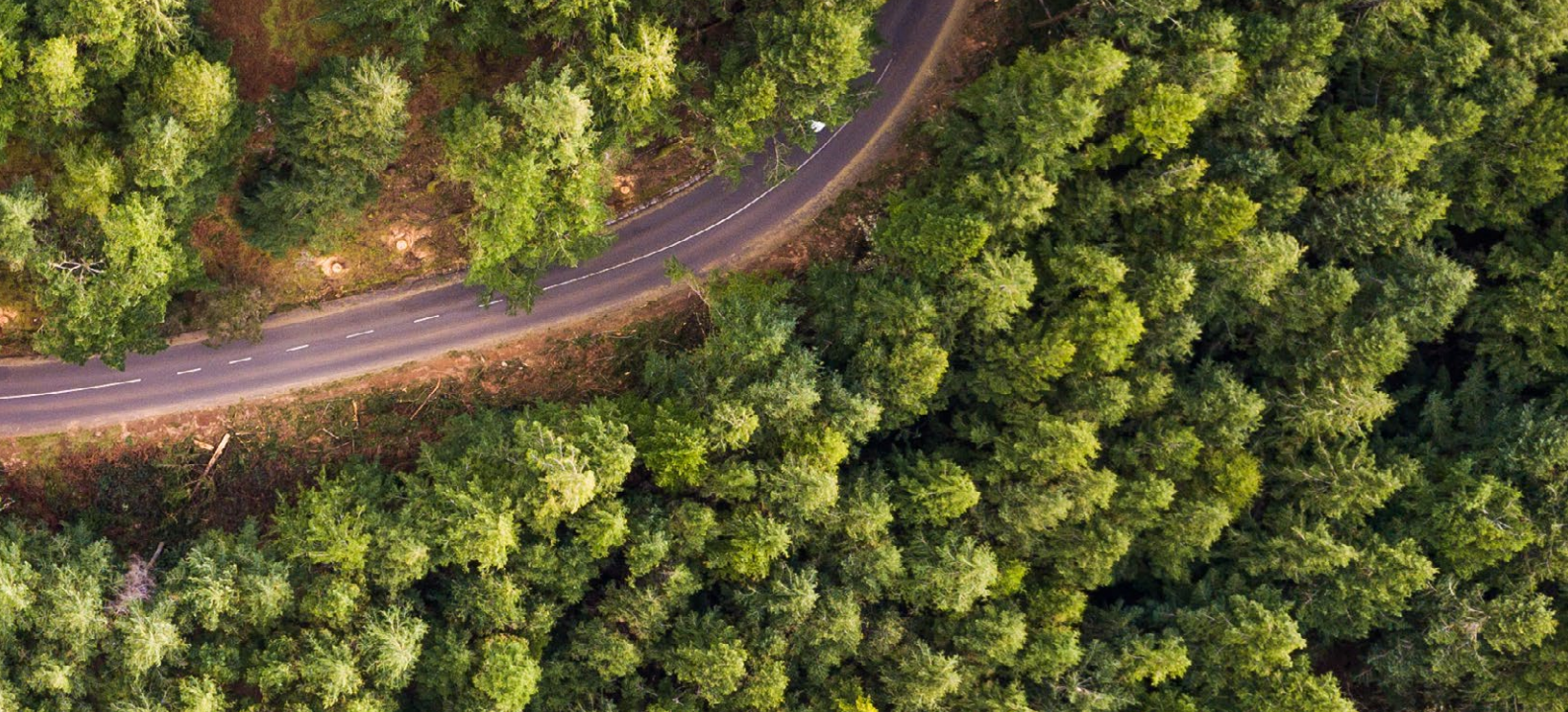
The disclosures to be made require a strategic positioning of all asset

managers regarding their sustainable finance approaches as they will have to be transparent about the following three topics:

- ▶ Sustainability risks
- ▶ Principle adverse impacts (PAI), and
- ▶ ESG approach positioning

