THOUGHT LEADERSHIP

Non-Financial Reporting: Ready, Set, Green

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Non-Financial Reporting (NFR) is slowly but gradually becoming mainstream, particularly when it comes to green or sustainable activities. It all began with the Kyoto Protocol in 1997 which paved the way for the climate change movement.

In the years following we saw the rise of multiple frameworks and initiatives, getting differing amounts of traction in the market. We saw a benchmark event in 2018 with the launch of the EU Action Plan on Sustainable Finance. It signalled that the EU is taking things seriously, and the initiatives sprouting from this all have their due dates in the coming years. Trailing the Action Plan are a number of initiatives and frameworks that are rapidly maturing and getting more and more recognition in the market.

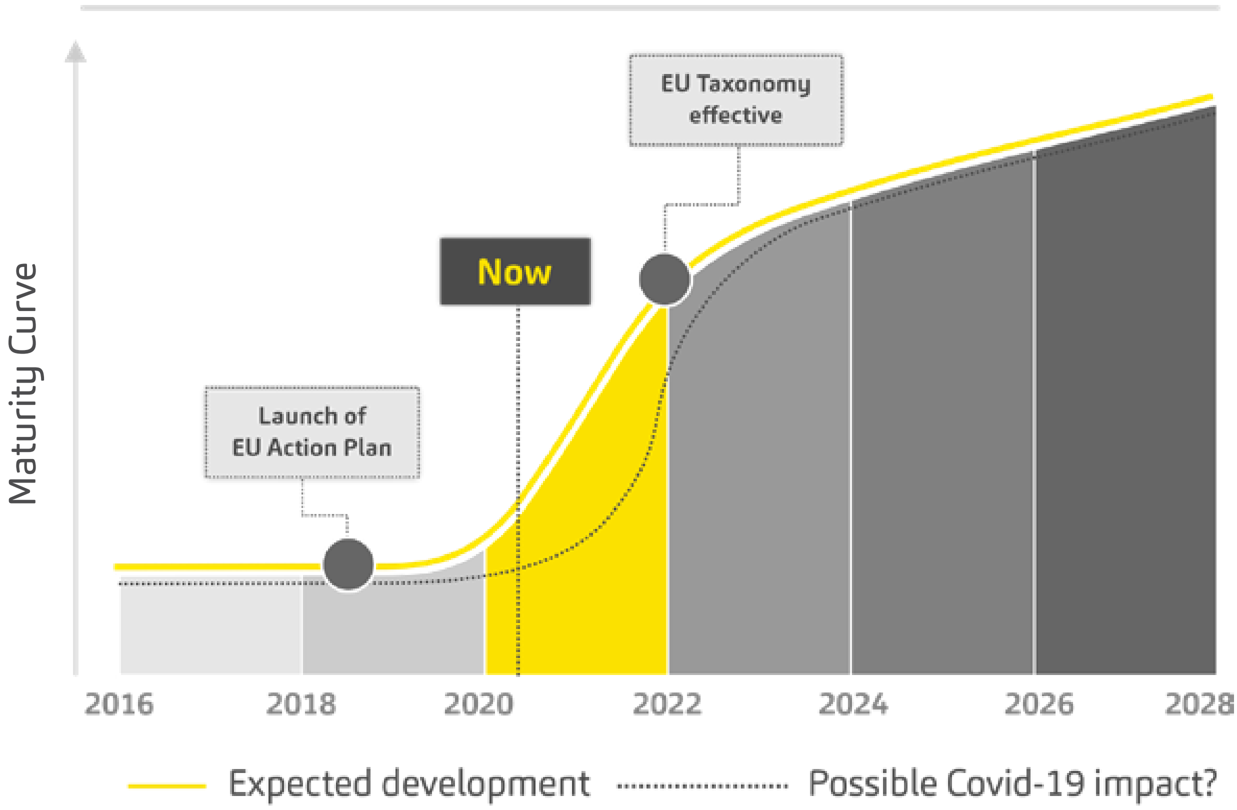
In the midst of all of the above initiatives, the challenge for financial institutions becomes to understand what is expected of them in terms of NFR. With the number of NFR regulations and initiatives skyrocketing, are banks prepared for what is coming?

