Changing Capital Markets’ expectations on ESG

Finnish Investor Relations Society, 05.10.
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Agenda of today

Understand upcoming changes to Sustainable Finance Regulation and their effects

Assess the role of Investor relations in ESG expectations

Consider implications for an impactful ESG investor story

Investors expect to drive sustainable, low-carbon economy transition and we are seeing a seismic shift in capital markets

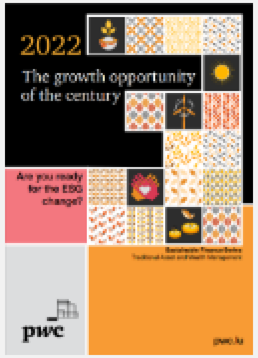
Societal demand for sustainable, low carbon economy

Increasing number of investors are implementing climate integration in their investment strategy

Growing interest to green financing – In 2019, there were issued $USD 260 billion worth of green bonds

Customers are committing to net zero ambition and Science-Based Targets

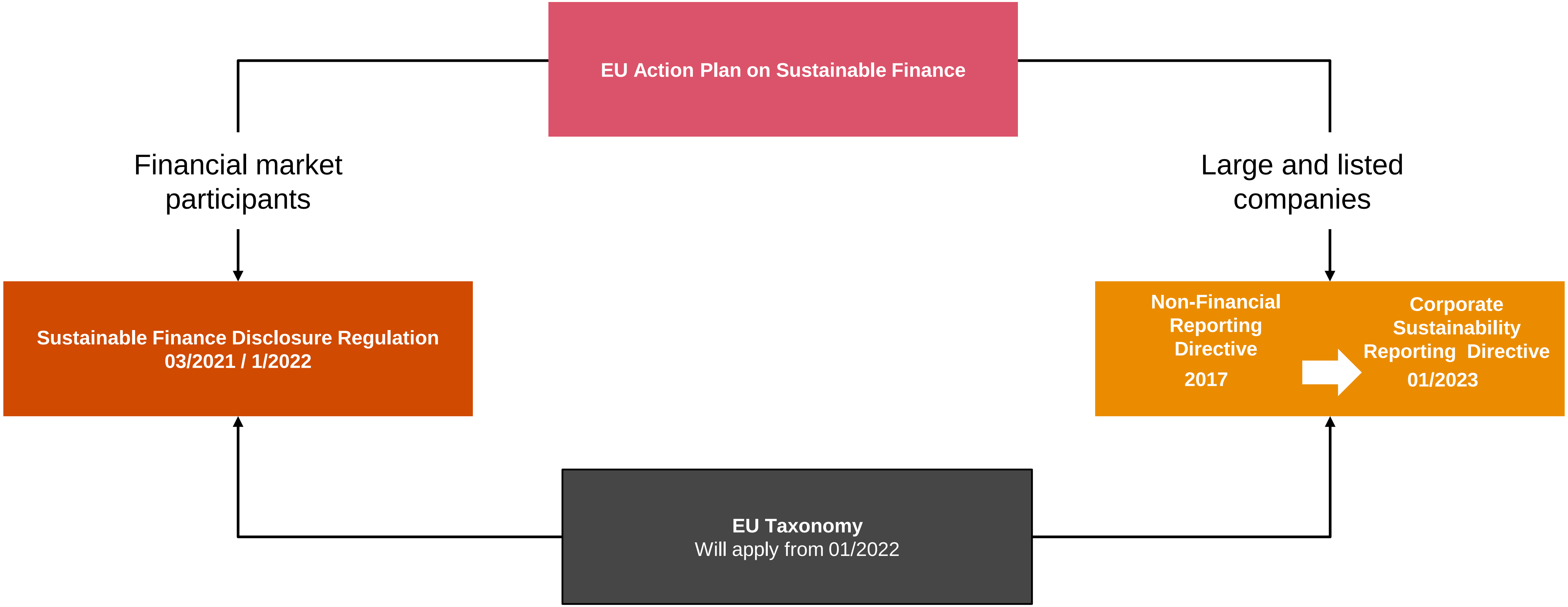
Regulatory action to mitigate climate change such as regulations on CO_2 emissions