Financial materiality of sustainability risks

In order to act in the best interests of their clients, Financial Market Participants and Financial Advisors should assess the likely impacts of sustainability risks on the financial return of financial products in a systematic way (i.e. integrate it in their due diligence and research processes on a mandatory basis). The EU regulator expects asset managers to assess sustainability risks continuously and apply this on a best effort basis to all asset classes. The proper management of sustainability risks becomes even more important with the increasing risks related to climate change. Therefore, over time



sustainability risk integration can be expected to become the new normal in the EEA asset management market. The Disclosure Regulation provides for the option to explain why sustainability risks are not relevant and do not need to be considered (comply or explain). However, in most cases this would not be a prudent approach and may be a breach of fiduciary duties of asset managers. Not considering risks related to climate change, for example, does not seem to be an option given the effects of climate change that we are already experiencing.

Principal adverse impacts (PAI) - footprint / active ownership and engagement

The Disclosure Regulation also requires asset managers to disclose on a “comply or explain” basis their policies regarding the consideration of principal adverse impacts (PAI) of investment decisions on sustainability factors. In a PAI statement they should describe their due diligence policies regarding PAI and provide summaries

of their engagement policies and how they discharge their stewardship responsibilities regarding the negative impact or footprint of their investments. Qualitative (narrative) disclosures should also include references to compliance with business conduct rules and international standards, e.g., Task Force on Climate-related Financial Disclosures (TCFD), Principles for Responsible Investment (PRI) and Principles for Responsible Banking (PRB).

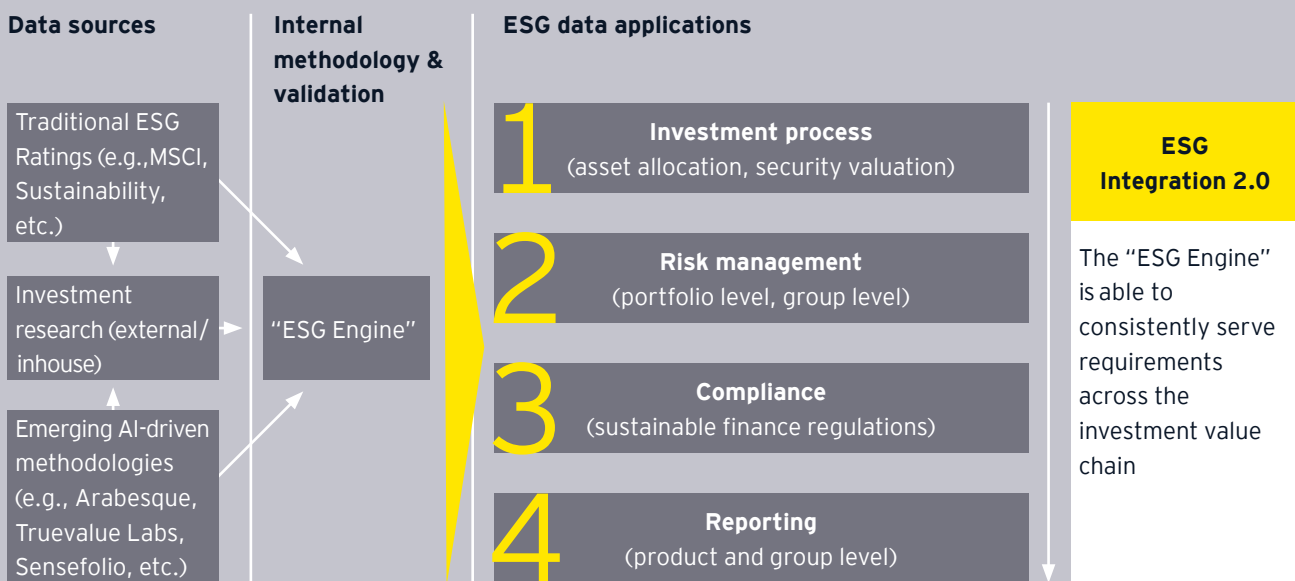
The draft RTS proposes a very granular template-based description of the PAI based on up to 50 quantitative key performance indicators (KPIs). Of these, 32 are mandatory and the remainder are optional. Asset managers would face real challenges to obtain all relevant ESG data across all financial products. It remains to be seen in Q4 2020 whether the pushback from the asset management industry to this draft RTS proposal will have an effect and whether full transparency will nevertheless need to be provided. At this point in time we assume, due to

the generally increased ESG data need, that a large part of the quantitative KPIs will remain, especially those related to environmental data as well as the general aim to link PAI to measurable KPIs.

