Governance Reform Fund (GRF) Project
Supporting the Government of Georgia in Enhancing Governance & Policies for a Transition to a Circular Economy

Environmental, Social and Governance Requirements

Sustainable Finance

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Key Objectives of the Seminar

- **An Overview of Sustainable Finance Principles**
  - General global facts, figures and trends.
  - Initiatives (PRI, UNEP FI Principles for Responsible Banking, etc.).
- **Commonly recognized ESG Investment Strategies, Mix of Strategies, ESG Filters**
  - How to integrate ESG Strategies into investment policy and process.
  - The link between ESG and financial returns.
  - The Importance of E&S risk management – beyond compliance.
- **An Overview of the EU Sustainable Finance Framework**
  - EU Regulation on Sustainable Investments Disclosure Rules.
  - The EU Sustainable Finance Framework.
  - The EU Taxonomy.
- **Overview of Typical Financial Institution's Environmental Due Diligence and Monitoring Requirements**

Key Principle of Sustainable Finance

- Sustainable finance refers to the process of taking **environmental, social and governance (ESG) considerations** into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects.
  - **Environmental considerations** might include climate change mitigation and adaptation, as well as the environment more broadly, for instance the preservation of biodiversity, pollution prevention and the circular economy.
  - **Social considerations** could refer to issues of inequality, inclusiveness, labour relations, investment in people and their skills and communities, as well as human rights issues.
  - The **governance** of public and private institutions – including management structures, employee relations and executive remuneration – plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.

Sustainable Finance in EU Context

- In the EU's policy context, sustainable finance is understood as finance to support economic growth while reducing pressures on the environment to help reach the climate- and environmental objectives of **the European Green Deal**, taking into account social and governance aspects.

- Sustainable finance also encompasses transparency when it comes to risks related to ESG factors that may have an impact on the financial system, and the mitigation of such risks through the appropriate governance of financial and corporate actors.

- Sustainable finance has a key role to play in delivering on the policy objectives under **the European Green Deal** as well as the EU's international commitments on climate and sustainability objectives. It does this by channelling private investment into the transition to a climate-neutral, climate-resilient, resource-efficient and fair economy, as a complement to public money.

What is Transition Finance?

- **Sustainable finance** is about financing both what is already environment-friendly today (green finance) and what is transitioning to environment-friendly performance levels over time (transition finance).

- **Transition finance** is about financing private investments to reduce today’s high greenhouse gas emissions or other environmental impacts and transition to a climate neutral and sustainable economy. For instance, these could be investments in green production methods or reducing the environmental footprint as far as possible, where no green technologies are yet available.

- **Transition finance** is urgently needed to reduce greenhouse gas emissions by 55% and our environmental impact by 2030. It is often needed by companies that want to become sustainable but need to do so in steps over time - in other words, companies with different starting points that want to finance their journey towards a sustainable future.

Commission Expert Groups on Sustainable Finance

Commission expert groups on sustainable finance:

- Platform on sustainable finance: The Platform is an advisory body subject to the Commission’s horizontal rules for expert groups.

- Member States expert group on sustainable finance: Further information on the MSEG is available on the European Commission Register of Commission Expert Groups and similar bodies.

- Technical expert group on sustainable finance (TEG): The European Commission set up a Technical expert group on sustainable finance (TEG) to assist it in developing its sustainable finance work, in line with the Commission's legislative proposals of May 2018.

- High-level expert group on sustainable finance: The European Commission established a High-level expert group on sustainable finance (HLEG) in December 2016.

Responsible Investing -
ESG relevant Material Factors

Environmental (E)	Social (S)	Governance (G)
Energy Efficiency	Employee Compensation	Board Independence
Carbon Emissions	Benefits	Director Compensation
GHG Emissions	Staff Turnover	Shareholder Voting
Biodiversity	Employee Health	Litigation Risks
Water Usage	Safety Practices and Targets	Corruption/ Bribery policies
Natural Resource Use	Training	Codes of Conduct
Recycling Practices	Diversity and Targets	Transparency Policies
Waste Disposal	Local Community Support	Suppliers Code

(Source: PRI – Global Sustain)

Indicators of the Environmental Pillar

- Emissions & pollution (1) CO2 emissions (metric tons per capita); (2) GHG net emissions/removals by LULUCF (Mt of CO2 equivalent); (3) Methane emissions (metric tons of CO2 equivalent per capita); (4) Nitrous oxide emissions (metric tons of CO2 equivalent per capita); (5) PM2.5 air pollution, mean annual exposure (micrograms per cubic meter);

- Natural capital endowment & management: (1) Adjusted savings: natural resources depletion (% of GNI); (2) Adjusted savings: net forest depletion (% of GNI); (3) Annual freshwater withdrawals, total (% of internal resources); (4) Forest area (% of land area); (5) Mammal species, threatened; (6) Terrestrial and marine protected areas (% of total territorial area);

- Energy use & security: (1) Electricity production from coal sources (% of total); (2) Energy imports, net (% of energy use); (3) Energy intensity level of primary energy (MJ/$2011 PPP GDP); (4) Energy use (kg of oil equivalent per capita); (5) Fossil fuel energy consumption (% of total); (6) Renewable electricity output (% of total electricity output); (7) Renewable energy consumption (% of total final energy consumption);

- Environment/climate risk & resilience: (1) Cooling degree days (projected change in number of degree Celsius); (2) Droughts, floods, extreme temperatures (% of population, average 1990-2009); (3) Heat Index 35 (projected change in days); (4) Maximum 5-day rainfall, 25-year return level (projected change in mm); (5) Mean drought index (projected change, unitless); (6) Population density (people per sq. km of land area)

- Food security: (1) Agricultural land (% of land area); (2) Agriculture, forestry, and fishing, value added (% of GDP); (3) Food production index (2004-2006 = 100);

Indicators of the Social Pillar

- Education & skills: (1) Government expenditure on education, total (% of government expenditure); (2) Literacy rate, adult total (% of people ages 15 and above); (3) School enrolment, primary (% gross);

- Employment: (1) Children in employment, total (% of children ages 7-14); (2) Labor force participation rate, total (% of total population ages 15-64) (modeled ILO estimate); (3) Unemployment, total (% of total labor force) (modeled ILO estimate);

- Demography: (1) Fertility rate, total (births per woman); (2) Life expectancy at birth, total (years); (3) Population ages 65 and above (% of total population);

- Poverty & inequality: (1) Annualized average growth rate in per capita real survey mean consumption or income, total population (%); (2) Gini index (World Bank estimate); (3) Income share held by lowest 20%; (4) Poverty headcount ratio at national poverty lines (% of population);

- Health & nutrition: (1) Cause of death, by communicable diseases and maternal, prenatal and nutrition conditions (% of total); (2) Hospital beds (per 1,000 people); (3) Mortality rate, under-5 (per 1,000 live births); (4) Prevalence of overweight (% of adults); (5) Prevalence of undernourishment (% of population);

- Access to services: (1) Access to clean fuels and technologies for cooking (% of population); (2) Access to electricity (% of population); (3) People using safely managed drinking water services (% of population); (4) People using safely managed sanitation services (% of population);

Indicators of the Governance Pillar

- Human rights: (1) Strength of legal rights index (0 = weak to 12 = strong); (2) Voice and accountability (estimate);
- Government effectiveness: (1) Government effectiveness (estimate); (2) Regulatory quality (estimate);
- Stability & rule of law: (1) Control of corruption (estimate); (2) Net migration; (3) Political stability and absence of violence/terrorism (estimate); (4) Rule of law (estimate)
- Economic environment: (1) Ease of doing business index (1 = most business-friendly regulations); (2) GDP growth (annual %); (3) Individuals using the internet (% of population);
- Gender: (1) Proportion of seats held by women in national parliaments (%); (2) Ratio of female to male labor force participation rate (%) (modeled ILO estimate); (3) School enrollment, primary and secondary (gross), gender parity index (GPI); (4) Unmet need for contraception (% of married women ages 15-49);
- Innovation: (1) Patent applications, residents; (2) Research and development expenditure (% of GDP); (3) Scientific and technical journal articles;

Responsible Investing – ESG Investment Strategies

Strategy	Explanation
Negative	Exclusionary Screening: The exclusion of certain sectors from investors' portfolios based on specific ESG criteria.
Positive	Best in Class Screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers.
Norms based screening	Screening of investments against minimum standards of business practice based on international norms.
Integration of ESG factors	The systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis.
Sustainability themed Investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture).
Impact Investing	Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.
Corporate Engagement and Shareholder Action	The use of shareholder power to influence corporate behavior, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.