In our latest report we outline the key catalysts for ESG growth:

1. Complete Regulatory Overhaul
2. ESG's outperformance
3. Increasing investor demand
4. Fundamental societal shifts

EU Action Plan on Sustainable Finance creates a level playing field for ESG within the EU



The EU Taxonomy is a tool for navigating the transition to a more sustainable economy and for classifying economic activities

EU Taxonomy is…

… a **tool for companies to help transition** to an economy which is consistent with EU's environmental objectives

…one of the **most significant developments in the area of sustainable finance**

…**a classification system** for environmentally sustainable economic activities

…expected **to help investors and companies** to shift investments where they are most needed

The Taxonomy Regulation sets out three groups of Taxonomy users:

1. **Financial market participants** offering financial products in the EU, including occupational pension providers
2. **Large companies** who are already required to provide a non-financial statement under the Non-Financial Reporting Directive
3. **The EU and Member States**, when setting public measures, standards or labels for green financial products or green (corporate) bonds

Source: Sustainable Finance: TEG Final Report on the EU Taxonomy, European Commission, Mar 2020; EU Taxonomy for Sustainable Activities, The European Commission.

Companies are expected to disclose information on climate change mitigation and adaptation in 2022, and should prepare for subsequent disclosures

Environmental objectives

= criteria developed

= criteria not developed

Criteria developed	Criteria not developed
Climate change mitigation	Transition to a circular economy
Climate change adaptation	Pollution prevention and control
	Sustainable and protection of water and marine resources
	Protection and restoration of biodiversity and ecosystems

To assess how and to what extent economic activities are environmentally sustainable, a five step approach can be used:

Identify:

1. Taxonomy Eligible activities

Comply with technical screening criteria:

2. Substantial contribution to climate change
3. Do no significant harm criteria
4. Minimum safeguards

Calculate and report:

5. Sustainable Turnover, CapEx and OpEx

Source: Sustainable Finance: TEG Final Report on the EU Taxonomy, European Commission, Mar 2020.

We see capital markets implementing EU Taxonomy in two waves, to eventually steer capital allocation

We see two waves for EU Taxonomy implementation both in equity and debt markets

1 Set-up reporting capabilities and apply the EU Taxonomy to classify investments as sustainable

2 Integration to investment strategies to steer capital allocation

Asset management

- Increased demand for shares and bonds of companies with a high Taxonomy-alignment
- Implications to the value of a company's publicly traded instruments
- **Companies will likely strive to improve their Taxonomy alignment**

Banks and lending

- Increased competition to lend to companies with a high Taxonomy-alignment
- Downward pressure on the interest rate margins for green assets
- Increasingly shift **banks' interest from green projects to green companies**

"We need all companies to play their part, both those already advanced in greening their activities and those who need to do more to achieve sustainability. Today's new rules are a game changer in finance. We are stepping up our sustainable finance ambition to help make Europe the first climate-neutral continent by 2050,"

-Mairead McGuiness, EU's Financial services Commissioner

Source: PwC Analysis, Sustainable Finance and EU Taxonomy, European Commission

The SFDR tool requires all financial market participants to disclose their ESG considerations providing investors with comparable data for decision making

Basics of SFDR

Phase 1 of SFDR went into effect on March 10th 2021 setting rules on **how and what sustainability-related information** financial market participants must disclose on both **legal and product level**, including:

- **Sustainability risks:** ESG events or conditions, such as climate change, that could impact investment value
- **Principal Adverse Impacts (PAI):** ESG events, such as climate change, that could impact the value of an investment
- **Remuneration policies** in relation to the integration of sustainability risks

Phase 2 of SFDR will come into force by 07/2022 and provide specific disclosure information and indicators for Principal Adverse Impacts