Asset managers with more than 500 employees as a parent of a group will be required to publish a PAI statement on an entity level from 30 June 2021. Others below this threshold may choose not to comply. This non-compliance must be made transparent on the website and should include a statement that the entity does not consider PAI (their investment footprint) along with a clear explanation why it chooses not to do so. It will be a strategic decision whether asset managers choose to opt in on an entity level or to issue such a statement, with key decisive factors being the sustainability ambition of an entity and/or pressure from their various stakeholders. By 30 December 2022 this decision will have to be made on a product level as well.

Challenge: Data quality and availability

Demand for ESG data is rapidly moving beyond the core area of investment research and portfolio management. Financial market participants are increasingly pressed to develop an integrated ESG architecture that can serve multiple requirements across the investment value chain - incorporating investment, risk management, compliance and reporting and that should also include data sets allowing a forward-looking scenario analysis for long-term climate related risks.



ESG approach positioning – positive impact (if any)

The ESG market includes a broad variety of ESG approaches (e.g., exclusions, norms-based-screening, best-in-class, ESG integration, thematic and impact related approaches). While not all of them necessarily lead to a positive ESG contribution or exclude unsustainable companies, the main rationale for providing transparency about the underlying ESG approaches is to prevent misleading the investor and, therefore, also reduce the prevalence of “greenwashing”. This aligns with the new strict marketing regime of the EU Action Plan, where promotion of ESG will only come at the price of transparency (and underlying internal ESG governance and processes).

The concrete disclosures required, as well as their form, channel and periodicity, depend on the type of product and some special features (e.g., use of an index or carbon emission reduction objective). It is therefore crucially important to classify the different types of products (product by product). Currently, debate about the exact lines between the different product categories has not yet been concluded. Considering the tight deadlines in March 2021, the finalization of the draft RTS due in Q1 2021 will hardly leave enough time to implement if entities are not prepared.

The Disclosure Regulation makes a clear distinction between financial products that have sustainable investments as their objective (SFDR Art. 9 products) and financial products that promote, among other characteristics, environmental or social characteristics (SFDR Art. 8 products). The ESAs draft SFDR RTS diluted this concept somewhat with

the introduction of a mixed type of SFDR Art. 8 product where only part of the investment is sustainable. In addition, the ESAs proposed that any sustainable investment must satisfy the Do No Significant Harm (DNSH) test by referring to the adverse impact indicators developed in the draft RTS.

There is also no clear line drawn between the two types of ESG products (SFDR Art. 8 and 9 products) and other financial products. The ESAs suggest in their RTS that the promotion of ESG should be limited in some way and that the industry should not “over disclose” on ESG. For this reason, they have come up with a vague concept that only products with underlying assets based on “binding” selection criteria should be promotable as ESG products (e.g., SFDR Art. 8 or 9 products). The French regulator AMF has taken a slightly different approach and asks for percentage limitations of the investment universe and a minimum percentage of assets to be screened according to the methodology if ESG is made a key part of communication (e.g., in the KIID or marketing material). The outcome of this debate will be highly relevant to position the financial products accordingly. Even if the SFDR Art. 8 category should end up being a catch-all category (also including pure sustainability risk integration approaches), we still believe ESG should be used more cautiously as a marketing factor since the reputational risk of greenwashing exists independent of the concrete underlying regulation.

