173 SHADES OF REPORTING

Focus on French Institutional Investors

Analysis of the reports published in response to article 173-VI of the French Law on Energy Transition and Green Growth.
A study conducted by Novethic's research center

novethic

GROUPE Caisse desDépôts

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TAKEAWAY

ONE HUNDRED INSTITUTIONAL INVESTORS UNDER SCRUTINY, A HETEROGENEOUS POPULATION

There is a myriad of financial institutions operating in France: insurance and mutual insurance companies, pension scheme organizations and more. Novethic chose to concentrate on the 100 most significant institutions and identified nearly seventy reports explicitly linked to the implementation of article 173 of the French law on Energy Transition and Green Growth.

Section VI of article 173 requires investors to publish information on how they integrate ESG criteria and take climate risks into consideration. For the first time, this article targets this group of heterogeneous players. The fact that many institutional investors are currently undergoing mergers and reorganization explains that the requirements introduced by article 173 are interpreted differently, not only in meaning but in implementation as well.

INVESTORS STRESS THE LIMITS OF METHODOLOGICAL TOOLS AND GENERALLY OUTSOURCE THEIR REPORTING

Institutional investors emphasize on the limits associated with the tools available in both areas (ESG and climate), while recognizing the long-term financial benefits of ESG and climate risk analysis. However, most investors outsource the analysis of their portfolios and mandatory article 173 reporting to third parties (specialized rating agencies or asset managers). This limits the impact of a legislation that was primarily intended to encourage them to fully assume their asset owners' role. The first fiscal year reflects the promise of these regulations, but to move investors to finance the ecological and energy transition more seriously, there is still a way to go.

ESG AND CLIMATE STRATEGIES FUNCTION AT DIFFERENT PACES

Article 173 separates the implementation of ESG criteria in asset management from the climate risk assessment. Only the largest institutions must address both dimensions. The analysis of the amount of public reporting shows that this differentiation persists in the reports, as both strategies do not rely on the same mechanisms. ESG policies build on existing processes, and stress the investors' long-term responsibility as well as their responsability for financing the economy.

Commitments on climate show that investors are ready to play their part and innovate, but their objectives and implementation strategies are still at an early stage, in relation to a cautious approach to climate risk analysis. Investment strategies targeted on green assets are the most specific steps currently reported.

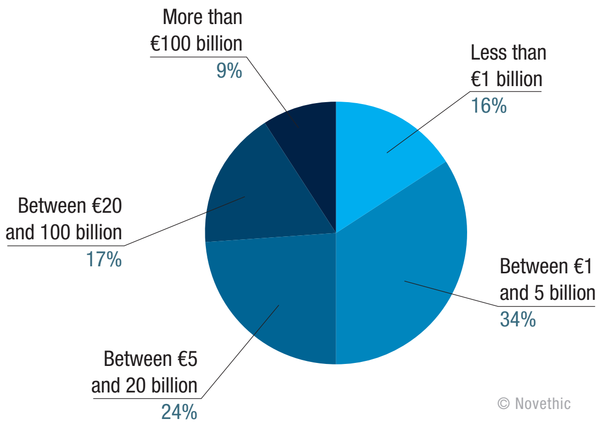
FOUR APPROACHES TO "ARTICLE 173" REPORTING

Article 173-VI of the French Energy Transition Law aims at shedding light on investment practices amongst French institutional investors. Its implemtation decree lists most categories subjected to it, for lack of a precise definition or legal scope. The decree states that only institutions whose assets exceed €500m are subject to mandatory climate reporting, meaning that institutions outside this scope are only asked to report on ESG. Some institutional investors, who weren't explicitly listed in the article 173 implementation decree, argued that they weren't included in the regulatory scope, although the spirit of the law was indeed intended to further ESG commitments within the financial sector, particularly those linked to climate change.

Panel

To build a panel representative of the French asset owner landscape, Novethic identified 100 major institutional investors, with help from FFA, the French Insurance Federation, and the French association of Institutional Investors (AF2I). This panel consists of the main insurance, provident and retirement institutions, with assets amounting to 3160 billion euros in total. Half of the institutions have assets that do not exceed €5bn, a quarter manages between €5bn and €20bn, while the last quarter manages more than €20bn. Where foreign companies and concerned, only assets owned by their French branch have been included.

