

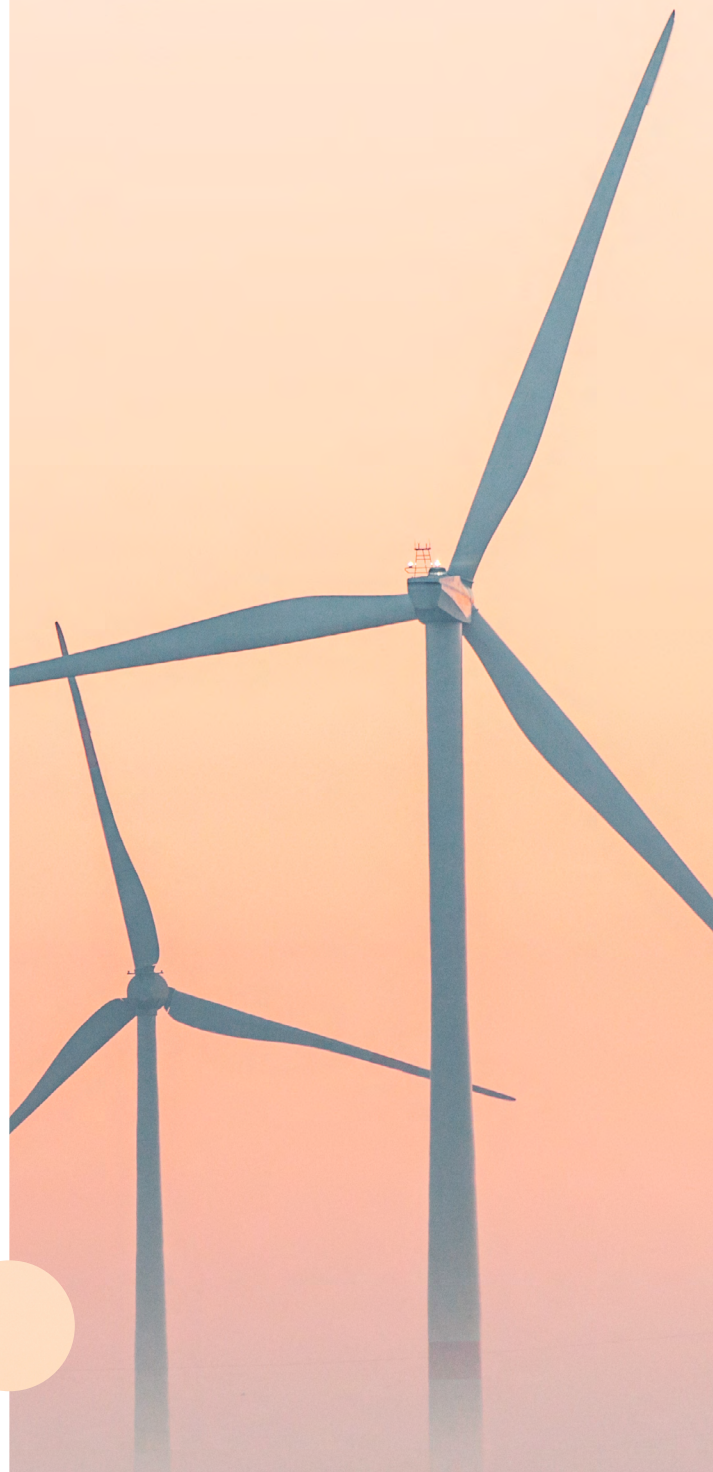
The three most common questions on the new EU regulation

A guide to sustainable
investing



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Marketing communication





The three most common questions on the new EU regulation.

A guide to sustainable investing

If you feel a bit lost faced with all the obscure acronyms that seem to be taking over the ESG debate these days, don't worry, you are not alone in that situation. We have created this series of short briefing notes to provide you, as an investor, with the essential things you need to know to understand how what some have dubbed a "regulatory tsunami" will impact you and what you need to do next.

Why so many new regulations now?

First, there was the Paris Agreement signed in 2015. This agreement saw most nations commit to keeping global warming below 2 degrees. This commitment led the European Commission to launch, in 2018, its Action Plan for Financing Sustainable Growth, acknowledging that finance had a big role to play in implementing the Paris Agreement, as well as other sustainability-related objectives.

At the same time, investors have been pouring billions into sustainable funds. Figures diverge depending on the definition of sustainability retained, but even by a conservative estimate several trillion euros are currently invested in sustainable strategies across Europe. Asset managers have responded to that flow of money by launching sustainable funds of all breeds encompassing every asset class one can think of. The European Union intends to rein in the perceived growth of the so-called green-washing investment offering by defining some stricter standards in terms of mandatory disclosures and minimum standards for a fund to qualify as sustainable.

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What is the EU's action plan all about?

At its heart, the Plan covers several initiatives all aimed at reorienting capital towards sustainable companies. However, some of the most impactful regulations are not part of that plan.

Taxonomy	For taxonomy purposes, the first requirement is obviously to define what a sustainable company is. This is precisely the objective of the EU Taxonomy of Sustainable Activities (the Taxonomy). "Taxonomy" is just another word for classification of company activities, defining which ones can be considered sustainable and under what conditions.
NFDR	At the same time, investors need companies to provide them with comprehensive and reliable information not only about their environmental performance, but also their governance and working conditions. Without that, how could they, for instance, assess whether a company meets specific sustainability standards. Providing this level of transparency is the objective of the Non-Financial Disclosure Regulation (NFDR).
SFDR	In an ideal world, once investors have a definition of sustainable company activities and the data from these companies, they should be able to integrate it to create great sustainable investment products and explain how they do so. Hence the Sustainable Finance Disclosure Regulation (SFDR), stipulating for all asset managers operating in Europe some minimum disclosure requirements, plus more specific ones for funds marketed as sustainable or integrating ESG considerations.

Taxonomy, NFDR, SFDR: these three initiatives form a regulatory trypsic to which other initiatives have been attached, each covering a specific objective or asset class.

Depending on the type of investor, only some of them will be relevant.

Example – Aluminium

Aluminium is an important metal in the energy transition process. It helps manufacturers make aeroplanes and cars lighter, is highly recyclable and its production process can be done using renewable energy. The EU Taxonomy therefore considers the production of aluminium in principle compatible with a sustainable future but, and that's the key point here, it defines strict conditions for its production to be deemed sustainable. For example, it may not emit more than 1,514 tons of CO2 per ton of aluminium, except for recycled aluminium.

Climate Benchmark	Some investors choose to adopt a passive investment approach that seeks to replicate a benchmark as closely as possible. Confronted with the proliferation of benchmarks claiming to integrate “green” or “climate”-related dimensions in their construction whilst not always following through in practice, the European Commission has created minimum requirements for benchmarks to make such claims. These requirements are contained in the regulation on Climate Benchmarks and other ESG-related benchmark disclosures adopted (Climate Benchmark regulation).
Green Bond Standard	In the fixed income space, green bonds have become highly successful at attracting capital from green investment-hungry investors. However, the sustainability cred of such green bonds rests to a large extent on the exact way bond proceeds are then used by companies, what kind of environmental impact is achieved, and which information is provided to investors. The EU has sought to address these concerns by evaluating the definition of EU Green Bond Standards (EU GBS). Obviously, when it comes to defining the company activities that can be financed by these bonds, the Taxonomy comes in handy.
Ecolabel	Having defined all these standards about what a sustainable company is and other rules stipulating what asset managers need to consider and disclose, the EU still lacked a standard for what a sustainable fund actually is. Such a voluntary standard, after all, already exists in several countries such as France, Belgium and Germany. EU authorities decided to create a pan-European label based on the existing 1992 Ecolabel regulation and apply it to the creation of an Ecolabel for investment funds . Here, also, the Taxonomy is used to defined screening criteria. The use of the Ecolabel regulation and the Taxonomy imply that only funds with a strong environmental focus, such as green bond funds or thematic equity funds, are likely to pass the EU label’s eligibility criteria, severely limiting the scope of the label.
SRD II	Finally, the EU is also keen to foster more engagement by investors with their investee companies and to facilitate that engagement. The Shareholder Right Directive II (SRD II) creates new obligations for asset managers to disclose the way they have exercised their voting rights or explain why they haven’t exercised them. Another objective of the directive is to foster long-term shareholding, away from the short-termism that forces companies into inefficient quarterly targets. A lot of the directive is dedicated to the role each party should play in the voting process to facilitate and make transparent the exercise of voting rights (custodians, proxy advisers, issuers, etc). Finally, the directive imposes a “say-on-pay” whereby shareholders should always be able to vote on directors’ remunerations.



So, what is already applicable, what comes next?

Not an easy question to answer, as most regulations provide for an implementation in several steps, whilst others have not been completely finalised yet.

<p>Applicable now</p>	<p>The Taxonomy has been adopted, which means that we have all the criteria we need to assess companies. Well, all criteria for 2 of the 6 environmental objectives covered by the Taxonomy (climate change mitigation and adaptation). We will publish a separate briefing just on the Taxonomy where this will all become clear. For now, let's just say that asset managers will have to disclose their share of investments in taxonomy-eligible activities, as it stands today, starting in 2022. Considering the breadth and depth of the screening required (70 industry sectors covered), this analysis will require a lot of data, much of which currently does not exist. Simulations and modelling will initially be used to palliate all the missing data, until companies start publishing the required information, which will become mandatory for them by 2022 as well.</p> <p>For climate benchmarks, the situation is simpler: the legislation has been adopted and has been applicable since July 2020, following publication of the technical standards. Therefore any benchmark making environmental claims has now to comply with the criteria defined by the regulation.</p> <p>Regarding Green Bond Standards, a Technical Expert Group mandated by the EU published a report in 2019 paving the way for the implementation of GBS at a later stage.</p> <p>The entry into force of SRD II varies between countries since the directive requires transposition by each national parliament. The deadline to do so was set by the directive in September 2020. It has already been transposed in Belgium and France and is already applicable in these countries.</p>
<p>2021</p>	<p>The disclosure regulations, at least for those mentioned above, will enter into force in 2021. The bulk of SFDR will kick in between March 2021, with the regular reporting requirements taking effect in 2022. As for NFDR, companies will have to start disclosing additional information by 2022 or 2023, depending on the topic of the disclosure.</p>
<p>2022 and beyond</p>	<p>As we have seen, although the Taxonomy has been set in stone, the related disclosures will become mandatory starting in 2022 and beyond for four of the six environmental objectives. The same delay will apply to NFDR requirements on these environmental dimensions.</p> <p>We don't expect the EU Ecolabel to open for application before 2022 or even 2023. Its scope will evolve with the Taxonomy as well as its ability to attract investors. A recent study published by the EU showed that, should the label open today based on realistic eligibility criteria and available data, only 3 funds out of the tens of thousands registered in the EU would qualify.</p>

Next

The **EU Taxonomy**: What is it? Why does it matter to all investors? Why could other global initiatives derail it?

SFDR: What does it require? What will it bring to investors? Why are asset managers fretting about it?



€128 B

AUM as of
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sustainable investing

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