EU Sustainable Finance Disclosure Regulation (SFDR)

WHAT DOES THIS MEAN FOR ISSUERS?

MSCI Virtual Event

Michelle Lapolla Friedman, Olga Emelianova, Samantha Sue Ping

February 2, 2021

Please note this presentation is provided for informational purposes only and does not constitute legal advice.
Today’s Speakers

Michelle Lapolla Friedman
Executive Director, ESG Product

Olga Emelianova
Executive Director, ESG Research

Samantha Sue Ping
Executive Director, ESG Research
Agenda

1. Welcome and Introduction
2. EU Sustainable Finance and SFDR
3. EU SFDR Metrics
4. What this means for Issuers
5. Q&A
As of March 31, 2020; defined as each share class of an exchange traded fund, as identified by a separate Bloomberg ticker. Only primary listings, and not cross-listings, are counted.

MSCI Inc. as of March 2020.
Introducing MSCI ESG Research
First ESG provider to assess companies based on industry financial materiality

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1,700+ clients
1,500+ ESG equity & fixed income indices use MSCI ESG Research ratings and data

Through our legacy companies KLD, Innovest, IRRC, and GMI Ratings. ESG Ratings dating back to 1999.

Source: MSCI ESG Research LLC as of June 2020. Includes full time employees, employees of foreign affiliates providing investment advisory services to MSCI ESG Research LLC, and global allocated staff performing non-investment advisory tasks.

Representative office for business development.

Information Classification: GENERAL
EU Sustainable Finance and SFDR
Who is Regulating ESG?

Grouped by Regulators for ALL countries.

Access the interactive graphic here: https://www.msci.com/who-will-regulate-esg

Source: Regulations database has been compiled using numerous sources, e.g. US Federal Register, Publications Office of EU, International Labor Organization (ILO) etc. Please contact MSCI ESG Research for more details.
...And Who is Being Regulated?

<table>
<thead>
<tr>
<th>Year</th>
<th>Region</th>
<th>Category</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>European Union</td>
<td>Primarily Investors</td>
<td>EU Sustainable Finance Action Plan</td>
</tr>
</tbody>
</table>

Source: Regulations database has been compiled using numerous sources, e.g. US Federal Register, Publications Office of EU, International Labor Organization (ILO) etc. Please contact MSCI ESG Research for more details.
EU Sustainable Finance Package

• One of most ambitious legislative plan globally, which aims to:
  • reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
  • manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
  • foster transparency and long-termism in financial and economic activity.

• Impact ≠ limited to the EU
  • Investment managers outside the EU may be impacted or wish to follow the new norms if they manage European assets
  • Other jurisdictions are also looking at putting in place similar measures
Combatting the Greenwashing of Funds

**ESG: Greenwashing under scrutiny**

**Sustainable finance, or just plain greenwashing?**

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

**How to spot greenwashing**

https://www.ipe.com/esg-greenwashingunder-scrutiny/16081923.article
MSCI’s ESG Transparency Resources

- Made public the MSCI ESG Ratings of over 2,800 issuers in our ESG Corporate Ratings search tool
- Launched provisional climate indexes designed to meet the minimum standards for the “EU Climate Transition benchmark” (CTB) and “EU Paris-aligned benchmark” (PAB) in order to help clients evaluate and test them
- Published the MSCI Principles of Sustainable Investing, a framework outlining best practices for ESG integration by investors globally
- Made public the MSCI ESG Fund Ratings for 36,000 multi-asset class mutual funds and ETFs in our ESG Fund Ratings search tool
- Made public ESG metrics for all MSCI indexes covered by the European Union (EU) Benchmark Regulation (BMR) in our Index Profile search tool
- Launch of Sustainable Finance resource page on msci.com
- Launch of the MSCI ESG Industry Materiality Map which aims to offer a window in the MSCI ESG Ratings model
The EU is harmonizing ESG disclosure standards, requiring financial market participants to integrate sustainability risk in the investment process and to report on such integration at both the entity and product level.

Beginning in March 2021 for principle-based disclosures per the SFDR. Detailed, prescriptive disclosures (e.g. on adverse impact indicators) likely due in January 2022.

EU SFDR Metrics
**EU SFDR: Adverse Impact Disclosures From Draft Regulatory Technical Standards (RTS)**

- Proposed disclosure indicators include a set of **Adverse Sustainability Impact Indicators**
  - Principal Adverse Impacts (32 mandatory metrics)
  - Additional 18 E&S Impact Indicators

- **Status:**
  - Outcome of consultation on SFDR Level 2
  - Text has been delayed until January 2021