100 institutions €3160 billion in assets



15 Engaged players

These investors possess a clear, proactive strategy on climate, primarily centered around green financing. They assess the risks to which they are exposed and set objectives for themselves all while maintaining their strategy over time.

20 Established Forerunners

These institutions have long initiated responsible investment strategies, to which article 173 offered new reporting dynamics.

34 New Entrants

This number demonstrates the positive impact of this legislation, in that it engaged new players in responsible investment and climate risk consideration. These players are mainly organisations providing supplementary insurance and retirement savings plans.

31 Absentees

This last category comprises almost a third of the investors who could have profited from article 173 to publicly explain how they factor environmental and social criteria into their asset management.

REGULATORY FRAMEWORK

SOFT REQUIREMENTS AIMED AT COMPANIES, NOW INTENDED FOR INVESTORS

To encourage companies to disclose their processes of Environmental, Social and Governance (ESG) criteria integration, France introduced a flexible regulatory framework, dating back to 2001. This approach was extended to investors via the Grenelle de l'Environnement (French environmental law).
The strength of these laws lies in the opportunity they provide stakeholders, shareholders and NGOs, to use public ESG data to campaign for reduced environmental and social harm associated with business activities. These measures were initially only enforced on major listed companies, but have gradually extended to other types of actors.

2001: FRENCH LAW ON NEW ECONOMIC REGULATIONS (NRE)

Article 116 of the law on New Economic Regulations requires listed companies to publish information on given social and environmental topics, without specifying a reporting scope. They must, for example, report on their water and energy consumption as well as gender distribution within the company.

2000

PIONEER ERA

2005: The French Reserve Fund for Pensions (FRR) launches its first SRI mandates, and ERAFP, the largest French public service additional pension scheme, whose investments are required to be entirely stamped SRI, launches its operations.
2006: Launch of the Principles for Responsible Investment (PRI), in which the *Caisse des Dépôts*, a French public sector financial institution, plays an active role.

2010: GRENELLE 2 LAW

Two new requirements are introduced with article 224 and 225 of the GRENELLE II Law. First, the obligation for companies to have their ESG data certified by an independent third party, and second, the obligation for asset management companies, including those involved in capital investment, to include information on how they integrate ESG criteria into financial management in their annual report, and to make this information available to their subscribers.

2010

SILENT INTEGRATION

After the financial crisis of 2008, French institutional investors progressively implement ESG integration strategies, either internally or onto funds under delegated management, covering increasing asset volumes that reached nearly €500bn in 2015. The integration process occurs discreetly, or via the adoption of Responsible Investment Charters, under the leadership of insurance companies.

2015: FRENCH LAW ON ENERGY TRANSITION AND GREEN GROWTH

For the first time, article173-VI introduces the requirement for institutional investors to disclose how they take climate risks into account, and more broadly, how they integrate environmental and social parameters in their investment strategy. Article 173 enters into force for the 2016 financial year. The first reports, published in 2017, will be evaluated in 2018 by the regulator who will then set more precise guidelines, in particular those regarding climate risk management.

2015

CLIMATE COMMITMENTS

In 2015, in the shadow of COP21, higher awareness of financial risks linked to climate change leads to progressive action concerning investment policies, particularly in the energy sector. French institutions, historically at the forefront of responsible investment, commit to assessing and reducing the carbon footprint of their portfolios in accordance with the Montréal Carbon Pledge and the Portfolio Decarbonization Coalition.

AND INVESTOR ENGAGEMENT

A LIMITED NUMBER OF COMMITTED FRENCH INVESTORS

The dynamic of French responsible investment is carried forward primarily by asset management companies. They largely outnumber institutional investors (142 - 14) on the list of PRI (Principles for Responsible Investment) signatories. However, implementing climate risks assessment and more generally integrating ESG criteria in financial management implies that institutional investors clarify their expectations in this area, not only to organizations they entrust with management mandates but also to companies in which they hold shares. For the legislator, article 173 of the Energy Transition Law was meant as an incentive to finance the essential transition towards a low-carbon economy. In theory, the reports published in response to article 173 must explain how financial institutions limit their investments in activities associated with high climate risk and maximize not only their financing of new green business but also, for existing companies, the swift transition towards a decarbonized economy.