Sustainable Finance rapidly maturing

Why is it critical to look at Sustainable Finance and its impact now?

- Green Deal proposal in the EU is a political landmark, showing the EU is serious about its climate change ambitions.
- EU Action Plan for moving investments towards more sustainable investment opportunities is taking shape.
- Examples are the published TEG report on the EU Taxonomy and first publications from the European Supervisory Authorities (EBA, ESMA and EIOPA).
- Climate awareness in society has been rising since the Paris Agreement and multiple natural disasters in the past years that make the potential effects of climate change more tangible.
- Pressure from stakeholders to integrate environmental, and more broad, ESG-considerations in company strategies. Not only from societal action groups, but also investors, clients and employees demand long-term responsibility.
- Competition is moving, green products and investment opportunities are becoming more and more common in the market.
- Potential impact of the Coronavirus and the impact on the timelines currently unknown, but could lead to a delay in implementation in the regulations and disturb the SF momentum.

Expected Maturity Curve of Sustainable Finance in the Coming Years



2020-2022	Rapid maturity development due to regulation on new SF concepts and start of supervisory incorporation of SF in existing frameworks, sparked by the EU action plan on SF
2022-2024	Market practice will become available, expected push for more consistency and start of more regulatory stringency

The Shape of Things to Come

The current form and shape of NFR is mostly based on the high-level of regulatory requirements as set in the non-financial reporting directive of the EU. Additionally, in The Netherlands most financial institutions (particularly big banks) publish detailed information on sustainability performance, either in their regular corporate disclosures or as a separate sustainability report. Some banks are already making use of the available voluntary frameworks to make their reporting more mature. The vast number of different approaches and the voluntary nature of the detailed disclosures, however, leads to a scattered reporting landscape in which the users of information cannot easily compare and use the information for decision making.

With the EU Action Plan as the driving force, 2020 was poised to be a year where financial institutions collectively as an industry would accelerate the march towards a mandatory, rigorous and standardized NFR. However, with the current Coronavirus crisis it is not yet known what will happen to the timelines of NFR and, more generally, Sustainable Finance. The below overview (Exhibit 1.) shows a selection of the most relevant regulations and initiatives with regard to NFR which we believe are poised to gain traction soon.

Exhibit 1. Most Recent Non-Financial Reporting Initiatives

Regulation or Initiative	Status	Summary
EU Parliament (2014) Directive 2014/95/EU about Non-Financial Reporting	**Compulsory** Effective since 2018	From 2018 onward, EU law requires large companies disclose certain information about the way they operate and manage social and environmental challenges. Review of the directive is underway with a public consultation in H1 2020.
EU Commission (2019) Guidelines on reporting climate-related information	**Non-Binding Guidelines** Effective since 2019	Explanations of key concepts in relation to reporting climate information under the Non-Financial Reporting Directive.
EU Commission (2020) Taxonomy on Sustainable Finance	**Compulsory** Effective by end of 2021	Delegated acts on the classification of activities as 'sustainable' or 'green', corporate disclosure delegated act expected on 1 June 2021.
European Banking Authority (2020) Pillar 3 update	**Expected Application Date in** June 2022	• The identification of key risk metrics (qualitative and quantitative) and disclosure. • Incorporating existing work such as the Guidelines on reporting climate-related information, the EU taxonomy and the Task Force on Climate-related Financial Disclosures (TCFD) recommendations (see below).
Financial Stability Board (2015) Taskforce Climate-related Financial Disclosure (TCFD)	**Non-Binding Guidelines** Recommended by EU	Helping companies understand what financial markets want from disclosure in order to measure and respond to climate change risks and opportunities.
United Nations (2019) The Principles for Responsible Banking. Banks commit to strategically align with the Paris Agreement and Sustainable Development Goals	**4 years After Signing Date**	Banks must be transparent and clear about how their products and services create value for their customers, clients, investors, as well as society. Supported by a strong implementation framework that defines clear accountabilities and requires each bank to set, publish, and work toward ambitious targets.
International Integrated Reporting Framework (2013) Integrated reporting framework	**Non-Binding Guidelines**	Prescribes disclosure on the most material topics of an organization, and relating it to the company's strategy, governance, metrics, targets and the impact it has on all stakeholders.
Platform for Carbon Accounting Financials (PCAF) From the Netherlands to a global collaboration (55+ FIs worldwide)	**Non-Binding Guidelines**	Improve carbon footprinting in the financial sector and to create a harmonised carbon footprinting approach for financial instruments. Enabling transparency, accountability and creating an open-source global carbon accounting standard covering various asset classes