Principles for Responsible Investment (PRI)

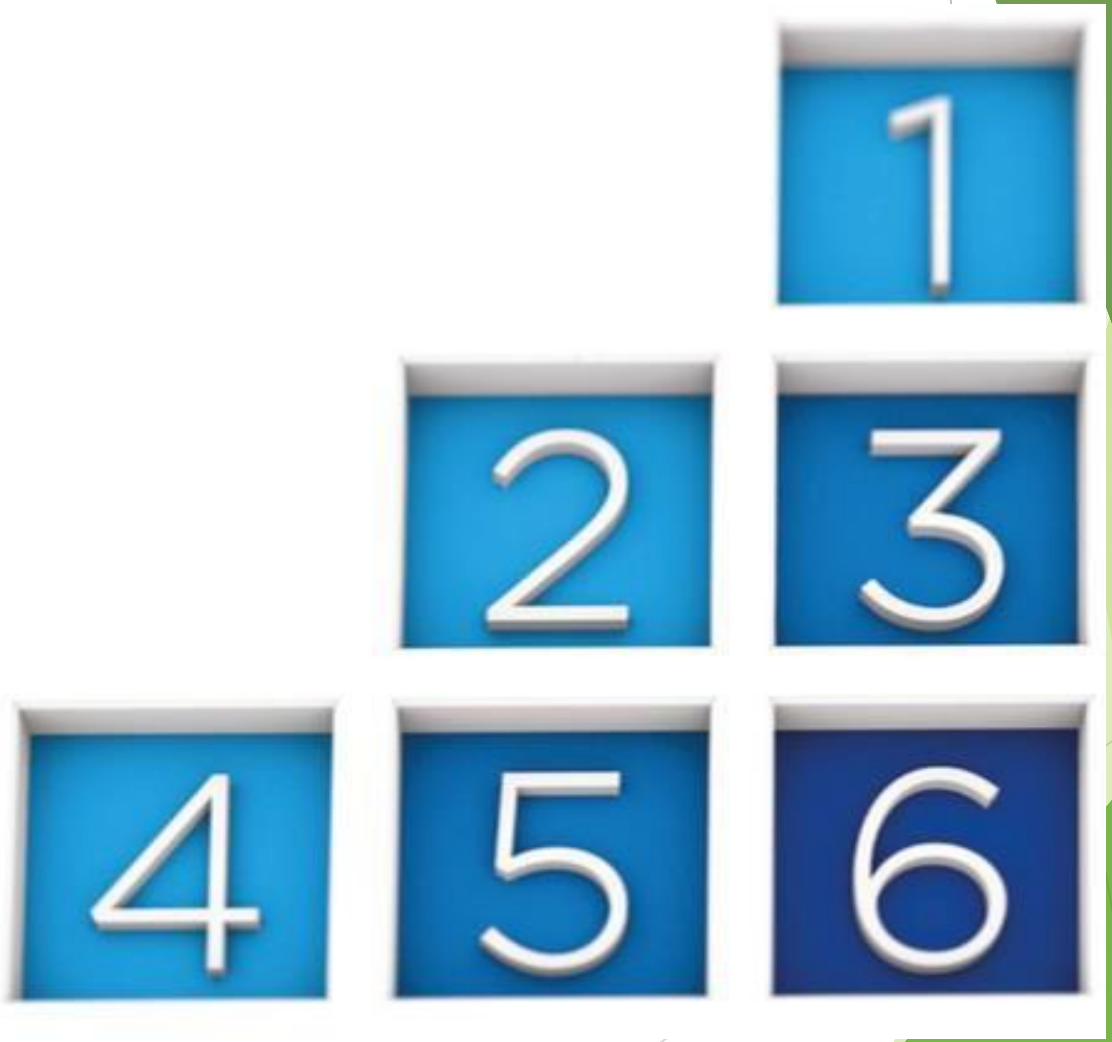
What is the PRI?

- The PRI is the world's leading proponent of responsible investment. It works:
  - to understand the investment implications of environmental, social and governance (ESG) factors;
  - to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions
- The PRI acts in the long-term interests:
  - of its signatories;
  - of the financial markets and economies in which they operate;
  - and ultimately of the environment and society as a whole.

PRI Principles for Responsible Investment

The six PRI Principles

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.



(Source: PRI)

The PRI Value Driver Model for Responsible Investing

(Source PRI)

Responsible Investing – ESG Investment Formula

ESG STEPS TO APPLY

1. Fundamental financial analysis strategy.
2. Development of a Responsible Investing (ESG) policy / strategy.
3. E&S due diligence according to e.g. EBRD standards:
    - Categorization of investment (high/medium/low E&S risk).
    - Identification of E&S issues and mitigation measures.
    - Comparison of ESG data of target company to ESG Policy of PE Fund.
    - Drafting of internal ESG report about target company.
    - E&S Action Plan (ESAP) if needed.
    - Inclusion of E&S requirements and ESAP into legal agreements.
4. Ongoing monitoring, annual reporting, dialogue and continuous improvement over the life of the investment.

ESG FILTERS TO APPLY

- 1st Filter: Generic Standard ESG policy and strategy.
- 2nd Filter: ESG Metrics Integration. Indicative ESG Weights: E:X%, S:X%, G:X%.
- 3rd Filter: Negative Screening applying the EBRD exclusion list (sectors excluded).
- 4th Filter: Positive Screening (preferred sectors/themes selected).
- 5th Filter: Norms-based selection.
- PE ESG relevant Portfolio created.
- PE Fund as active ESG Investor.

EU Sustainable Finance

EU Regulatory Framework

An overview of the EU Sustainable Finance Framework:

- EU Regulation on Sustainable Investments Disclosure Rules.
- EU Taxonomy.
- EU Green Bond Standards.
- EU Climate Benchmarks.
- Climate Related Reporting.

European Union Sustainable Finance

ec.europa.eu

The Grand Design for the EU Financial Industry

EU Sustainable Finance Framework documents (633 pages in total):

1. An EU classification system – the so-called EU taxonomy – to determine whether an economic activity is environmentally sustainable (414 pages +25 pages the supplementary report).

2. An EU Green Bond Standard (78 pages).

3. Methodologies for EU climate benchmarks and disclosures for benchmarks (66 pages).

4. Guidance to improve corporate disclosure of climate-related information (50 pages) including alignment to the Non-Financial Reporting (NFR) Directive and TCFD (Task Force for Climate-related Financial Disclosures).

EU Sustainable Finance Strategy

Over the past years, the EU has been building a sustainable finance framework to:

- support the flow of private finance towards sustainable economic activities
- make the transition to a carbon neutral economy by 2050 possible

2018: THE EU LAID THE FOUNDATIONS FOR SUSTAINABLE FINANCE

1. EU TAXONOMY

A common classification of economic activities substantially contributing to environmental objectives, using science-based criteria.