IN-DEPTH ANALYSIS

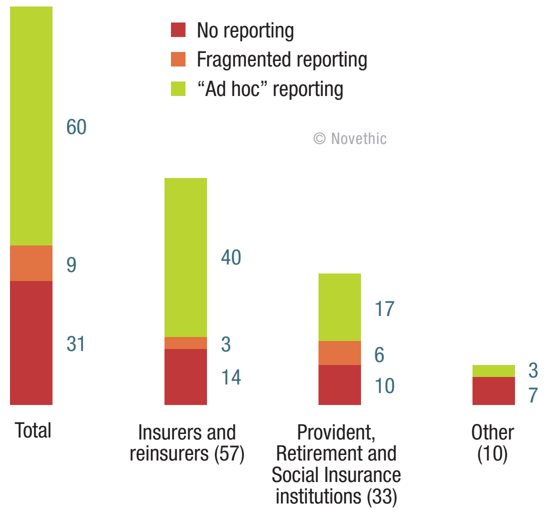
WIDESPREAD MOBILIZATION OF THE LARGE FRENCH INVESTORS SETS OTHERS IN MOTION

69 out of the 100 investors examined in this study have published reporting on their ESG and climate policies. Many had already reported on ESG and climate in previous documents, but have published new reports more explicitly in response to article 173 of the Energy Transition Law.
Over 90% of insurers who manage more than €20bn in assets have published customized reporting, but institutional players of smaller size have also heavily engaged, including institutions whose assets do not exceed €1bn. More than two thirds of insurers and reinsurers, the main category in the panel, have incorporated requirements that stem from article 173. In comparison, only half of the provident, pension and supplementary social protection institutions have published detailed reporting, while six additional institutions published only very synthetic extra-financial information.

CEOs HIGHLIGHT RESPONSIBILITIES AND RISKS

Around twenty editorial notes from CEOs and directors shed light on the institutions' perception of the ESG and climate challenges. Institutional investors stress first and foremost their long-term responsibility and the impact that investing can have on the economy and society. They choose to highlight their implementation record concerning ESG and climate challenges. These editorials also look back on the first major commitments and welcome the opportunity to showcase prior responsible investment practices. As they note a "multiplication of major extreme weather events", climate is progressively incorporated into financial risks, while ESG remains seen as "criteria" or "considerations" allowing for better profitability.

↓ Publication of "article 173" reporting by institution category



INTERPRETATION OF ARTICLE 173

For some, publishing a portfolio's carbon footprint is necessary and sufficient

"In compliance with article 173 [...], the carbon footprint was measured."
"The implementation decree of article 173 of the Energy Transition law requires investors to make their carbon footprint public"
Extract from two reports

Article 173 provides open leads to analyze and report on ESG and climate

"The implementation decree of this article rewrites article D.533-16-1 of the Monetary and Financial Code, without imposing a prescriptive method"
"COP 21 was an essential catalyst to establish the link between the environment and investment. The French government took up the matter and transformed it into a regulatory incentive for institutional investors"
Extract from two reports

CLIMATE RISK MANAGEMENT: FROM CARBON FOOTPRINTING TO 2°C SCENARIOS

ANALYSIS AND STATISTICS BASED ON 69 PUBLIC REPORTS BY INSTITUTIONAL INVESTORS

INVESTORS PLAY THEIR PART

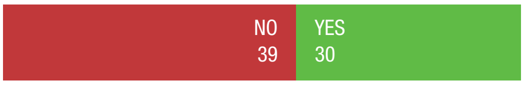
More than 80% of the analyzed reports include actions on climate risk management, and the rest mention that these risks will soon be included in the management. 30 reports explicitly mention the worldwide objective of limiting global warming to 2°C and wish to follow an enhancement trajectory, which corresponds to the ambition behind article 173.

Investors' climate reference: the 450 Scenario by the International Energy Agency

The reflection on climate risk is generally based on a comparative analysis of portfolios using the "450 Scenario" of the International Energy Agency (IEA), the main source of reference. A majority of institutions provide a comparison of the energy mix funded through their portfolios with the global energy mix that the agency envisions for 2040, although an insurer and a pension institution went beyond this scenario, citing more ambitious scenarios from the same organization ("2DS" and "Bridge") or additional energy mix projections. Finally, only two investors opted to communicate on the global warming trajectory with which all or part of their assets portfolio is aligned, citing + 3.6° C and + 4° C respectively.