Three classifications of investment products

Article 6	ESG risks are not considered, i.e. Non ESG Fund
Article 8	Integrating environmental / social characteristics
Article 9	Products targeting sustainable investment activities

Based on SFDR reporting requirements, companies are required to report the percentage of their portfolio invested in activities aligned with the EU Taxonomy

Ultimately SFDR **aims to prevent "greenwashing"** and it is expected to be a revolutionary tool for Sustainable Finance in the EU region

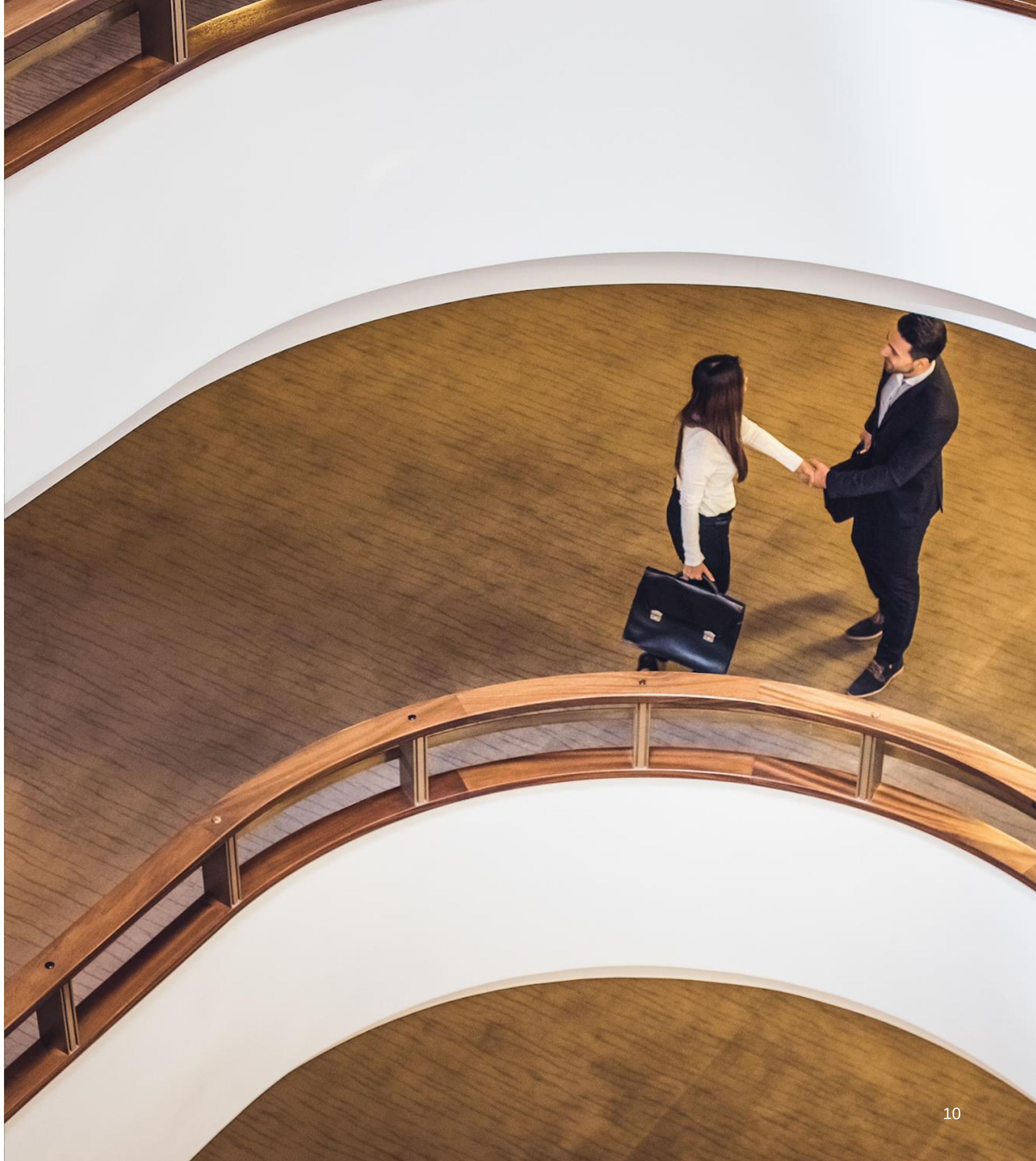
Corporate sustainability reporting disclosure (CSRD) will involve more companies to report on non-financial aspects and require them to inform taxonomy-aligned activities