- Taxonomy Regulation: adopted on 18 June 2020

2. DISCLOSURES

Comprehensive disclosure regime for both non-financial and financial institutions to provide investors with the information necessary to make sustainable investment choices.

- Sustainable Finance Disclosure Regulation (SFDR) applies since March 2021
- Corporate Sustainability Reporting Directive (CSRD) proposed by the Commission in April 2021
- Sustainability preferences: adopted by the Commission in April 2021

3. TOOLS

Broad toolbox for companies, market participants and financial intermediaries to develop sustainable investment solutions, while preventing greenwashing.

- EU Climate Benchmarks Regulation applies since April 2020
- Standard for European green bonds (EuGB), proposed by the Commission today

New Actions under EU Action Plan

- Reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth:
  1. Establishing an EU classification system for sustainability activities
  2. Creating standards and labels for green financial products
  3. Fostering investment in sustainable projects
  4. Incorporating sustainability when providing investment advice
  5. Developing sustainability benchmarks
- Mainstreaming sustainability into risk management
  6. Better integrating sustainability in ratings and research
  7. Clarifying institutional investors and asset managers' duties
  8. Incorporating sustainability in prudential requirements
- Foster transparency and long-termism in financial and economic activity
  9. Strengthening sustainability disclosure and accounting rule-making
  10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

The EU Sustainable Finance Action Plan: An Overview

Main developments (sustainable finance)

- **2018:** EU Commission's action plan for financing sustainable growth
- **2021:** Strategy for financing the transition*

Main Developments (climate law)

- **2019:** European Green Deal.
- **14 July 2021:** "Fit for 55" Package.

EU Goals towards climate neutrality.

The 2018 Plan outlines **ten objectives** in **three areas**:

Macro-areas	Objectives	EU Initiatives
Reorienting capital flows towards sustainable investment	1. Establishing an **EU classification system** for sustainability activities	Taxonomy Regulation and Taxonomy Delegated Regulations (climate mitigation and adaptation)
	2. Creating **standards and labels** for green financial products	EU Green Bond Standard
	3. Fostering investment in sustainable projects	
	4. Incorporating sustainability when providing **investment advice**	Rules on sustainability preferences and investment advice (MIFID II)
	5. Developing **sustainability benchmarks**	EU "Climate Transition" and "Paris Aligned" benchmarks
Mainstreaming sustainability into risk management	6. Better integrating sustainability in **ratings** and research	
	7. Clarifying **institutional investors and asset managers' duties**	SFDR
	8. Incorporating sustainability in **prudential requirements**	
Fostering transparency and long-termism in financial and economic activity	9. Strengthening **sustainability disclosure** and accounting rule-making	Taxonomy Regulation, CSDR
	10. Fostering sustainable corporate governance and attenuating short-termism in capital markets	CSDD

EU Taxonomy

EU Taxonomy

6 Environmental Objectives

- Climate change mitigation
- Climate change adaptation
- Water and marine resources
- Recycling and waste management
- Pollution prevention and control
- Biodiversity

To be taxonomy-aligned...

Taxonomy Eligible	Economic activity that has been technical screening criteria for one of the 6 environmental objectives
Substantial Contribution	Economic activity meets the technical screening criteria threshold for substantial contributions
Do No Significant Harm	Economic activity does not do significant harm to any of the other 5 environmental objectives
Taxonomy Eligible	Does not breach social safeguards set out in OECD multinational guidelines

Establishing an EU classification (Taxonomy) system for sustainable activities

- **The EU Taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. Setting a common language between investors, issuers, project promoters and policy makers, it helps investors to assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change.**

- The Taxonomy Regulation entered into force on 12 July 2020. Delegated Act sets out a list of Technical Screening Criteria for the first two objectives:

  - Climate Change Mitigation

  - Climate change adaptation

- From October 2020 the TWG of the Platform for SF has been working on set of technical criteria for the remaining 4 environmental objectives. The results of the Platforms work were published for consultation in August 2021 and were expected to be formalised in the Delegated Act in 2022.

- On 2 February 2022, the Commission approved in principle a Complementary Climate Delegated Act including, under strict conditions, specific nuclear and gas energy activities in the list of economic activities covered by the EU taxonomy.

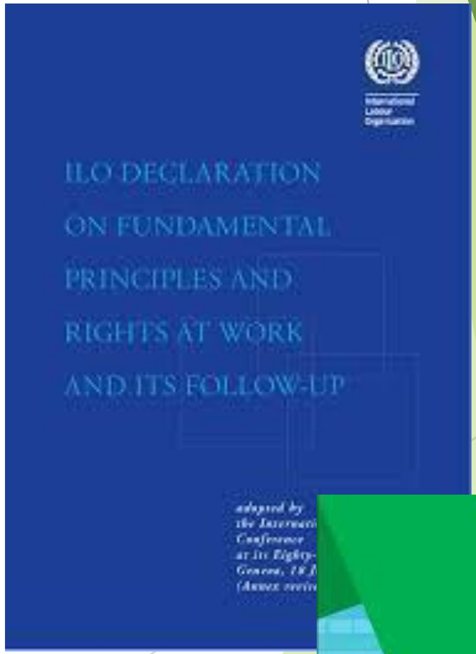
The EU Taxonomy – Minimum Social Safeguards

The minimum safeguards referred to in Article 3(c) of the Taxonomy legislative proposal shall be procedures implemented by the undertaking that is carrying out an economic activity to ensure that the principles and rights set out in the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work are observed.

Adopted in 1998, the Declaration commits Member States to respect and promote principles and rights in four categories, whether or not they have ratified the relevant Conventions.

These categories are: freedom of association and the effective recognition of the right to collective bargaining, the elimination of forced or compulsory labour, the abolition of child labour and the elimination of discrimination in respect of employment and occupation.

https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-minimum-safeguards_en.pdf



How Investors will use the Taxonomy in 5 Steps

1	Identify the activities conducted by the company, issuer or covered by the financial product (e.g. projects, use of proceeds) that could be eligible.
2	For each activity, assess whether the company or issuer meets the relevant criteria for a substantial contribution e.g. electricity generation <100g CO^{2}/kWh.
3	Verify that the DNSH criteria are being met by the issuer. Investors using the Taxonomy would most likely use a due-diligence like process for reviewing the performance of underlying investees.
4	Conduct due diligence to avoid any violation to the social minimum safeguards stipulated in the Taxonomy regulation (article 13).
5	Calculate alignment of investments with the Taxonomy and prepare disclosures at the investment product level.

Substantial Contribution to Climate Change Mitigation

Type of activity	Technical screening criteria	Examples
1) Activities that are already low carbon. Already compatible with a 2050 net zero carbon economy	Likely to be stable and long-term	• Zero emissions transport • Near to zero carbon electricity generation • Afforestation
2) Activities that contribute to a transition to a zero net emissions economy in 2050 but are not currently operating at that level.	Likely to be subject to regular revision, tending towards zero emissions.	• Building renovation; • Electricity generation <100g CO2/kWh • Cars <50g CO2/km
3) Activities that enable those above.	Likely to be stable and long-term (if enabling activities that are already low carbon) or subject to regular revision tending to zero (if enabling activities that contribute to transition but are not yet operating at this level).	• Manufacture of wind turbines • Installing efficient boilers in buildings

To transition to a net-zero emissions economy, the EU must grow the low-carbon sector, encourage sequestration, decarbonise existing industry and avoid promoting activities which are incompatible with climate mitigation goals.

The Taxonomy will reflect this by considering three kinds of activities as making a substantial contribution to climate change mitigation.

The Taxonomy will not include efficiencies in activities which ultimately undermine climate mitigation objectives, such as coal-powered electricity generation. Improving the efficiency of these activities may provide short-term benefits, but they are not considered consistent with the aims of the Taxonomy.