↓ **Mention of a position on the 2°C scenario?**

Based on 69 reports



The implementation decree of article 173 of the Energy Transition Law

"b) The criteria relating to environmental objectives are assessed, by each entity, based on internal or external analysis **that may relate, depending on their relevance to the activity of each entity and the nature of the assets considered**, on […]
"- measurements of current and / or future greenhouse gas emissions associated with emitters included in the investment portfolio, specifying, in particular, what methodology was used

CARBON FOOTPRINT: A STATIC INDICATOR

74% of the 69 analyzed reports include a mention of carbon footprint measurement for their portfolios. It is interesting to note the fact that the size of assets is not important in this percentage. Although carbon-footprinting is still relatively new and its relevance often questioned, this high percentage can be linked to three factors:

- It is a tangible indicator that illustrates a link between investments and impact on climate;
- Carbon footprint is now widely available for a large range of companies and at a limited cost, especially when including only scope 1 (direct emissions) and 2 (indirect emissions from consumption of purchased electricity, heat or steam) and when omitting scope 3 (other indirect emissions);
- It has been interpreted as a prerequisite within the requirements stemming from article 173, even though it is not formally required (see boxed text).

2°C TRAJECTORIES, IN ACCORDANCE WITH THE PARIS AGREEMENT

Poor understanding: issue not adressed

"To this day, the measure of our contribution to the 2°C objective has not been carried out due to its technical complexity"

Extract from a "article 173" report

Good understanding: analysis and contextualization of 2°C scenarios that are still perfectible

"We have defined five pillars that reflect our commitments and practical actions".
"A trajectory of the carbon intensity of the portfolio turnovers has been calculated until 2025. It is put into perspective with a theoretical alignment trajectory to control the increase in global temperature at 2°C"

Extract from two "article 173" reports

A widely discussed indicator

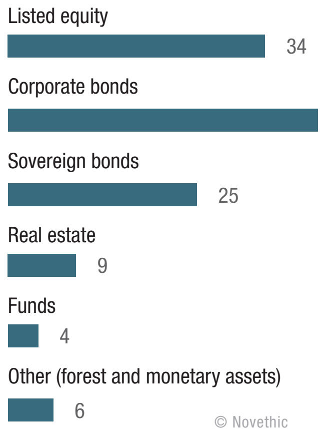
A third of the institutions in the panel voice their desire to at least see improvements in the reliability and scopes of the carbon footprint. Some use this comment as a justification for not publishing a carbon footprint, while most of the critics point out that the footprint is a mere measurement indicator, whose result isn't always relevant.
Newcomers often use the carbon footprint for lack of a better indicator, while commenting on the difficulty to aggregate data that doesn't always encompass the same scopes. Investors with more experience in the analysis of climate risks note that carbon footprinting isn't a dynamic enough measurement when it comes to incorporating it into long-term asset management. For some investors, carbon footprint is a snapshot in time, thus unsuitable to analyze transition dynamics among economic players and the potential of avoided emissions (sometimes also called scope 4).
The report analysis shows that publishing a carbon footprint hardly reflects the maturity of climate strategies, nor an investor's ambition to take part in the collective effort to limit global warming.
Carbon footprint assessment is first and foremost deployed on one or several asset classes, sometimes with a sector-by-sector variation ranked by carbon intensity.
The footprint is measured most particularly on corporate bond portfolios (41 mentions), followed by listed shares (34), sovereign bonds (25) and real estate portfolios (9). In the case of sovereign bonds, methodological biases are particularly highlighted.