		Who needs to report and what needs to be reported?	What is the content and is assurance mandatory?	How many companies does it apply to & when is it valid?
CURRENT STATUS	NFRD	• Companies with ≥ 500 people and listed companies, banks and insurers	• ESG related matters • Due Diligence processes • Risk management • ESG performance indicators • Assurance not mandatory • Taxonomy aligned activities	• Applies to ~ 80 companies in Finland • 11600 companies in the EU • Valid since 2017
FUTURE	CSRD	• All listed companies, excluding micro-enterprises • Companies with ≥ 250 people, including credit institutions and insurance companies	• Double materiality • New EU sustainability reporting standards • Taxonomy aligned activities • Third party assurance needed	• ~600-800 companies in Finland • 49 000 companies in the EU • Valid from 01/2023

IR plays a crucial role in communicating the company approach to sustainable finance

We recommend creating a coherent ESG Investor story to assess the most relevant regulations in different industries.

1. **Decide together with the C-suite the level of ambition** of what the company hopes to accomplish concerning the regulations
2. **Focus the narrative** on the issues which investors care about the most
3. **Assess market trends,** evaluate what competitors are doing and understand the levers that give your company the advantage
4. **Communicate relevant changes** consistently to investors, e.g. schedule changes of regulations or different requirements



New regulations will bring different aspects for several functions in a company

Investor Relations should interact with other experts when it comes to updates in ESG regulations. Understanding the changes will improve the quality of disclosure and related decision-making

How does the ESG performance affect availability and price of funding? **C-level**	• Understand how EU Taxonomy will impact business strategies and activities • Establish a reporting and governance model • Assess competitive advantage or disadvantage of regulations
Will systems require changing? **ICT**	• Implement necessary changes, if needed • Support in improving data quality and reliability • Consider ESG analytics and reporting changes
Is the company reporting coherently? Are there shortcomings? **Auditor**	• Understand (regulatory) reporting requirements • Evaluate changes in regulations, directives or delegated acts • Advise companies if reporting is not coherent
How will the regulation changes impact financial reporting needs? **Controller**	• Implement necessary EU Taxonomy reporting requirements in terms of CAPEX, OPEX and Turnover

A well communicated ESG Investor story can directly effect an investors evaluation of a company

A successful ESG Investor Story incorporates the following four elements:

Explain market shift and ambition

- Explain ESG-related market shift and implications for companies' business
- Provide a narrative how the company positions itself in the changing market
- Be transparent in current understanding of regulatory changes and potential implications going forward

Demonstrate financial impacts

- Analyse and disclose the financial impacts of sustainable and low carbon economy transition
- Highlight ESG related factors and KPIs relevant to investors' decision-making
- Illustrate how the company considers financially driven ESG-related KPIs vs "traditional" ESG-related KPIs

Make into a core of investor dialogue

- Make sustainability a core element of investor dialogue led by CEO and CFO
- Steer and communicate the role ESG plays in the strategy from the executive team, deliver impact in the business areas
- Consider which messages should be communicated by the management vs subject matter experts

Walk the talk

- Build a compelling ESG story that meets investor expectations, delivers a value-driven message and describes implications on company's strategic paths
- Enable investors and analysts to assess ESG performance transparently and maintain leadership in ESG rankings

Thank you

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