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**Principal Adverse Impact Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>GHG Emissions</td>
<td>e.g. carbon footprint, solid fossil fuel sector exposure</td>
</tr>
<tr>
<td>Energy Performance</td>
<td>e.g. total energy consumption from non-renewable sources</td>
</tr>
<tr>
<td>Biodiversity</td>
<td>e.g. ecosystem preservation practices</td>
</tr>
<tr>
<td>Water</td>
<td>e.g. exposure to high water stress</td>
</tr>
<tr>
<td>Waste</td>
<td>e.g. hazardous waste ratio</td>
</tr>
<tr>
<td>Social and employee matters</td>
<td>e.g. implementation of ILO Conventions, gender pay gap, excessive CEO pay ratio</td>
</tr>
<tr>
<td>Human rights</td>
<td>e.g. processes for preventing human trafficking, exposure to controversial weapons</td>
</tr>
<tr>
<td>Anti-corruption and anti-bribery</td>
<td>e.g. convictions/fines for violations</td>
</tr>
</tbody>
</table>

**Additional Environmental Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emissions</td>
<td>e.g. emissions of air pollutants</td>
</tr>
<tr>
<td>Water, waste and material</td>
<td>e.g. land degradation</td>
</tr>
<tr>
<td>Green securities</td>
<td></td>
</tr>
</tbody>
</table>

**Additional Social Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social and employee matters</td>
<td>e.g. incidents of discrimination, lack of CEO/Chair separation</td>
</tr>
<tr>
<td>Social securities</td>
<td>e.g. not certified as social</td>
</tr>
</tbody>
</table>
What Our Clients Have Said About the EU SFDR Draft RTS

**August 2020**
**Client Workshops**

66 clients based in Austria, France, Germany, the Netherlands, the Nordics, North America, Spain, Switzerland and the UK

**Goals**

- Share views on the draft regulatory technical standards
- Enable a forum to discuss views on the biggest challenges in complying with the regulation
- Provide initial assessment of the adverse sustainability impact indicators

We are concerned that many of the adverse impact indicators are not readily available, the requirements to disclose on 32+ indicators could be a burden, and the quality of company disclosures unclear.

It would be inefficient and costly if financial market participants are in fact required to collect data directly from companies first rather than relying on third parties.

The availability of data addressing the SFDR requirements is the highest priority for us. Transparent sourcing for this data will be very important.

The aggressive timeline for compliance is a major concern; seemingly not feasible.
SFDR Draft Principle Adverse Impacts Indicators: Company-Level Data Availability

## SFDR Draft Principle Adverse Impacts Indicators: Company-Level Data Availability (Cont’d)

### Social and Employee, Respect for Human Rights, Anti-Corruption and Anti-Bribery Matters

<table>
<thead>
<tr>
<th>Indicator</th>
<th>% of Relevant Companies Disclosing</th>
<th>Alt Data or Proxy Available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementation of fundamental ILO Conventions</td>
<td></td>
<td>near 100%</td>
</tr>
<tr>
<td>Gender pay gap</td>
<td>&lt;10%</td>
<td>None</td>
</tr>
<tr>
<td>Excessive CEO pay ratio</td>
<td>&lt;10%</td>
<td>None</td>
</tr>
<tr>
<td>Board gender diversity</td>
<td>near 100%</td>
<td>None</td>
</tr>
<tr>
<td>Insufficient whistleblower protection</td>
<td>near 100%</td>
<td>None</td>
</tr>
<tr>
<td>Investment in investee companies without workplace accident prevention policies</td>
<td>10%-25%</td>
<td>None</td>
</tr>
<tr>
<td>Human rights policy</td>
<td>25%-50%</td>
<td>None</td>
</tr>
<tr>
<td>Due diligence</td>
<td>25%-50%</td>
<td>None</td>
</tr>
<tr>
<td>Processes and measures for preventing trafficking in human beings</td>
<td>near 100%</td>
<td>none</td>
</tr>
<tr>
<td>Operations and suppliers at significant risk of incidents of child labor</td>
<td>&lt;10%</td>
<td>near 100%</td>
</tr>
<tr>
<td>Operations and suppliers at significant risk of incidents of forced or compulsory labor</td>
<td>&lt;10%</td>
<td>near 100%</td>
</tr>
<tr>
<td>Number and nature of identified cases of severe human rights issues and incidents</td>
<td>&lt;10%</td>
<td>near 100%</td>
</tr>
<tr>
<td>Exposure to controversial weapons (land mines and cluster bombs)</td>
<td>50%-95%</td>
<td>None</td>
</tr>
<tr>
<td>Anti-corruption and anti-bribery policies</td>
<td>50%-95%</td>
<td>None</td>
</tr>
<tr>
<td>Cases of insufficient action taken to address breaches of standards of anti-corruption and anti-bribery</td>
<td>&lt;10%</td>
<td>near 100%</td>
</tr>
<tr>
<td>Number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws</td>
<td>&lt;10%</td>
<td>near 100%</td>
</tr>
</tbody>
</table>

Proposed hierarchy approach

1. Financial Market Participants (FMPs) should collect readily available adverse impact information from investee companies.

2. But if information is not readily available, FMPs should use best efforts to obtain it directly from investee companies.