Strict marketing regime

In accordance with the new regime introduced by the SFDR, asset managers must review their marketing materials, pre-contractual (e.g., prospectus) and website disclosures in respect of the three topics summarized above that will be applicable after 10 March 2021. In addition, they will also need to implement product and marketing approval and maintenance processes to continuously monitor compliance with these disclosure requirements.



Measuring the greenness of economic activities (Taxonomy)

Background and developments

The EU Taxonomy is intended to be a common harmonized tool for understanding when an economic activity is considered “environmentally sustainable” or “green”. It sets measurable performance thresholds (technical screening criteria) for economic activities that:

- ▶ Make a substantial contribution to one of six environmental objectives
- ▶ Do not significantly harm (DNSH) the other five environmental objectives
- ▶ Meet minimum safeguards (e.g., OECD Guidelines on Multinational Enterprises)
- ▶ Meet the technical screening criteria defined in delegated acts by the European Commission

The EU Taxonomy is the framework regulation of the EU Action Plan and is a tool with various use cases. It can be used to:

- ▶ Measure the degree of environmental sustainability of an investment
- ▶ Support active ownership efforts
- ▶ Identify growth opportunities
- ▶ Help investors plan and report on their transition

Overall, the taxonomy acts as a European Green Deal policy tool to incentivize the ultimate goal of the EU Action Plan, i.e., to build a net zero, resilient and environmentally sustainable economy.

The EU Taxonomy will be supplemented by delegated acts that contain detailed technical screening criteria for determining when economic activities can be considered environmentally sustainable. In this regard, the TEG was established and mandated to develop technical screening criteria for the environmental objectives of climate change mitigation and adaptation, as a first step. The mandate to further and consistently develop the EU Taxonomy and to expand the current scope of economic sectors will be taken over by the Platform on sustainable finance. The first set of technical screening criteria have been developed for the agriculture, manufacturing, energy, transport, water, waste, ICT and building sectors. However, the EU Taxonomy must be developed further and more sectors will follow. These criteria already address green activities as well as similarly important transition activities. There are also certain review clauses whereby the European Commission is permitted

to extend the EU Taxonomy, e.g., to include ways of identifying substantial contributions to social objectives in addition to the minimum safeguards, or to include performance criteria for activities that are significantly environmentally harmful (“Brown” Taxonomy). Nuclear energy and natural gas are not explicitly addressed. By choosing not to address these topics, it is left to the delegated legislation to regulate the involvement of nuclear energy and/or natural gas based on input from the Platform on sustainable finance. However, like other activities, they would need to overcome the DNSH principle. It is expected that these topics will be addressed within the technical screening criteria for transition activities.

Main requirements

Financial market participants will be required to complete their first EU Taxonomy disclosures, covering activities that substantially contribute to climate change mitigation and adaptation objectives, by 31 December 2021. By the end of 2022 the disclosures will have to cover the remaining four environmental objectives (water, a circular economy, pollution prevention and control

and protection of biodiversity and ecosystems). By 1 June 2021, the European Commission will adopt a delegated act specifying how the corporate disclosure obligations should be applied in practice, considering the differences between non-financial and financial companies. The TEG recognizes that the timeline of the delegated act will be a challenge to implementation, as corporate disclosures may not be available for financial market participants to use in their 2021 reports. Currently there are no readily available market solutions to fill this data gap, but regulators will expect best efforts to fill those gaps.

The disclosures to be made based on the EU Taxonomy come on top of the SFDR disclosure regime as the EU Taxonomy introduces a new form of non-financial reporting based on economic activities. It will have to be applied by:

- ▶ Financial market participants as defined in the SFDR
- ▶ Large financial and non-financial companies (>500 FTE) who are already required to provide a non-financial statement under the Non-Financial Reporting Directive (NFRD)