EU Taxonomy compass

The EU Taxonomy Compass aims to make the contents of the EU Taxonomy easier to access for a variety of users. It enables users to check which activities are included in the EU Taxonomy (taxonomy-eligible activities), to which objectives they substantially contribute and what criteria they have to meet. It is important to note that minimum safeguards (social standards) have to be met for an economic activity to be considered taxonomy-aligned.

Link: https://ec.europa.eu/sustainable-finance-taxonomy/

EU Green Bonds Standards

What are Green Bonds

- A Green bond is a fixed-income financial instrument which is used to fund projects that have positive environmental and/or climate benefits.

- Green bonds are fundamentally the same as conventional bonds: a loan made by an investor to an organization to finance a project, with the investor receiving the principal amount at the end of the loan's life, in addition to interest payments (depending on the loan terms) throughout the loan's term.

- Green Bonds - use The International Capital Market Association (ICMA) standards.

- The Green Bond Principles (GBP) seek to support issuers in financing environmentally sound and sustainable projects that foster a net-zero emissions economy and protect the environment. GBP-aligned issuance should provide transparent green credentials alongside an investment opportunity. By recommending that issuers report on the use of Green Bond proceeds, the GBP promote a step change in transparency that facilitates the tracking of funds to environmental projects, while simultaneously aiming to improve insight into their estimated impact.

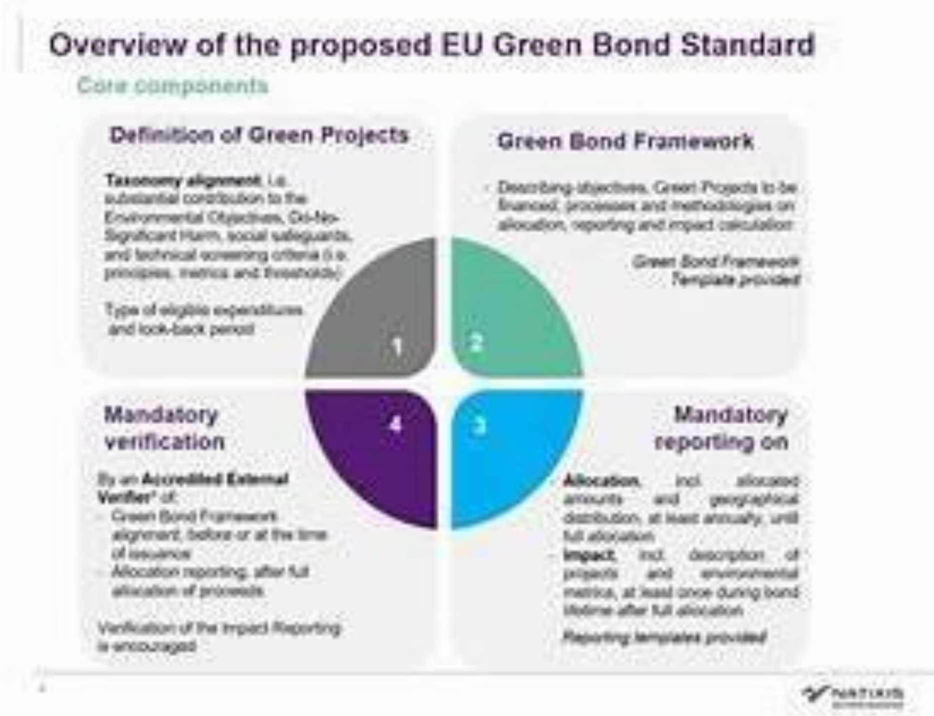
The Green Bond Principles

EU Green Bonds Standards

- **Creating standards (EU Green Bond Standard) and labels for green financial products**

  Confusion and greenwashing involving green financial products reduces confidence in the market and diverts capital away from activities that can deliver sustainable outcomes. The creation of standards and labels for green financial products – such as green bonds – will increase investors' confidence and encourage more capital flow to these products.

- On the 6th July 2021 the EU proposed a new regulation to create the EU Green Bond Standard (EuGBS)



<u>Issues to Consider:</u>

ICMA Green Bond and Sustainability Linked Bonds principles used. These are not Taxonomy based.

Q. Will ICMA be same as EU Green Bond?

Green and Sustainability Linked Bonds

We will see more and more use of capital market instruments to finance projects. Such projects need to have clear KPIs to define what is green:

- Green Bonds – use ICMA Guidelines in future EU Green Bond criteria (i.e. taxonomy). Climate Bond Initiative is developing guidance for Green bonds definition for existing and new plants (mainly for GHG emission).
  - Definite real targets and green criteria will be essential
  - Sustainability linked bonds – definition or KPIs and verification.
- Good advice is need and Second Party Opinion (SPOs). For the steel sector the definition of what is green and what are realistic targets will be key
- The bonds will require annual reporting, this will be done internally and externally.
- Use of capital markets and Green instruments such as Green Bonds and Sustainability Linked Bonds will increase.
- ICMA principles and standards are key https://www.icmagroup.org/sustainable-finance/

Sustainable Finance Disclosure Regulations

The Sustainable Finance Disclosure Regulation (SFDR): Overview

Aim:

- Increase transparency on how institutional investors and financial advisers consider ESG factors in their decision-making processes and activities.
- Make "sustainable" investment options more comparable.
- Prompt firms to consider and make internal strategic changes about how they operate their business before making the mandatory SFDR disclosures.

- Introduced three new concepts of "sustainable investment"; "sustainability risk"; and "sustainability factors"
- Phased approach of implementation with two levels of requirements:
  - Level 1 Requirements (10 March 2021): general harmonised disclosure requirements
  - Level 2 requirements (1 January 2023) regulatory technical standards (RTS) to further specify the content, methodologies and presentation of information under the SFDR
- Has three types of disclosures applied at an entity and product level:
  - public disclosure (website),
  - pre-contractual disclosure (materials circulated to investors)
  - periodic disclosure (eg annual reports).

SFRD – Key Facts

Key facts	– Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment – Published in the Official Journal on 22 June 2020 and entered into force on 12 July 2020
Goals	Focuses on the “E” in ESG to: – define what’s green vs not – mitigate the risk of greenwashing
Who it applies to	The regulation has various strands – one is to amend the SFDR to require additional product level disclosures (e.g. around pension products, insurance-based investment products, UCITS, PEPPs, alternative investment funds etc. and as distinct from entity level disclosures). This strand applies to firms in scope of SFDR – e.g. asset and fund managers, insurers in relation to insurance based investment products, etc
What it does	– Framework to allow for the progressive development of an EU-wide classification system for environmentally sustainable economic activities (i.e. what is considered “green”) – Will ultimately be the mandatory reference point for sustainable financial products in the EU (including any European Green Bond Standard or Ecolabel for Financial Products) – For asset/fund managers and other SFDR “in scope” – in the main, requires “top up” disclosures for products with environmental characteristics or objectives, to disclose their alignment with the taxonomy
When	Commences in a staged way from 1 January 2022 (Level 1) Regulatory Technical Standards (RTS) on product disclosure requirements expected to come into force 1 Jan 2023

Key aspects of SFDR – "Why" & What

"Sustainability risk" is defined in the EU's Sustainable Finance Disclosure Regulation (2019/2088) **as an environmental, social or governance event or condition which, if it occurs, could cause an actual or potential material negative impact on the value of an investment.**

Examples of **sustainability risks** which are **potentially likely to cause a material negative impact on the value of an investment**, should those risks occur, are as follows:

- environmental sustainability risks may include climate change, carbon emissions, air pollution, rising sea levels or coastal flooding or wildfires;
- social sustainability risks may include human rights violations, human trafficking, child labour or gender discrimination; and
- governance sustainability risks may include a lack of diversity at board or governing body level, infringement or curtailment of rights of shareholders, health and safety concerns for the workforce or poor safeguards on personal data or IT security.

Prevent greenwashing

Transparency

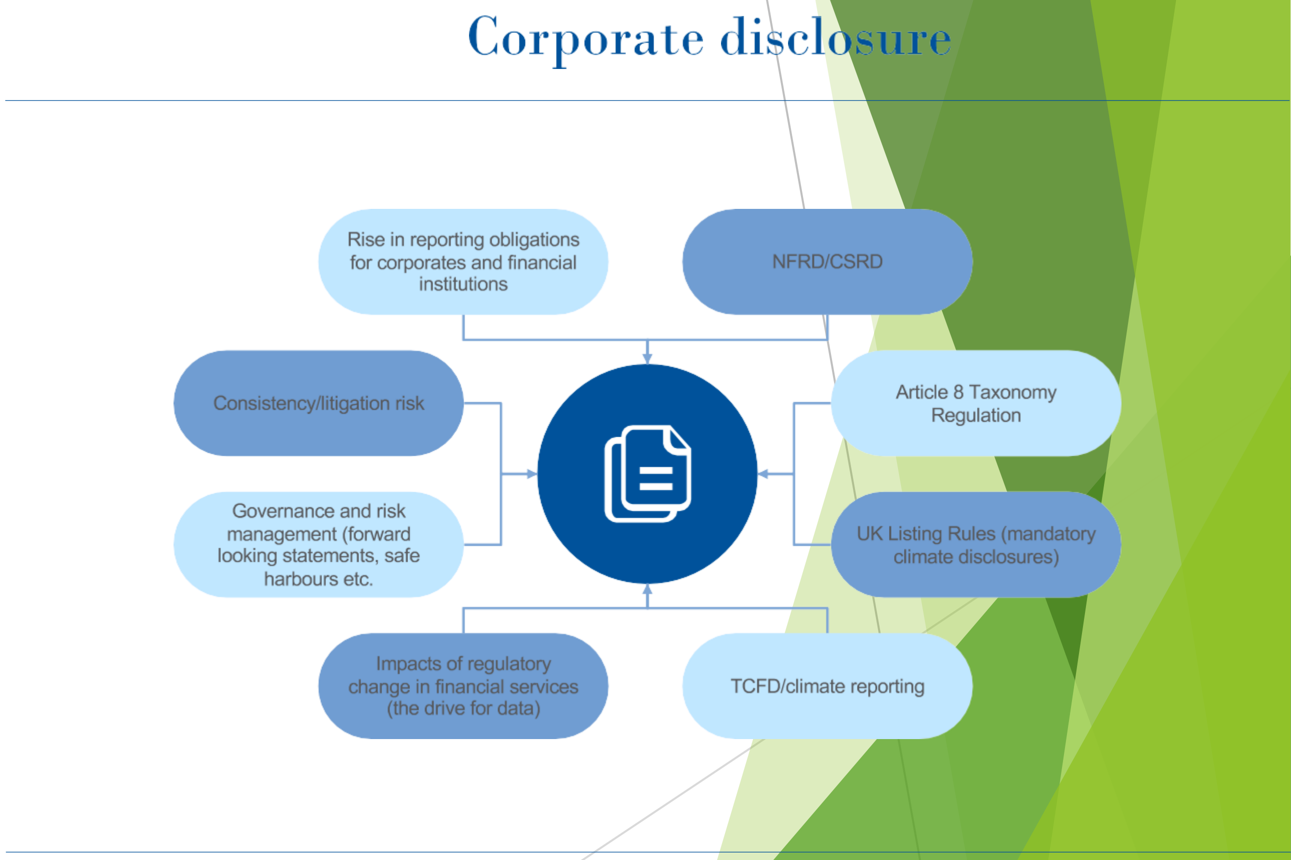
Steer private capital into "ESG"

Corporate Sustainability Reporting Directive (CSRD)

Sustainability Disclosure –

Strengthening sustainability disclosure and accounting rule-making

- Corporate reporting on sustainability to provide sufficient information to guide investors.
- Commission guidelines on reporting climate-related information (June 2019) through the non-financial Reporting Directive.
- 21st April 2021 the EU published a new package of measures including the proposal on the Corporate Sustainability Reporting Directive (CSRD), which will replace the NFRD from 2022.
- November 2022 EFRAG published the European Sustainability Reporting Standards (ESRS) which are to be approved by mid 2023.



Corporate Sustainability Reporting Directive (CSRD)

Amends the existing non-financial reporting rules under the Non-Financial Reporting Directive (NFRD)

- **Aim:**
  - Ensure that both in-scope EU and non-EU companies (including financial institutions) provide adequate public disclosure of the risks that sustainability issues present for those companies, and the impacts of those companies on people and the environment (such as climate change or human rights issues) (known as "the double materiality approach")
  - Make companies more accountable for the risks, opportunities and impacts of their activities on people and the environment.
  - Equip investors and other stakeholders to make better informed decisions on sustainability issues.
  - Make companies more attractive to investors, who will also need to know and to report on the impact of their investment decisions.

NFRD vs CSRD

11,600 companies

APPLICABLE TO

49,000 companies

NFRD

- Large public interest entities with **more than 500 employees** and meeting 1 out 2 financial criteria (total assets > EUR20 million or net turnover > EUR40 million)
- Some countries have applied more strict criteria

CSRD

- **All large companies** (meeting 2 out of 3 criteria: **>250 employees**, total assets >EUR 43 mln or turnover >EUR 50 mln)
- **All companies** (including non-EU companies) **with securities listed on the EU regulated markets** (with >10 employees)

CSRD: Key Features

- Links ESG disclosures to financial reporting: "sustainability report" to be included within management report.
  - Covering, as a minimum, how sustainability factors affect: i) business model ii) policies, including due diligence processes implemented iii) the outcome of those policies; iv) risks and risk management; v) key performance indicators relevant to the business.
- Reporting will be in accordance with new ESRS sustainability reporting standards - giving users of the report an integrated view of their impact and performance on ESG factors.
- Applies a double materiality approach - i.e. entities should report not only how sustainability issues (i.e. sustainability risks, like climate-related risks) affect their business model ("financial materiality") but also the impact of their business activity on the people and the environment ("impact materiality").
- Requires a transition plan - to ensure that its business model and strategy are compatible with the transition to a sustainable economy
- Requires disclosure of due diligence information/ sustainability risks in value chain – sustainability risks within entities' value chain, covering the upstream value chain (i.e. suppliers) and the downstream value chain (i.e. consumers).
- Provides an audit requirement on sustainability reporting
  - "limited assurance": a second party confirms that nothing has come to their attention to indicate that the information is materially misstated.
  - EU Commission expected to require "reasonable assurance", i.e. verification of the compliance with substantive requirements, by 2028
- Promotes digitalisation –requires financial statements and the management report to be in a single XHTML format, tagged in accordance with a digital taxonomy, to make information simple and more accessible

CSRD: Who does it apply to?

EU Undertakings	• Large undertakings as defined in the Accounting Directive: • exceed at least two of the following three criteria: (i) balance sheet total of EUR 20 million; (ii) net turnover of EUR 40 million; and (iii) an average number of employees during the financial year of 250. • Small and medium-sized undertakings with securities listed on EU markets, subject to simplified disclosure requirements. • In case of "large" groups*, the EU parent company will produce a consolidated sustainability report.
Non-EU Undertakings	• Parent institutions or Subsidiaries of non-EU groups (i.e. groups whose parent company is not governed by EU law) with substantial presence in the EU, namely: i) substantial operations: net turnover of more than €150 million in the EU for each of the last two consecutive financial years. ii) branch in the EU generating more than €40 million in the preceding financial year.

The Directive will not apply to micro-undertakings, which do not meet two of the following criteria: a balance sheet total of € 350 000, a net turnover of € 700 000; an average of 10 employees.****

European Sustainability Reporting Standards (ESRS)

- The draft European Sustainability Reporting Standards (ESRS) sets out the detailed disclosure requirements under the CSRD.

- Developed by the European Financial Reporting Advisory Group (EFRAG). The standards are tailored to EU policies while building on and contributing to international standardisation initiatives.

  - **Aim:** Provide common, coherent standards to make ESG reporting within the EU more accurate, consistent, comparable, and standardized, just like financial accounting and reporting.

  - **Application:** The ESRS will apply to entities within the scope of the CSRD.

ESRS: Key Features and Provisions

- The ESRS shall consist of three layers of disclosures:
  i) sector-agnostic
  ii) sector-specific
  iii) entity-specific
- The latest ESRS version provides for 12 sector-agnostic standards.
- The first sector-agnostic set of the ESRS will become mandatory from 2024 along with the CSRD.
- Sector-specific standards for 41 identified sectors are expected in 2024, 2025 and 2026.

Current Draft Standards

Cross-Cutting Standards (mandatory and covering all sustainability matters)	ESRS 1: General principles ESRS 2: General, strategy, governance, and materiality assessment
Topical standards (when material)	Environment: ESRS E1: Climate change ESRS E2: Pollution ESRS E3: Water and marine resources ESRS E4: Biodiversity and ecosystems ESRS E5: Resource use and circular economy Social: ESRS S1: Own workforce ESRS S2: Workers in the value chain ESRS S3: Affected communities ESRS S4: Consumers and end-users Governance ESRS G1: Business conduct

CSRD interaction with Taxonomy Regime

Taxonomy Regulation and Delegated Regulation 2021/2178

- The Taxonomy Regulation applies to all entities that make NF statements (and others).
- It establishes additional provisions **obliging entities that make NF statements to disclose how and to what extent their activities are associated with environmentally sustainable economic activities** (Article 8(1)).
- The information must, *for non-financial undertakings*, include the proportion of their:
  - **turnover derived from products/services associated with economic activities that qualify as environmentally sustainable; and**
  - **the proportion of their capital expenditure and operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable (Article 8(2)).**
- Delegated Regulation 2021/2178 provides KPIs for *financial undertakings* (i.e. credit institutions, asset managers, investment firms, and insurance undertakings).
- The Delegated Regulation also specifies the content and presentation of the information to be disclosed by all undertakings and the methodology to comply with the aforementioned Article 8 disclosure.
- The Delegated Regulation complements the CSRD by providing a common reference point for taxonomy-related reporting requirements under the two Directives.

Corporate Sustainability Due Diligence Directive (CSDDD)

Requires companies to undertake due diligence checks to identify, prevent, mitigate, and account for actual and potential adverse impacts on human rights and environmental factors in the company's own operations, their subsidiaries, and their value chains.

- **Aim:**
  - Increase corporate accountability for adverse impacts.
  - Avoid fragmentation of due diligence requirements and ensure coherence with international standards on responsible business conduct (eg UNGP or OECD Guidelines). This should also increase legal certainty for business and stakeholders in turn.
  - Introduce uniform remedies across EU member states for those affected by adverse impacts.
- **Expected impact:**
  - Improved corporate governance practices: mechanisms to identify, manage and mitigate risks and adverse impacts to environmental factors and human rights.
  - Facilitate the identification of adverse impacts across value chains as more companies make this data available.

CSDDD: Key Features

- **Due diligence policies** - Companies will have to disclose their due diligence policy, to be updated annually.
- **Due diligence measures** – Companies will need to implement due diligence measures that map and identify potential adverse impacts across their chain of activities and establish measures to either prevent or bring them to an end.
- **Supervisory authorities** - Member States will designate an authority to supervise and impose effective, proportionate and dissuasive sanctions, including fines and compliance orders.
- **Civil Liability** - Member States will ensure that victims get compensation for damages resulting from the failure to comply with due diligence obligations.
- **Transition plans** – need to disclose a plan, including *implementing actions and related financial and investments plans*, to ensure that the business model and strategy of the company are *compatible with the transition* to a sustainable economy and with the limiting of global warming to 1.5ºC in line with the *Paris Agreement* and the objective of achieving *climate neutrality by 2050.*

CSDDD: Who does it apply to?

Large EU limited liability companies	Non–EU companies

According to employee and turnover criteria (in line with CSRD):
 	
Group 1: 500+ employees and net EUR 150 million+ turnover worldwide.
 	
Group 2: 250+ employees and net EUR 40+ million turnover worldwide, and operating in defined high- impact sectors.
 	
• Estimated to cover about 13,000 EU companies.
	Third country companies active in the EU with turnover threshold aligned with Group 1 and 2.
	
	• turnover needs to be generated in the EU to ensure that third country companies are not more likely to fall within the scope.
	
	• Covered third country companies should designate an EU-based representative:
	  • To receive communications from supervisory authorities.
	  • To cooperate with supervisory authorities on compliance and enforcement matters (Article 16).
	
	• Estimated to cover about 4000 third-country companies.

EU Council CSDD text

Overview of the related standards

List of key standards/guidance

#	Organisation	Initiative / Document
1	European Financial Reporting Advisory Group	Draft European Sustainability Reporting Standards
2	International Sustainability Standards Board	Prototype Climate and General Disclosure Requirements
3	Task Force on Climate-related Financial Disclosures	TCFD Recommendations
4	Global Reporting Initiative	GRI standards
5	Value Reporting Foundation	Relevant sectoral SASB Standards
6	Climate Disclosure Standards Board	CDSB Framework
7	CDP	CDP data
8	World Benchmarking Alliance	WBA Benchmarks
9	Greenhouse Gas Protocol	GHG Protocol

#	Organisation	Document
10	EU	Accounting Directive/Corporate Sustainability Reporting Directive
11	EU	Sustainable Finance Disclosure Regulation (incl. delegated acts)
12	EU	Taxonomy Regulation (incl. delegated acts)
13	EU	Conflict Minerals Regulation
14	Shift and Mazars	UN Guiding Principles on Business and Human Rights Reporting and Assurance Framework
15	OECD	OECD Due Diligence Guidance for Responsible Business Conduct
16	Science Based Targets Initiative	SBTi tool
17	The Paris Agreement Capital Transition Assessment	PACTA tool

CDP
TCFD
GRI
SASB
CDSB
INTEGRATED REPORTING

EU Taxonomy, SFDR, CSRD

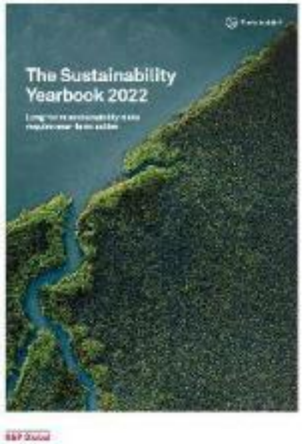
European Commission

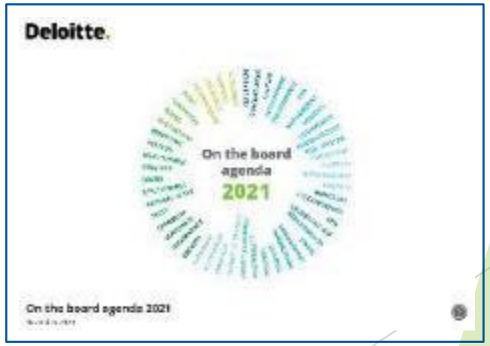
EU Taxonomy

EU Benchmarks

Sustainable Finance Disclosure Regulation

ESG reporting guidance - ISSB set up at COP 26





Network for Greening the Financial System

Several policy options for greening monetary policy instruments have been explored by **the NGFS**:

- **Green refinancing operations:** central banks can adopt green conditions when banks refinance themselves from central banks, for example by granting a lower interest rate if banks issue a certain volume of loans for green projects.