Our Preliminary Observations

It can be a daunting task for any institution to interpret all of the above regulations and initiatives, particularly when there is considerable overlap. Below you will find some key highlights (especially from the recently published EU approach) that Financial Institutions need to pay attention to, in particular:

- **Broad Impact:** Sustainable Finance is bound to impact not only the reporting department of a given bank, but other critical areas including governance, strategy, risk management and finance.

- **Climate in Focus:** The current focus in the EU is mostly on climate action, evidenced by the recent publication of the Technical Expert Group on Sustainable Finance. Two of the six main objectives of the EU action plan have been worked out in detail, namely: climate mitigation and climate adaption. The other four have only been defined in the context of do-no-significant-harm criteria. Implementation timelines for climate-related objectives and other objectives vary considerably.

- **Impactful Disclosures:** Disclosures from banks should cover the areas where they make the biggest impact – their client investment and lending portfolios. This means that new client data is probably needed, and interaction is necessary with all client segments to obtain the needed data.

- **Current Practices:** In their approach, the EU surely takes into account the current market practice – for example the green bond standards or green loan standards that were already published by industry associations.

- **Disclosure Alignment:** The EU action plan is expected to further push for mandatory disclosures based on the existing EU Directive. This implies that NFR will need to be closely aligned to financial reporting in terms of policies, data, internal governance and controls.

Beyond Reporting

Strategy, governance, risk management and client data are important topics which are all expected to be impacted in one way or another by the NFR initiatives. In short, these initiatives will spark a much broader debate than just reporting and discussions could even go up to the level of the managing board. How to start the discussion, and where to start implementation? In Exhibit 2. below we have listed some considerations that can help you in getting started on NFR and the broader area of Sustainable Finance. They reflect our views on what is important.

Exhibit 2. Synechron's Key Considerations on Non-Financial Reporting

Create urgency within the institution - With the EU action plan initiatives coming into effect already in 2020, there is a unique opportunity to create urgency and priority. Also, the pledges made by a large amount of financial institutions to comply with the Principles of Responsible Banking can assist you here.	**Set up a clear (data) governance process** - Assign ownership, with senior management sponsorship, and assigned data stewards on an operational level to ensure data quality as close to the source as possible and/or quick response in case of data quality issues.
Think about data early - Clearly define data requirements needed to support (future) reporting requirements and identify the key sources of this data. Ensure consistent definitions, data-gathering, storage and controls and think about how to collect data from prospective clients.	**Involve a broad range of departments** - Involve finance to leverage on the existing financial reporting processes to embed non-financial data and reporting in your organisation. Involve risk management, strategy and governance departments to ensure embedding in key processes within the institution.

From Obligation to Opportunity

One lesson to be learned from the last financial crisis is that regulations/initiatives should not only be seen as an obligation but also an opportunity to create competitive advantage. This can hold true especially for initiatives in which the society benefits from the outcome; for example, the reduction of greenhouse gas emissions.

Food for thought: If the lack of action regarding "Sustainable Finance" has the potential to threaten our very existence, it is better to have a proactive approach (ACT NOW). A pertinent question all financial institutions must be asking themselves: are we ready to not only oblige in terms of the regulation and latest initiatives but also to convert this into an opportunity for the company and a gift to society and customers?

Synechron's Business Consulting Practice

Synechron's team of highly skilled Business Consultants can help by providing analysis of the current market practices and draft regulations in your jurisdiction. We can offer strategies to translate these into a structured data approach, set up the correct governance processes, and leverage key data science techniques for proper management practices.

Clear data governance structures and good data management practices are key elements that facilitate financial institutions to adapt swiftly to new and emerging regulations while having the mechanisms in place to be in control. Our targeted approach to sustainable finance is ambitious and at the forefront of innovation to develop the overall vision of Sustainable Finance embraced by Synechron.

Global Footprint

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