↓ Measure of the carbon footprint of at least part of the assets

Out of 69 reports

↓ Asset classes covered by the carbon footprinting

Out of 51 mentions on portfolio carbon footprint



Publishing a carbon footprint does not reflect the maturity of climate strategies

EVALUATION OF THE CARBON FOOTPRINT

Poor understanding: no perspective analysis
"The carbon footprint of the assets under delegated management has been calculated. It was of *x* tons".
Extract from a report

Good understanding: using the footprint as a progess indicator
"While there isn't always a strong correlation between the level of the carbon footprint and the ability to reduce it, it will be useful for an *ex post* cross-check of the emitters' commitments".
"Results of the carbon footprint analysis have been incorporated in the investment process via shareholder engagement directed at companies".
Extract from two reports

Units of measurements

Rather technical, the choice of relative units for the measure of carbon footprints is the subject of relevant questioning comments that seem to have been brought about by article 173. There is no consensus on the units used, be it absolute emission figures, normalized emissions apportioned to invested assets or turnovers, or even normalized by production units. 33 reports present data using at least two different units.
The measure of a relative carbon intensity using turnover or GDP as normalization variables (teq CO_2/M€ of turnover for securities or teq CO_2/M€ of GDP for sovereign bonds) outnumbers the measure of financed emissions (teq CO_2/M€ invested in companies or Government bonds). Other recorded units include tons of global greenhouse gas emissions, emissions normalized using tons of oil equivalent in the energy mix of a sovereign issuer, or even a ratio without unit. Although this diversity demonstrates a certain degree of methodological emulation, it also translates into a lack of comparability between investors. Some investors even report significantly higher carbon footprints compared to a benchmark without adding a single word of comment!

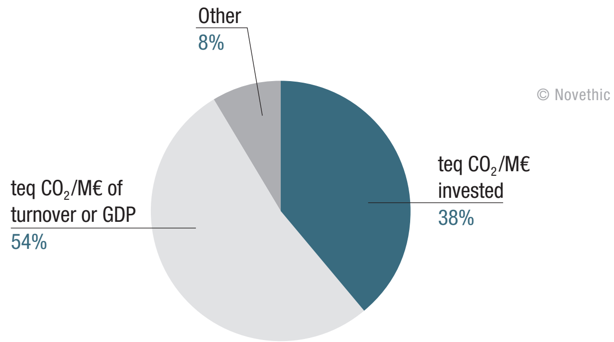
Evaluation of indirect and avoided emissions

Out of 51 institutions that carried out a carbon footprint analysis, 45 included the results in their reporting and 38 detailed what emissions scopes were taken into account. Among investors who manage more than €20bn, half include scope 3 and 40% mention at least one measure of avoided emissions. When looking at the subpanel that manages less than €20bn, the share of investors who include scope 3 is of one third, and there is virtually no mention of avoided emissions. When justifying why they did not go further than scope 2, investors mention insufficient data provided by carbon emitters.

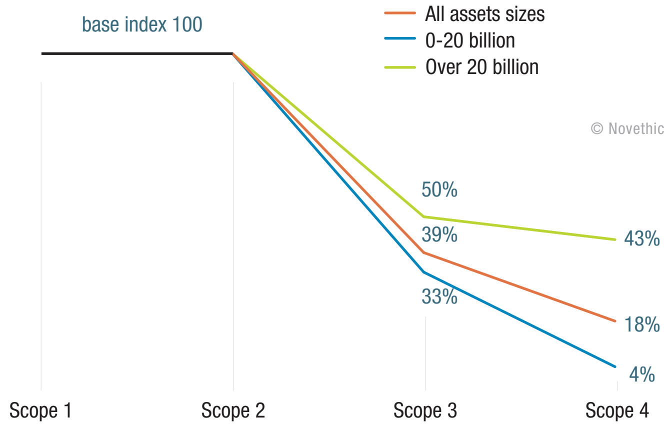
Measuring the CO_2 content of a kWh: an indicator that highlights the French energy model

The measure of the CO_2 content of the kWh produced by companies in which institutions have invested is a way to pinpoint the "brown share" of portfolios, or on the contrary to showcase the assets invested in companies who play a role in the energy transition. This type of analysis underlines the specificity of the French energy mix in Europe. However, not all investors note that the high share of nuclear power and a lower use of coal compared to other OCDE countries explain why their carbon footprint is "performing" well.