- **Green collateral frameworks:** central banks can restrict collateral eligibility rules by excluding polluting assets, or requiring banks to mobilize a pool of assets that is aligned with net zero trajectories.

- **Green quantitative easing:** central banks could restrict their asset purchases programmes to green bonds.

Environmental and Social Requirements of Financial Institutions

Lender Finance - why it matters

All Project need to secure financing, this often include combination of debt and equity. This applies for both public and private sector Projects. Some sources of financing can be:

- Multilateral Development Banks (MDBs) – EBRD/IFC/World Bank/EIB/AIIB etc.
- National Development Agencies or State Development Banks (KfW, DEG, JBIC, US OPIC etc.)
- Private sector banks
- Investors and private equity, etc.

Most financial investors apply environmental and social standards and safeguards, MDBs and Development Banks finance projects in the form of long-term loans at market rates, very-long-term loans below market rates, and through concessional grants.

- IFC Performance Standard (PS) commonly used (EBRD Performance Requirements (PRs) akin to IFC but EU focused). Many commercial Bank's have signed up to Equator Principles.
- International standards on reporting (SFDR, CSRD, ISSB etc).
- Investors are developing Green Financing tools and reporting and disclosing Environmental, Social and Governance (ESG) information.

Overall increasing pressure on disclosure and reporting and investors will shy away from risky project or project that can have a negative impact on reputation etc.

Key elements to manage ESG risks and performance

- ESG Policy
- Processes
  - Risk (and opportunity) identification
  - Managing risks and taking actions
  - Setting metrics and targets
- Reporting
  - Internal
  - External, including regulatory requirements (if any)
- Organizational capacity and training
- Emergency preparedness

Good ESG performance starts by identifying relevant ESG risks, supports ESG performance through management systems, and facilitates financing through consistent and reliable ESG reporting

Environmental and Social Policies

The ESPs help the banks achieve their commitment to promoting “environmentally sound and sustainable development” in the full range of their activities.

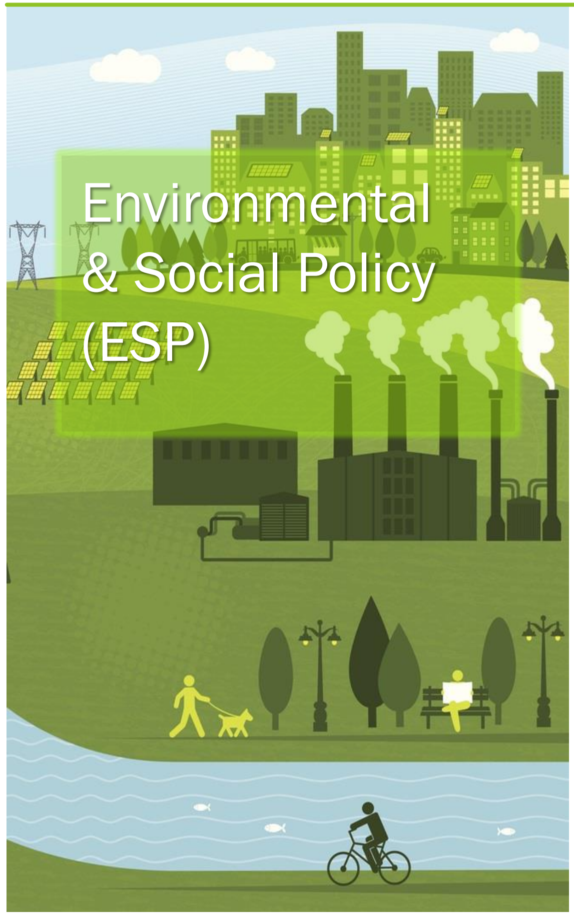
In addition, the ESP:

- Helps banks anticipate risks and liabilities that could have significant impact on project costs and schedule.
- Protects banks from reputational risk by anticipating risks and ensuring that projects are structured to properly manage environmental and social risks and engage with stakeholders.
- Aligns with bank’s other commitments including those related to green transition, climate change, gender and inclusion.
- Provides additionality to clients in their approach to sustainability by committing them to good international practice.

How IFIs Approach Project

- IFIs finance Projects developed by Sponsors (Clients), often permitted and sometimes providing finance to existing Clients (i.e. for existing portfolio).
- For each Project, IFIs undertake an Environmental and Social Appraisal to ascertain compliance with National law and their own performance standards.
- Projects are screened based on sensitivity and risk.
- As part of agreement governing the operation, an Action Plan (e.g. ESAP) is agreed with client and part of financing agreement.
- All Project are required to have a monitoring program in place.
- Often, IFIs provide specific assistance in terms of climate reporting and technical co-operation to assist Clients in developing and implementing climate governance.

ESP – Key Requirements



Definition of Project limited to the use of the Bank's proceeds, the PRs apply to the project only, although E&S Appraisal must consider Associated Facilities and other aspects.

Associated Facilities limited to “new facilities or activities: (i) without which the project would not be viable, and (ii) would not be constructed, expanded, carried out or planned to be constructed or carried out if the project did not exist”, only the objectives of the PRs apply to the AFs.

E&S appraisal and monitoring will be ‘commensurate with risk’

Projects will be structured to meet the requirements of the PRs within a reasonable time frame through ESAP

Projects are structured to meet EU environmental principles, practices and substantive standards, where these can be applied at the project level, regardless of their geographic location

Environmental and Social Requirements/Standards

1 - ENVIRONMENTAL AND SOCIAL POLICY (ESP)

- Purpose, principles & commitments
- Integrating E&S considerations into projects
- Public reporting and accountability

Bank Responsibility

PR 1
Assessment & Management of Environmental and Social Impacts & Issues

PR 2
Labour and Working Conditions

PR 3
Resource Efficiency and Pollution Prevention and Control

PR 4
Health, Safety & Security

PR 5
Land Acquisition, Involuntary Resettlement and Economic Displacement

PR 6
Biodiversity Conservation and Sustainable Management of Living Natural Resources

PR 7
Indigenous Peoples

PR 8
Cultural Heritage

PR 9
Financial Intermediaries

PR 10
Information Disclosure and Stakeholder Engagement

2 - PERFORMANCE REQUIREMENTS (PRs)

Client Responsibility

Project timeline: depends on Category

CAT A

- Projects that could result in potentially significant E&S impacts, including **direct and cumulative impacts**, that cannot be readily identified or assessed and will require the Client to carry out a comprehensive and participative ESIA. ESIA disclosure: 60/120 days

CAT B

- Projects where potential E&S impacts are typically site specific and/or readily identified and addressed through mitigation measures. ESDD: case-by-case.

CAT C

- Projects which are likely to have minimal or no adverse E&S impacts.

IESE – Initial Environmental and Social Examination: to determine project category and scope of appraisal

FI – Financial Intermediaries

PR1 – Key Requirements

- Assess and manage **environmental & social performance** through the **project lifecycle**
- Use of **appraisal** and appropriate **mitigants.**
- **Improve** environmental and social **performance** through the use of Environmental and Social Management Systems (ESMS)
  - Organizational capacity (structure, roles, responsibilities, etc..)
  - ESMS to be fit for purpose (commensurate with organization size and risks posed). Certification encouraged but not mandatory.
- Adopt **mitigation hierarchy**: *Avoid* and if not possible *Minimise*; *Mitigate*; and as last resort *Compensate/Offset*
- Include **Associated Facilities** and **supply chain** not part of the EBRD financed project but essential to the project

PR1

Assessment & Management of Environmental and Social Impacts & Issues

PR2 – Key Requirements

- Respect of the fundamental rights of workers (no harmful child labour, no forced labour, no discrimination, and the freedom to organise and bargain collectively)
- Compliance with national labour & social protection laws
- Protection of vulnerable workers (e.g. migrant workers, refugees, contract and supply chain workers, disabled,...)
- Sound worker-management relations, equal-opportunities and decent work
- Access to grievance redress mechanism

PR2

Labour and Working Conditions

PR3 – Key Requirements

- Apply Pollution Prevention and Mitigation on all Projects
- Ensure compliance with National law and EU substantive standards
- Circular Economy and resource management, including energy, water and resource use efficiency
- GHG management and reduction

PR3

Resource Efficiency and Pollution Prevention and Control

PR4 – Key Requirements

- Protect and promote the safety and health of workers by:
  - Ensuring safe and healthy working conditions
  - Implementing a Health and Safety Management System, appropriate to the relevant issues and risks associated with the project
- Anticipate, assess, and prevent or minimise adverse impacts on the health and safety of project-affected communities and consumers during the project life cycle
- Address natural hazards, road safety, transmittable diseases, emergency preparedness, amongst others

PR4

Health, Safety & Security

PR5 – Key Requirements

- **Avoid** or, when unavoidable, **minimize** resettlement
- Mitigate adverse **social & economic impacts of displacement** both **physical** (relocation or loss of shelter) **and economic** (loss of assets or resources, or loss of access to these)
- **Improve / restore the livelihoods & standards of living** of displaced people
- **Consider** both legal right holders and **informal ones**
- Consult on compensation solutions
- Monitor and evaluate

PR5

Land Acquisition, Involuntary Resettlement and Economic Displacement

PR6 – Key Requirements

- Adopt the mitigation hierarchy in the design and implementation of projects with the aim of achieving no net loss, and where appropriate, a net gain of biodiversity.
- Maintain ecosystem services.
- Promote good international practice in the sustainable management and use of living natural resources.

PR6

Biodiversity Conservation and Sustainable Management of Living Natural Resources

PR7 – Key Requirements

- Identify Indigenous Peoples affected by the project
- Involve them in project decision-making that affects them
- Where there are impacts on land, cultural heritage or natural resources used by IP groups:
  - Confirm Free Prior and Informed Consent (FPIC)
  - Prepare an Indigenous Peoples Development Plan
- At this point, not considered applicable in many of our countries of operation but we've been increasingly challenged on this

PR7

Indigenous Peoples

PR8 – Key Requirements

- Support conservation of cultural heritage (tangible and intangible)
- Meaningful consultation with local users and custodians of CH
- Protect cultural heritage from adverse impacts of Project activities
  - Screening for risks & impacts
  - Avoid or assess & manage impacts (mitigation hierarchy)
- Develop a CHMP and Chance Finds Procedure
- Relevant for projects involving:
  - Earthworks, demolitions significant changes in physical environment
  - Recognised and informal cultural heritage

PR8

Cultural Heritage

PR9 – Key Requirements

- Environmental and Social Management System (ESMS)
- Clear designation of E&S responsibility
- Apply applicable E&S risk management procedures including
  - Screening (exclusion and referral lists)
  - Categorisation
  - Checking compliance with national requirements
  - Monitoring
  - Reporting
- Comply with PRs 2 and 4

PR9

Financial Intermediaries

Environmental and Social Management System (ESMS)

Environmental and Social Management System (PR 9: FIs)

Internal E&S

- PR 9: Address material environmental issues eg energy, waste, paper.
- PR 2: Meet international and national standards on labour and working conditions and security (direct and contracted workforce).
- PR 4: Meet international standards on management of occupational health and safety (direct and contracted workforce).

Outcome oriented

Investing in clients/projects

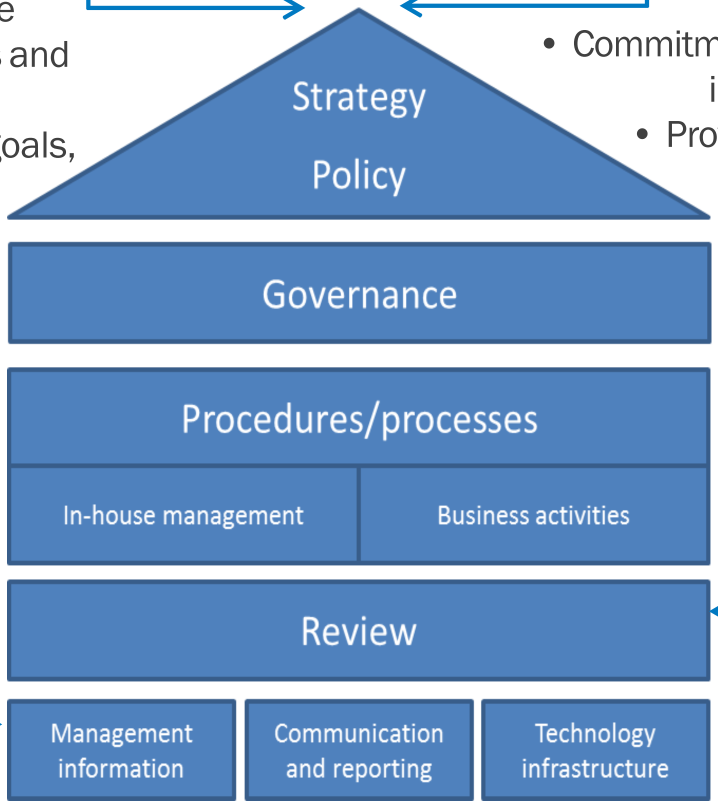
- E&S Risk Management Procedures: screening & risk assessment to categorise and determine standards to be applied.
- Category A apply EBRD PRs 1-8 and 10.
- Must meet national law on E&S
  Assess risk: high, medium, low & determine approach – see EBRD ES procedures.
- Make decision, agree controls and monitoring approach.

PR 9 - Communication and Reporting: Annual and incident reporting to EBRD & external communication as appropriate.

Elements of an ESMS

Strategy:
- Overall approach to sustainability for the organisation considering current status and future goals.
- Clearly articulated strategic priorities, goals, milestones.

Policy:
- Commitments on how E&S will be managed in-house and in business activities.
- Provides the framework for consistent approach to E&S management.



Governance:
- Board member with accountability for E&S Performance.
- Identification of team with E&S responsibility and training needs.

Procedures / Processes:
- Risk Assessment E&S impacts, risks to the FI and stakeholder concerns.
- In house and transactions.

Supporting infrastructure and data:
- Management information – performance data at transaction and team level.
- Communication and reporting.
- Technology infrastructure for data capture.

Review:
- Internal review to understand effectiveness.
- Report to lenders / investors.
- Report to external stakeholders.

PR10 – Key Requirements

- Identify people or communities affected by the project
- Ensure meaningful engagement that is timely, inclusive, coercion free
- Maintain constructive relationship/ consider stakeholders' views through Project lifetime
- Develop a Stakeholder Engagement Plan, in practice will mean also Non-Technical Summary (NTS) on Cat B
- Implement an extra-judiciary grievance mechanism for communities (PR2 covers worker grievance mechanism)

PR10

Information Disclosure and Stakeholder Engagement

Thank you!

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გარემოს დაცვისა და სოფლის მეურნეობის სამინისტრო

შვედეთი
Sverige

UNDP

Governance Reform Fund (GRF) Project

Supporting the Government of Georgia in Enhancing Governance & Policies for a Transition to a Circular Economy