3. Where, despite above best efforts, information cannot be obtained directly, FMPs should detail additional efforts used including cooperation with third party data providers.
**MSCI’s Approach**

**Collect**

MSCI ESG RESEARCH ANALYSTS REVIEW COMPANIES FOR ADVERSE SUSTAINABILITY IMPACT DISCLOSURES

We are accelerating collection of adverse impact data points across a broad set of global companies.

**Engage**

MSCI ESG RESEARCH CONTACTS COMPANIES TO VERIFY FINDINGS AND ENCOURAGE PUBLIC DISCLOSURE OF ADVERSE IMPACT INFORMATION

We will leverage our extensive company contact database and Issuer Communications Portal for data verification and to encourage disclosures on behalf of our investor clients.

**Fill Gaps**

MSCI ESG RESEARCH DRAWS ON ITS EXTENSIVE SUITE OF ESG DATA TO OFFER SUPPLEMENTAL INDICATORS FOR ASSESSING ADVERSE IMPACTS.

We anticipate significant gaps in company disclosure and responsiveness and so will also offer indicators that are not reliant on company disclosure or communication.

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EU SFDR - What This Means for Issuers
Issuer Communications – Connecting Companies and Investors

Interacting with issuers: a competitive advantage

• Independence
  – No advisory or consulting

• Consistency
  – Systematic outreach to issuers
  – Standard data review process

• Traceability
  – Use of publicly available data
  – No confidential information

• Transparency
  – Issuer access to data and own reports at no cost
  – Record of all interactions

Issuer Interaction Rate – MSCI ACWI Investable Market Index (IMI)

Source: MSCI ESG Research, as of December 31, 2020.
Interaction volume is inclusive of any inbound communication from issuers, e.g. queries and feedback submissions throughout the stated year.
Interaction rate is the % of companies in the MSCI ACWI IMI that have reached out in the given year.
SFRD Data Review Process

- **Dec 2020 Advance notice**: MSCI sent all issuers an advance notice about the upcoming SFDR data outreach.

- **Jan 2021 Outreach begins**: Companies notified when their SFDR data is available for review in the Issuer Communications Portal (ICP). This outreach is executed in approximately weekly batches.

- **Jan-Mar 2021 Initial review period**: Ahead of the initial MSCI SFDR data launch to investors, companies have a period to review the information we have collected and make any necessary updates.

- **Ongoing Data review open**: After the initial review period, the SFDR data is available for review and update at any time, similar to the other MSCI ESG data sets accessible in ICP.
SFDR Data in the Issuer Communications Portal (ICP)

NEW!
SFDR data tab in the MY DATA section.
Reminder: How to Comment on Data

1. Help Guide, for assistance using the form.
2. Pencil icon, to enter a comment.
3. More info on the specific datapoint.
4. Submit comments when review is complete.
Other Resources for Issuers

Issuer Communications Portal

Growing resource library! FAQs, methodology guides, webinar recordings and more!

Contact us: esgissuercomm@msci.com

Solutions for Issuers

For those needing more in-depth peer benchmarking insights or a license for corporate financing purposes, MSCI ESG Research offers the following commercial solutions to Issuers:

- Subscription to MSCI ESG Ratings for benchmarking purposes
- License to use issuer’s MSCI ESG Rating to support ESG-linked loans or credit facilities
- License to use issuer’s MSCI ESG Rating to help support debt issuance programs
- License to use issuer’s MSCI ESG Rating to promote securities offerings

For more information, please visit: https://www.msci.com/our-solutions/esg-investing/esg-research-for-issuers-and-their-advisors
Appendix
Challenge: Inconsistent Disclosure Requirements Across EU ESG Policy Initiatives

EU Benchmark Regulation ESG Disclosures

EU SFDR Adverse Sustainability Impact Disclosures

EU Taxonomy regulation disclosure elements:
- Sustainable Activities
- Do No Significant Harm
- Minimum Safeguards

- Potential for market confusion
- Costly implementation
Proliferation of Standards

CFA Institute wants feedback on ESG disclosure standards

SOPHIE BAKER

The CFA Institute wants industry input on its new standard for environmental, social and governance disclosures by money managers.


Iosco at Work on Global ESG Standard

September 6, 2020

The International Organization of Securities Commissions has commenced work on a global ESG disclosure standard akin to international financial accounting standards, FTfm reports.

https://www.ignites.com/c/2875653/357513/iosco-work-global-standards

UK Delays Decision on Adopting EU Sustainable Finance Taxonomy

The delay may complicate the regulatory landscape for sustainable finance as the EU moves toward a standardized classification system.

https://www.ignites.com/c/2895063/359273/four-accounts-draft-standards

Big Four Accountants Draft ESG Standards

September 22, 2020

The Big Four accounting firms have jointly developed a reporting framework for ESG standards, in the latest industry effort to forge ESG consensus, the Financial Times reports.

https://www.globalelr.com/2020/06/uk-depays-decision-on-adopting-eusustainable-finance-taxonomy
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