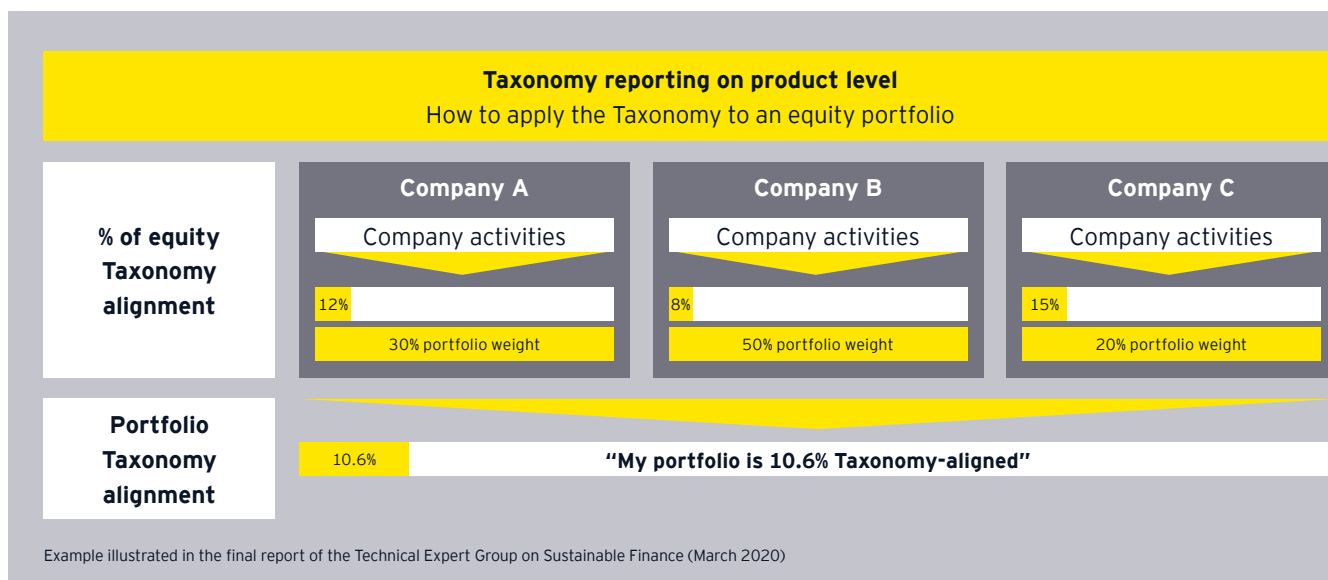
- ▶ EU regulators when setting public measures, standards or labels for green financial products of green bonds

While including real economy undertakings in the scope of the EU Taxonomy may come as a bit of a surprise, it is necessary in order for financial market participants to obtain the underlying data to fulfill their reporting obligations. The requirements differ between financial and non-financial companies (e.g., non-financial companies must include in their disclosures the proportion of turnover and capital expenditure aligned with the EU Taxonomy).

Financial market participants offering financial products in the EU are required to make disclosures in line with the EU Taxonomy on a mandatory basis for products promoting environmental characteristics or that have an environmental objective (SFDR Art. 8 or 9 products) and may choose to opt in for all other products. If the financial product is not required to make a full EU Taxonomy disclosure, it may carry a standard disclaimer that it is not aligned.

EU Taxonomy reporting requires (in addition to disclosure obligations under SFDR) a statement in existing pre-contractual and periodic reporting disclosures on:

- ▶ The environmental objective(s) towards which the financial products contribute
- ▶ How and to what extent the underlying investments are aligned with the EU Taxonomy
- ▶ The proportion of underlying investments that are EU Taxonomy aligned, providing a breakdown between enabling and transition activities