↓ Units used to measure the carbon footprint of portfolios
Based on 45 carbon footprinting results



↓ Emission scopes considered (where available)
38 reports



COMPARABILITY OF THE CARBON FOOTPRINT

Lack of analysis
"The carbon footprint of the portfolio of corporate bonds is 40% higher than the reference index".
Extract from a report

Linking carbon footprint and climate strategy
"We do not aim to reduce our carbon footprint in the short term; we favor investments in companies that develop solutions and services for a low carbon economy".
Extract from a report

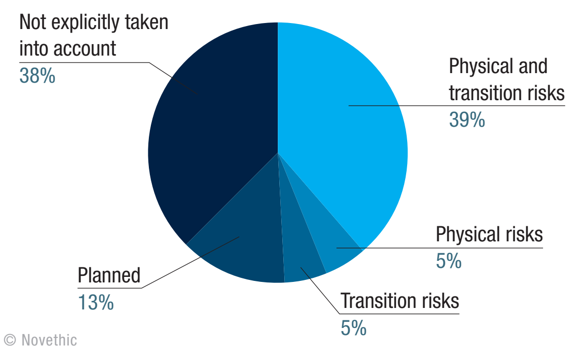
The implementation decree of article 173 of the Energy Transition Law

[The reports] contain, in particular, criteria relating to:
“a) the risks associated with climate change as provided for in the fourth paragraph of the corresponding article L. 533-22-1:
“- physical risks, defined as the exposure to the physical consequences directly induced by climate change;
“- transition risks, defined as the exposure to changes induced by the transition to a low-carbon economy.
“b) the contribution to meet the international objective of limiting global warming and achieve the objectives of the energy and ecological transition provided for in the fourth paragraph of Article L. 533-22-1.

IMPORTANT SHORTCOMINGS IN THE CLIMATE RISKS ANALYSIS

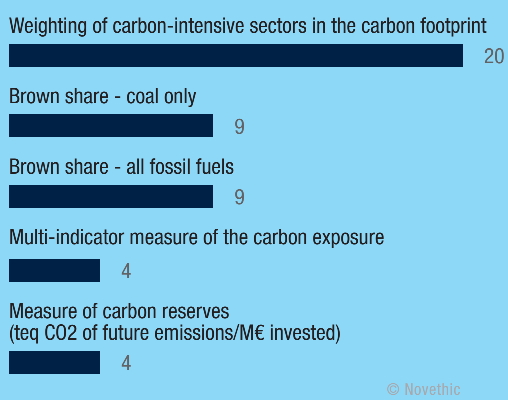
The implementation decree for article 173 is ambitious. Analysis of climate risks is a prescriptive and precise requirement *(see boxed text)*, yet it applies to a field where data is still far from stabilized. As of today, there is no analytical model for physical or transition risks linked to global warming that would be simple to implement. Additionally, some investors voice their support for the work of the Task Force on climate-related Financial Disclosures (TCFD) in promoting the development of reporting standards for climate risks.
Nevertheless, more than half of the reports mention ongoing efforts on the topic, for the most part on both physical AND transition risks. Finally, some investors admit to not having dealt with these risks but consider doing so in the near future.
The driving forces behind these new strategies are the largest institutions. All institutions with over €100bn in assets under management mention at the very least one of the two types of risks.
Divestment from fossil fuels, or at least coal exclusion from portfolios, is another factor leading to a larger acknowledgement of transition and physical risks. More than 80% of investors in this case also cite climate risks in their “article 173” reporting.
It can also be noted that investors who outsource their asset management to one or several companies address climate risks in their reporting much less (45%) than those whose assets are mainly managed internally or via an “in-house” manager (75%). Dialogue on climate risks between investors and asset managers is one of the areas of improvement to prioritize.

↓ **Mention of specific work on climate risks**
Based on 69 reports



Measuring the share of “brown assets” in portfolios: a useful indicator

30 investors tried to evaluate the “brown share”, in the broad sense, of their porfolios. It corresponds to the share of investments in carbon-intensive assets (fossil fuels, mining, metals …) that are at risk of depreciation as a result of the combat against climate change. Detailed sectorial analysis is confined to the fossil fuel sector, except for three investors who also apply an analysis on other sectors like the automotive and transport industries, and raw materials-producing industries. The methodologies used in the reports range from a simple coal exposure measurement to a multi-indicator methodology to assess the carbon risk exposure. In addition, four investors carry out a measure of the carbon reserves of their listed shares portfolios, while about twenty institutions break down their carbon footprints by sector to illustrate the significance of carbon-intensive sectors in their portfolios. Finally, 13 investors include a list of the most carbon-intensive companies they are invested in.



↑ **Brown share assessment methodologies**
Found in 30 reports

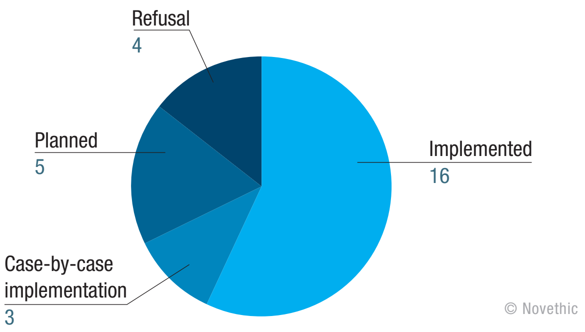
CLIMATE RISKS MANAGEMENT POLICIES

Proactive investment policies aligned on a 2°C trajectory are still extremely rare. In concrete terms, practices found in the reports include: divestment, portfolio decarbonization, green investments and, seldom, shareholder engagement on climate.

Divestment, a non-consensual first step

28 investors take a stance on divestment. Around twenty of them practice coal divestment, and, for two investors, this practice extends to carbon-intensive companies on a case-by-case basis. Some consider implementing it, while four investors state that they do not wish to incorporate this approach.

↓ Stance on divestment
Based on 28 reports



€ 15,1bn.
The total amount of green assets reported by the panel

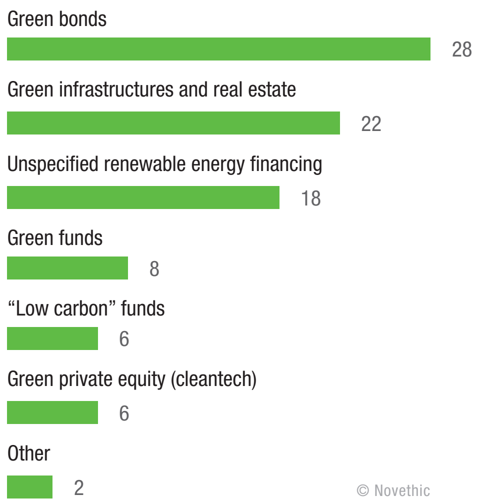
Portfolio decarbonization, an additional strategy

This approach consists in reducing the carbon footprint of portfolios, albeit its practice is subject to a number of methodological limits. Decarbonization is practiced by ten investors, mainly in addition to a divestment approach, except in two cases where investors refuse any sector-based exclusion. Several institutions have initiated their decarbonization strategy by joining the Portfolio Decarbonization Coalition, launched by the United Nations Environment Programme Finance Initiative (UNEP Fi). Investors mention their desire to assist economic players in their transitions towards low-carbon strategies, even though only five mention their participation in the main collaboration platforms for shareholder engagement on climate (Aiming for A, collaborative engagement initiative on Oil & Gas drilling in the Arctic, RE100 initiative). An investor also reports that it "wishes to pursue its engagement strategy until every fossil fuel company will have published a report on the long-term viability of their business model in a +2°C world".

GREEN ASSETS: INVESTING IN SOLUTIONS

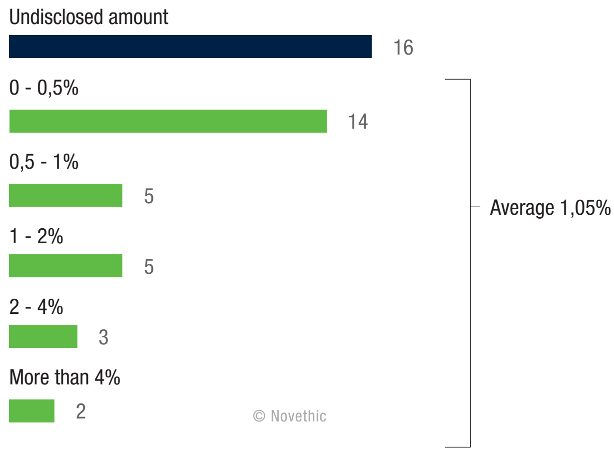
45 institutions report investments in at least one class of green assets, even though 16 of them do not disclose any invested amount, while these investments aren't always easy to sort out in the reports. Only a single investor presents a clear recap chart of its green investments.
Policies applied on real estate investment portfolios are also frequently cited, but given the variety of standards, only positive energy buildings were counted in this overview.

↓ Mention of green investments
Based on 69 reports



The amounts declared in the 29 reports where they are specified add up to €15,1bn of green investments, equalling on average 1,05% of the assets of these investors. Nevertheless, two investors own green assets that represent more than 4% of their portfolios.
In practice, no more than 0,5% of the over €3000bn of assets under management by the hundred largest French financial institutions is invested in the green economy, and only 8 institutions announce a short-term goal to increase the share of green investments in their portfolios, typically with a 2020 timeline.
In parallel, 15 investors include a percentage of the "green share" of their portfolio of listed companies. Depending on the scope (strict or broad) and the revenue share threshold for "energy transition solution provider" companies, this green share spans from 0,6 to 18%. Furthermore, two pension institutions published a measure of the contribution intensity of their portfolios on climate transition, while a handful institutions present data in a way that puts the green and brown share in perspective.

↓ Green investments as a share of the total assets
Based on 45 mentions



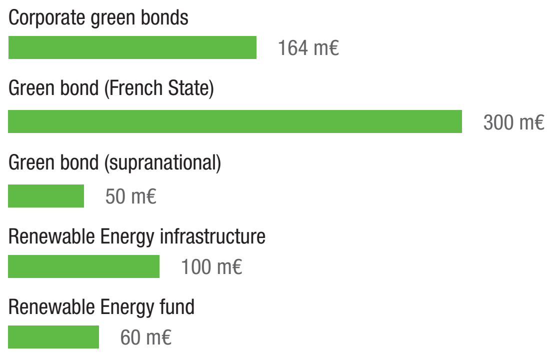
What about the articulation between climate and ESG?

Overall, the analyzed reports show evidence of a decorrelation between climate strategies and ESG integration, without the history of the latter having really contributed to the accelerated development of the first. Although ESG approaches represent on average two thirds of the content of article 173 reporting, climate is the object of all the methodological and strategic reflections, while ESG struggles to be more than an exercise limited in strategic significance.

CATEGORIZATION OF GREEN INVESTMENTS

Poor understanding: misinformed statements
"Our positive contribution is also illustrated by the financing of public infrastructure projects, [...] including €52m in a motorway in France, a mobility facilitator in rural areas".
Extract from a report

Good understanding: simple and clear categorization of green assets



Extract from a report

ESG: NEW PLAYERS, LITTLE STRATEGIC AMBITION

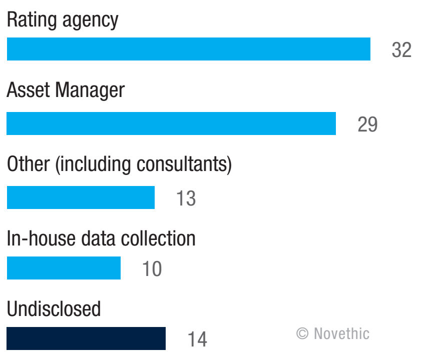
ANALYSIS AND STATISTICS BASED ON 69 PUBLIC REPORTS BY INSTITUTIONAL INVESTORS

Article 173 has initiated important momentum, in that around twenty investors declare having launched their first processes in 2015, or explain having carried out a first ESG analysis exercise of their portfolios specifically for this reporting. About fifty investors display greater maturity but rarely specify what goals they wish to pursue. Finally, a handful of investors remain indisputably skeptical of the benefits offered by ESG analysis.

ESG REPORTING OUTSOURCED TO THIRD-PARTY EXPERTS

Article 173 expects investors to mention the ESG criteria they take on. However, most of them rather rely on external providers (asset management companies or extra-financial rating agencies), and only about ten investors rework on the provided data themselves. 15% of the reports present the selected criteria and base their selection on the materiality of ESG data. Ten more investors present detailed criteria, often referring to their SRI charter or the institution's responsible investment policies, also combining them with selected management approaches. Approximately twenty investors describe analysis topics sorted into main groups. The content of the reports illustrate the importance of specialized rating agencies, to whom investors largely outsource the analysis of their portfolios. Data provided by MSCI, Vigeo Eiris, oekom research or Sustainalytics make up the foundation of ESG analysis. More advanced investors work with several agencies, to corroborate data or address topics like governance or proxy voting separately (in particular with ISS or Proxinvest). