November 2020

Sustainable Finance

Redirecting investment flows is essential for mainstreaming sustainability, an increasingly urgent political and societal goal. The financial sector is called upon to do its part: new sustainable finance regulations are being issued, and bringing significant challenges for financial institutions.

Are you ready to contribute to the transition to a sustainable economy?

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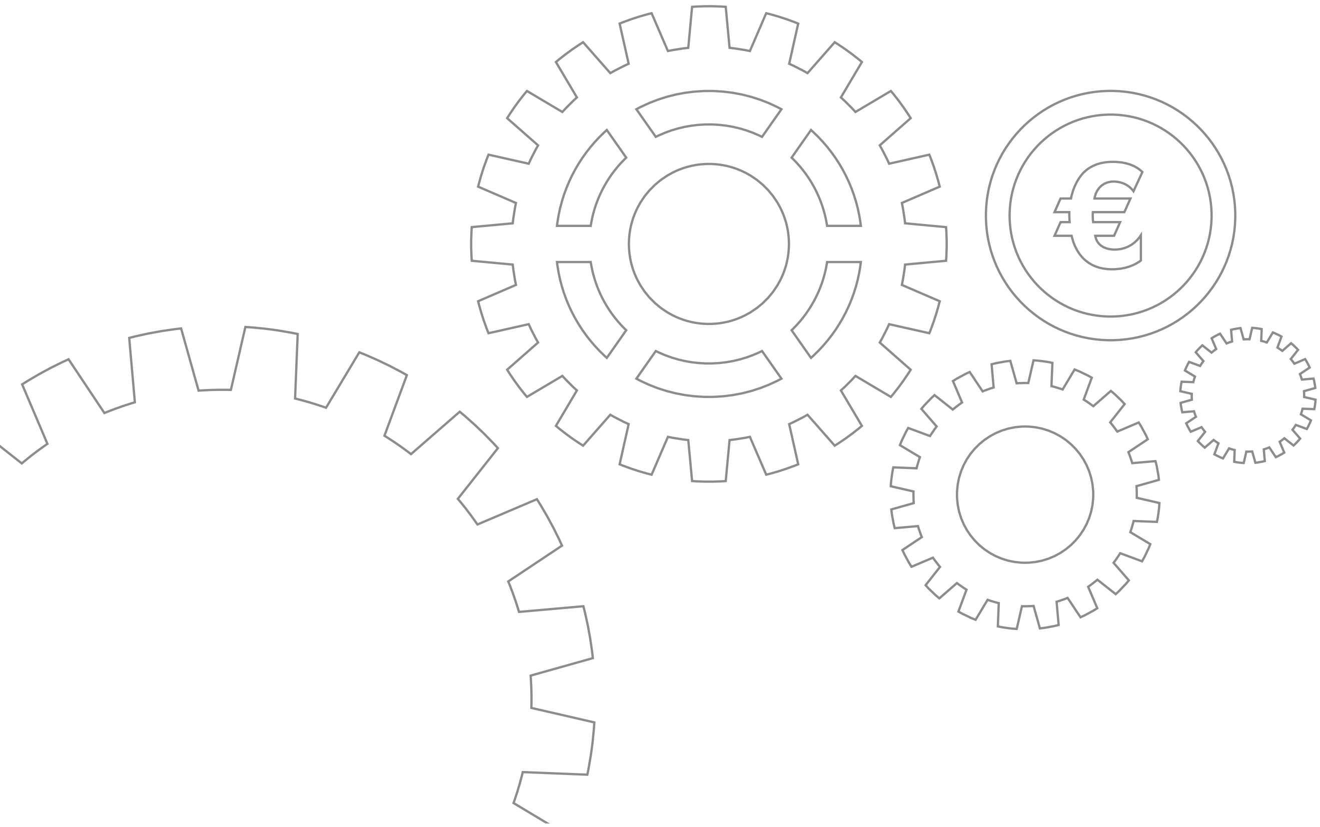


What is sustainable finance?

Sustainable finance is the mobilisation of finance to integrate environmental, social and governance (ESG) criteria into business or investment decisions, leading to sustainable growth and the transition to a climate-neutral economy. Wider society expects the financial services sector to contribute to a sustainable future; consequently regulators and supervisory authorities are designing new standards with which financial institutions will have to comply. PwC is ready to support financial institutions and their workforces to prepare and implement sustainable business practices for optimum business performance leading the transition to a sustainable economy.

Who's affected?

All financial market players.

Why should financial institutions engage with sustainable finance?

1

It means more regulation

The regulatory landscape is changing fast, in support of the European Union's commitments to climate and environmental action. Compliance with the new regulations will be both challenging and rewarding for financial institutions. PwC is committed to advising and supporting clients through this transition to sustainable economy, with a view to optimising long-term sustainable growth and business performance while giving the right attention to their regulatory obligations.

2

It affects strategy

By developing new products/services, new client segments, and new business models, financial institutions can gain a competitive advantage and increase the profitability of existing business segments (via consideration of ESG factors) while simultaneously creating new revenue streams.

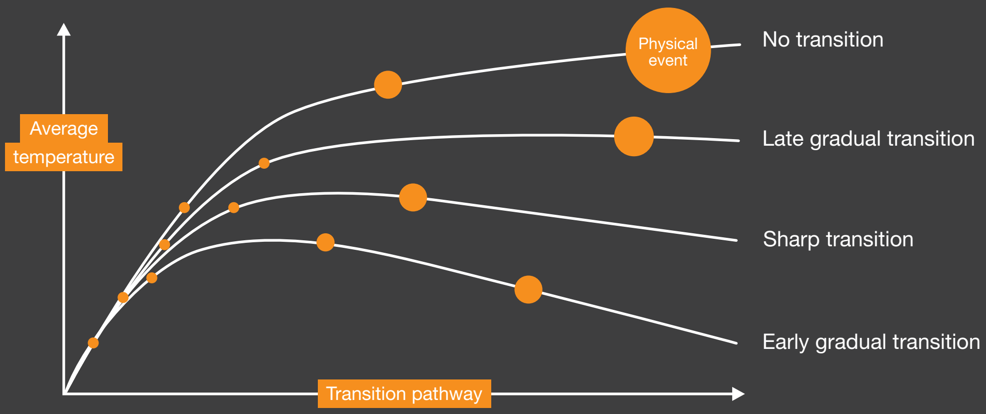
3

Addressing risk

Climate-related and environmental risks are already manifesting. For financial institutions, these risks translate into:

- **Physical risks**
  The financial impact of a changing climate, including more frequent extreme weather events and gradual changes in climate, as well as environmental degradation like air, water and land pollution, water stress, biodiversity loss and deforestation.
- **Transition risks**
  An institution's financial loss that can result, directly or indirectly, from the process of adjusting towards a low-carbon and more environmentally sustainable economy.

Depending on the effort,
several scenarios are in front of us:



Actions	Physical risk	Transition risk
No transition	↑	↓
Early gradual transition	↘	↗
Sharp transition	↘	↑
Late gradual transition	↗	↗

Climate-related risks	vs.	Environmental risks
Physical		
Frequency of extreme weather events / pattern definition of climate events / temperature pathways / …		Pollution / water stress frequency / resource scarcity / biodiversity loss rate / …
Transition		
Policy and regulation / technological advancement / market sentiment		Carbon price pathways / commodity and energy prices / emission pathways / consumer behaviour changes

What is the impact on financial institutions?

Sustainable finance is set to transform financial institutions, affecting all organisational levels. **The journey towards sustainability needs to focus on governance, risk management and disclosure around a newly integrated business model and strategy based on an initial regulatory impact assessment**, as illustrated below:

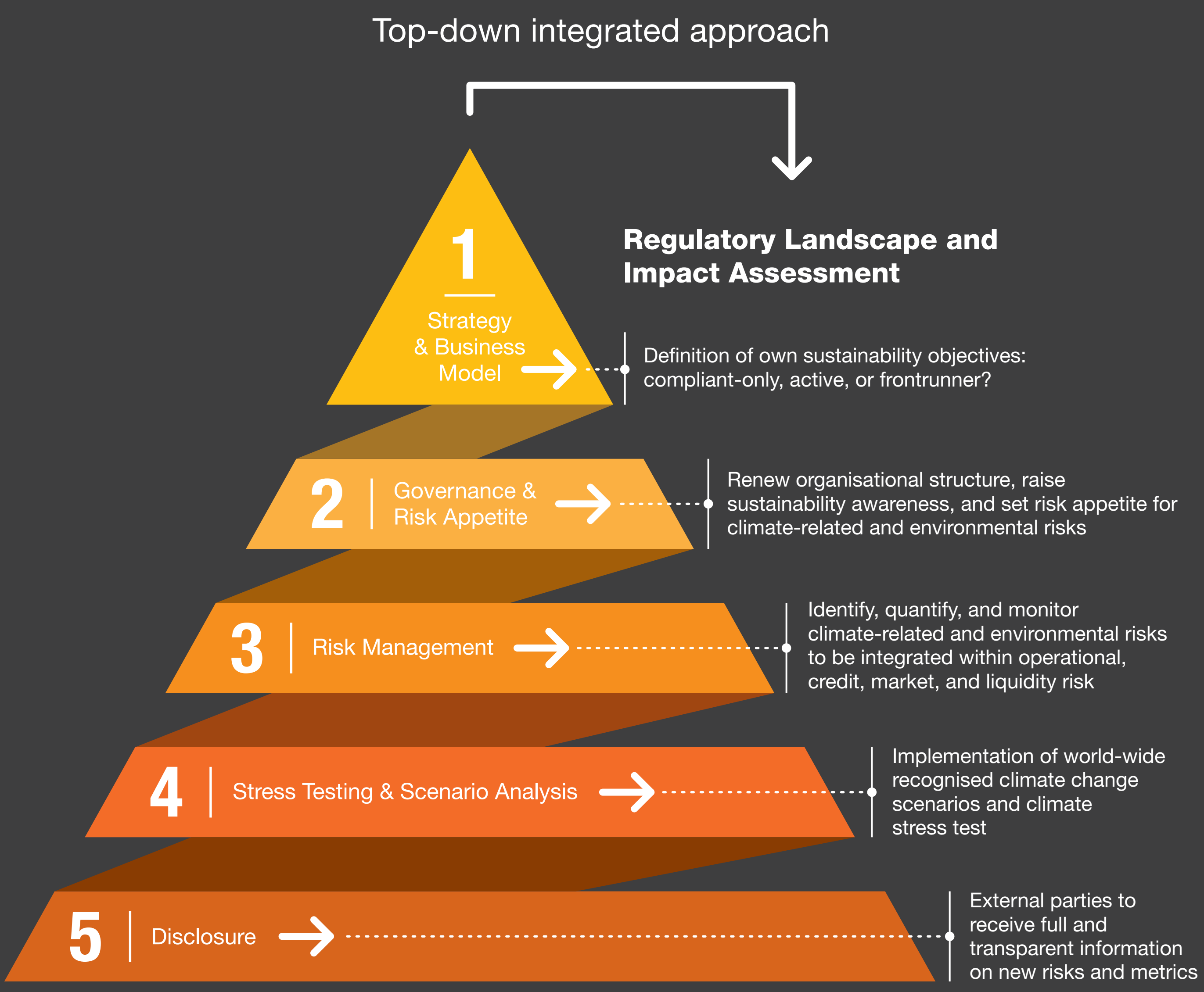
A newly integrated strategy and business model with three areas of focus:

- Key metrics
- Full transparency for external parties to assess physical and transition risks

- Risk appetite framework
- Organisational structure
- Internal reporting

- Risk management framework
- Credit, market, liquidity, operational risk management
- Scenario analysis and stress testing

Reviewing the current operating model



The five essential elements to consider in your transition to sustainable finance

Regulatory landscape and impact assessment

The EU Action Plan on Sustainable Finance is leading to several new EU regulations and amendments of existing regulatory texts applicable to financial service providers. These new regulations will have far-reaching consequences for the entire value chain of banks, insurance companies and asset managers, and will require significant implementation efforts. New requirements are being added to existing legislation, such as the Non-Financial Reporting Directive.

What do you want to do?

- Understand EU and national regulatory requirements and their implications for products, services, processes and business segments.
- Identify concrete actions necessary for compliance.
- Design a target operating model for processes and IT to integrate the new requirements.
- Define implementation timelines and milestones.
- Implement solutions.

PwC can help you assess the regulatory landscape and perform an impact assessment, followed by a gap analysis. Our specialists will work closely with you to review policies and develop a new target operating model and roadmap. We will help to determine where your organisation stands and build a tailored sustainability plan depending on where you want to go.

1

Strategy and business model

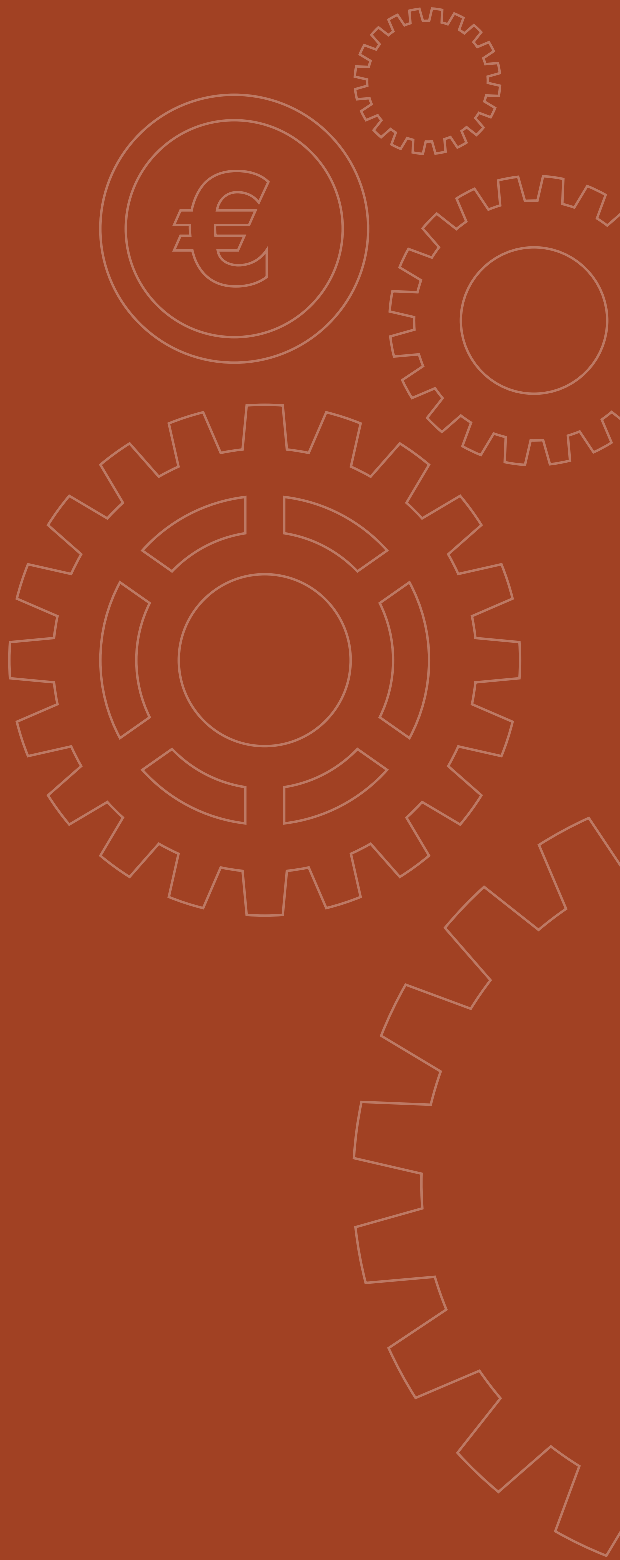
Sustainable finance offers very attractive opportunities for business development, competitive advantages and profitability, and thus should be an integral part of your corporate strategy. Identifying the best options for building sustainable product and service portfolios and strategic positioning in the market will be essential to your future success.

What do you want to do?

- Understand the changing needs and wants of your customers.
- Analyse the positioning of key competitors and identify best practices.
- Identify opportunities to deliver added value to clients.
- Identify the potential for development of new products, services or business models.
- Identify opportunities and risks in the market, optimum positioning and the right strategy for long-term profitability and competitiveness.

PwC can help you perform a market analysis of existing and potential clients' needs for your lines of products and services. PwC can provide analyses of the strategies and positioning of key competitors, a readiness assessment, and define options for strategic positioning.

2



Governance and risk appetite

Integrating sustainability means revising your governance model and risk appetite framework. Sustainable finance will affect all levels of your organisation, along with your relationships with investors, customers, workforce, government and wider society.

3

What do you want to do?

- Review organisational structure from a climate and environmental perspective to align with market and supervisory expectations.
- Embed ESG elements into the institution's mission, vision and core values in order to promote conscious positive decision-making and behavioural change in your workforce.
- Upskill staff and senior management.
- Embed climate-related analysis into core capabilities, such as: portfolio decisions, development or refinement of products and services, pricing and underwriting, overall risk management and business continuity management.
- Review existing partnerships and assess new strategic partnerships (e.g. industry groups such as TCFD, NGO, public sector).
- Define tailored communication and disclosure channels, including escalation process for unexpected ESG issues.
- Revise reporting frameworks to include ESG-related KPIs.

Combining financial performance and sustainability criteria will create new opportunities. For example, how developed is your climate governance?

PwC can help you to:

- adjust your organisational structure to incorporate climate and environmental criteria;
- assess your data governance framework, for compliance-readiness;
- conduct cost-benefit analyses to evaluate current and potential partnerships;
- raise awareness of the governing bodies and their risk management responsibilities; and
- foster a company-wide environmental, social and governance (ESG)-conscious culture.