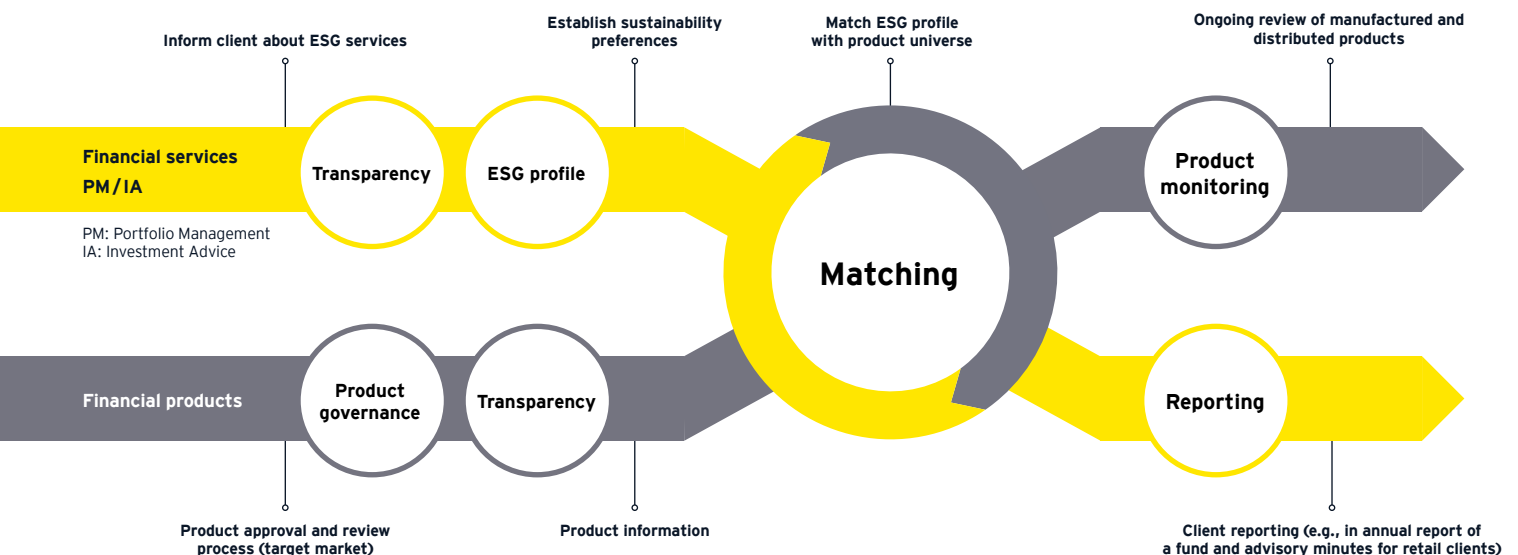




Integrating sustainability into advisory processes (MiFID and IDD)

Background

The European Commission is seeking to amend the Markets in Financial Instruments Directive (MiFID II) and Insurance Distribution Directive (IDD) delegated acts to ensure that sustainability preferences are considered in the suitability assessments when providing investment or insurance advice (related to insurance-based investment products). Key changes that will affect advisory and product governance processes under MiFID II (IDD requirements are very similar) are summarized below.





Focus: MiFID processes

According to the current draft, MiFID firms providing investment advice or portfolio management services must enhance their advisory processes and respect sustainability preferences expressed by their clients. They are also required to implement and maintain adequate processes and systems taking into account sustainability risks when selecting or recommending financial products.

The changes provide for ESG profiles to be established as it is required to mandatorily assess the sustainability preferences once the client's investment objectives have been identified, i.e. preferences regarding SFDR 8 and 9 products and (as of 30 December 2022) PAI products (financial products providing transparency about their engagement with regard to PAI on sustainability factors). Embedding clients' expressed sustainability preferences into the existing advisory processes will trigger operational issues already known under the MiFID processes. This involves classifying the product universe in order to allow a matching to the client's sustainability preferences. There is a strong link to the definitions of the SFDR. It is expected that part of

the basic sustainability information will be made available via enhanced product governance processes, since the product manufacturers will be required to identify, at a granular level, the potential target market for each financial instrument and specify the type of client for whose sustainability preferences the financial instrument is compatible.

Furthermore, general client information duties also apply regarding ESG, e.g., general client information about sustainability factors considered in the selection process and sustainability preferences referenced in advisory minutes). When providing suitability reports to retail clients, investment firms must include whether the client's investment objectives are achieved by considering his or her sustainability preferences. There are also some governance requirements that are impacted by the changes, most importantly mis-selling must be avoided. Remuneration principles should, for example, aim not to oversell ESG if there is no impact or binding approach behind (see also SFDR - ESG approach positioning).



Using climate-related reference benchmarks (Low Carbon Benchmark Regulation)

In the past, several “low carbon” labeled indices with broadly varying ambitions were available in the market. The aim of the Low Carbon Benchmark Regulation is to increase transparency and uniformity in the use of low-carbon indices, i.e., avoid greenwashing. Obligations under the Regulation take effect at different times with a main application date of 20 April 2020. The TEG assisted the European Commission in the implementation of minimum standards for two new categories of benchmarks, and the content and form of the respective ESG disclosure requirements. The TEG published its final report in September 2019 followed by a handbook in December 2019. Based on this work the European Commission published the draft delegated acts for public consultation in April 2020.

Two new categories of benchmarks are established to assist investors in understanding the carbon impact of their investments: i) Climate Transition Benchmarks (CTB), and ii)

Paris-aligned benchmarks (PAB). CTBs are composed of underlying assets selected such that the benchmark portfolio follows a measurable, science-based “decarbonization trajectory” supporting the target of the Paris Agreement over time, whereas PABs are composed of underlying assets which already actively contribute to the target of the Paris Agreement.

This Regulation directly applies to benchmark administrators, requiring them to disclose information regarding the methodology used to measure and reconcile ESG and low-carbon factors in the composition of CTBs and PABs. Further, benchmark administrators must specify within each benchmark’s statement whether it has ESG objectives and whether the benchmark administrator’s general offering includes ESG-focused benchmarks. Significant benchmark administrators are expected to take reasonable efforts to provide at least one CTB by 1 January 2022.

While the Regulation directly applies to benchmark administrators, there are indirect impacts for all climate benchmark users as it is expected to align SFDR 9 product with PABs and CTBs. It is intended that clients will increasingly demand that their financial products are aligned with these benchmarks, e.g., expressing their wish to have a Paris-aligned investment portfolio.



Embedding sustainability risks into overall (risk) governance (UCITS and AIFMD)

The current proposal to amend UCITS, AIFMD and MIFID are of a principle-based nature and are designed to integrate sustainability risks into the overall risk framework and identify conflicts of interest that could hinder this integration (e.g., incentives based on remuneration).

Many national regulators (such as PRA, BaFin, and AMF) have referred to the same principles without referring to new regulations. They have expressed their expectation with regard to an adequate consideration of ESG/sustainability risks (physical, transitional and reputational risks) that should already be applied based on the existing regulatory framework.

Climate risks have very specific characteristics. The lengthy and unclear time horizons, the depth of impacts and the (dis)orderly way of shifting from fossil brown to green involves many uncertainties and makes it very challenging to integrate into existing risk models. On the other hand, it is a foreseeable systemic risk that will impact the industry.

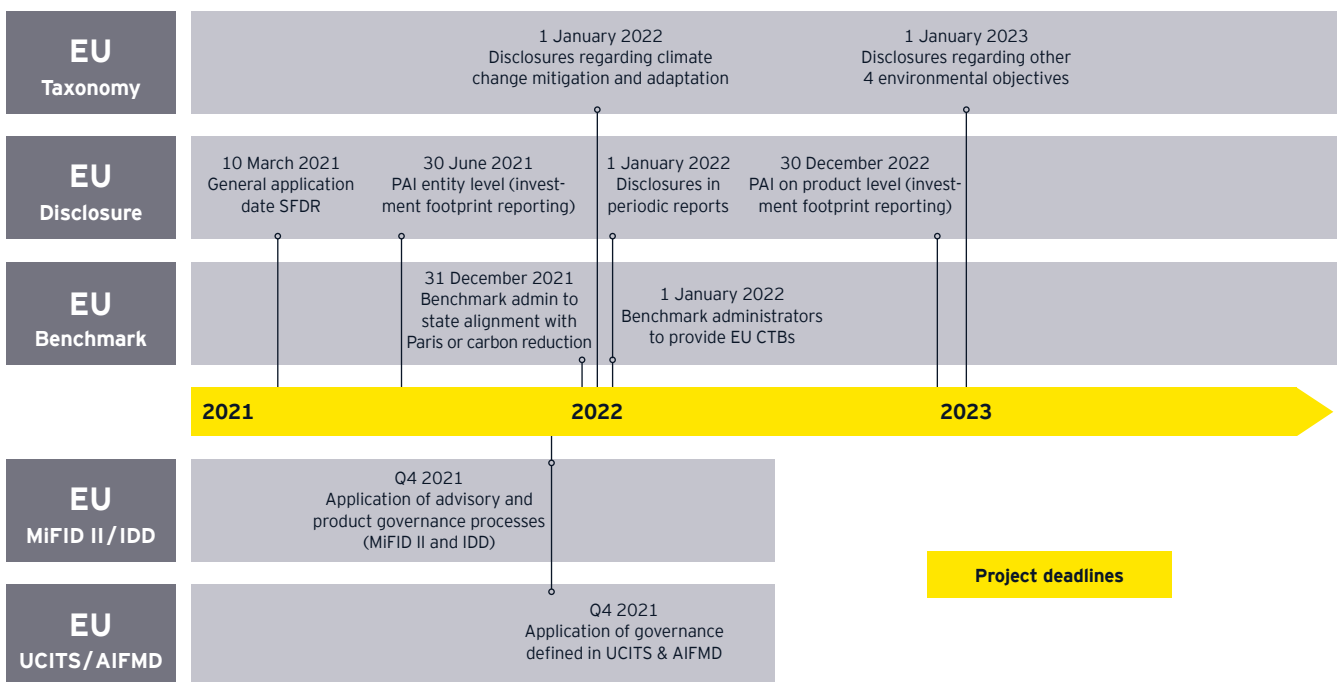
Asset managers should, therefore, make best efforts to continuously develop and enhance their risk management processes in this regard. These improvements will be supported by innovations on better data quality and enhanced data availability in the next years based on transparency regulations from the EU Action Plan and initiatives like the Task Force on Climate-related Financial Disclosures (TCFD) which was set up by the Financial Stability Board (FSB) to develop voluntary, consistent, climate-related financial risk disclosures for use by industry companies, banks, and investors in providing information to stakeholders.





How EY can help

Indicative and subject to change



The first implementation timelines of the EU Action Plan are quickly approaching and it is, therefore, time to act. EY teams can assist you with in-depth experience from sustainable finance-related engagements. We pair regulatory know-how with long-standing financial services industry and regulatory transformation experience. The service offering

ranges from regulatory transformation to risk and reporting advisory and assurance services. It includes the following key elements to make your EU Action Plan project a success:

- ▶ Our long track record of assisting in multi-disciplinary regulatory transformation projects for large banks, asset managers and insurance companies

- ▶ Our insights and experience in providing ESG - sustainable finance related support
- ▶ Our ability to leverage EY EMEA Sustainable Finance and cross-border network to provide collective international insights.



Let us start a conversation:

Chief Compliance Officer

How can we make sure we're compliant with the EU Action Plan (and all the other standards) requirements?

Product Management

How should we position our products with regard to negative impacts/promoting ESG?

Head of Sustainability

How aligned are our business activities with external developments such as the objectives of the Paris Agreement or industry initiatives? Will we buy or make our ESG research?

Chief Risk Officer

What are our key ESG transition and physical risks and how can we mitigate them?
What is the financial implication of climate change and how do we quantify our climate exposure to risk?

Chief Investment Officer

How do I incorporate ESG into our investment strategy and position for the upside opportunities?

Chief Sales Officer

How can I market ESG in the future with all these marketing restrictions?

Chairperson

How will climate change and sustainable finance affect the future of banking and how can we benefit from related opportunities?

Chief Executive Officer

How are we leveraging climate and sustainable finance as a source of competitive advantage? Who has ownership and accountability?



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