Risk management, stress testing and scenario analysis

Financial institutions will need to integrate climate-related and environmental risks into their overall business model and strategy. This means re-assessing risk appetite, governance, risk management and disclosure functions across the entire business.

At an early stage, the scarcity of climate-related data and the question of how it relates to traditional risk drivers can be challenging for institutions. Support from quantitative analysts and climate-related and environmental experts may be needed. New KPIs and key risk indicators (KRIs), such as climate Value-at-Risk (VaR) and adjusted probability of default (PD) should be embedded into internal reporting frameworks to allow senior management to take the right courses of action.

What it means for banks?

The European Central Bank (ECB) will require progress reports on the integration of such risks, based on upcoming guidelines. Specifically, these reports will have to show how financial institutions are living up to the ECB's expectations on climate-related and environmental risks by integrating them at all stages of their risk management framework with, among other factors, sufficient involvement of the management board.

The ECB and the European Banking Authority (EBA) are invested in pushing financial institutions to actively manage climate-related and environmental risks with scenario analysis and stress tests at the centre of the discussion.

4

What it means for insurance companies?

Considering that, to a certain extent, current underwriting and pricing strategies might already take into account the expected impact of climate change, and that the guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA) on Own Risk and Solvency Assessment (ORSA) require undertakings to have a forward looking assessment of solvency needs (also reflecting undertaking's risk profile), it seems however relatively clear that the ORSA's will have to further assess climate change risks using scenario analysis, with a longer-term perspective when performing the related quantitative analysis. While several consultations are still open, EIOPA expects undertakings to integrate climate change risks in their system of governance, risk-management system and ORSA, in line with Solvency II legislation, guidelines and the Opinion on Sustainability within Solvency II.

What do you want to do?

- Understand where your institution stands compared to best practices for climate-related and environmental risk management.
- Anticipate the potential impacts on your business model and strategy.
- Embed climate-related and environmental criteria into your risk management framework (operational, credit, liquidity, and market risk).
- Manage portfolios' exposure to climate-related and environmental risks.
- Perform climate change scenario analyses and stress testing.
- Develop the appropriate KPIs and KRIs.
- Assess the impact of climate-related and environmental risks on your capital adequacy.

PwC can help you to:

- perform an initial gap analysis across the ECB principles and best market practices;
- define a target state and road map for implementation;
- identify material climate and environmental risks for your business model and strategy; and
- support the integration of climate-related and environmental risks into your risk management framework (including modelling and stress testing).

PwC's Climate Excellence tool

Our Climate Excellence tool will help you to calculate the likely impact of specific climate transition risks such as changing prices, demand, technological advances or regulatory intervention. The tool enables holistic climate-risk analysis of the financial portfolios of up to 40,000 listed securities.

Disclosure

Financial institutions will soon be required to disclose new information on their business activities. While disclosure requirements were already applicable for some companies under the Non-Financial Reporting Directive (information included in the annual reports on the way they operate and manage social and environmental challenges), the EU Taxonomy Regulation (2020/852) defines the criteria to be considered by companies (including all financial market participants) when disclosing their sustainable business activities. Additionally, the Sustainable Finance Disclosure Regulation (2019/2088) adds further disclosure requirements for financial market participants and financial advisers. It's essential to start preparing now to meet the demand for transparency and accountability from regulators, shareholders, customers and society at large.

5

What do you want to do?

- Understand which products fall within the scope of the requirements.
- Match the disclosure requirements with available data.
- Prepare the data to be disclosed as per applicable regulatory requirements.
- Disclose ESG related risks.
- Reinforce your sustainable finance positioning within the industry by implementing voluntary disclosure.
- Effectively communicate your ESG-related achievements to the public.
- Leverage existing reporting frameworks to allow for more transparency and comparability.

PwC can help you to:

- create a data requirements flow;
- map the investments behind your financial products according to the EU Taxonomy criteria;
- prepare the required financial disclosures (environmentally sustainable turnover and expenditure) Identify the impacts of the various disclosure requirements on your organisation; and
- build a roadmap that integrates your priority actions for pre-contractual and organisational disclosure information.

We can also help you to evaluate voluntary sustainable finance initiatives (e.g. United Nations Principles for Responsible Investment, UN Global Compact, etc.) by developing decision trees that will allow you to assess the impact on your products, design and implement CSR/Non-Financial Reporting (e.g. TCFiD, GRI).

The transition to a sustainable economy is accelerating

Organisations need to prepare now.

It means better business for a better world.


BANK

To find out more about sustainable finance, the likely impact on your organisation and how PwC can help, please get in touch.

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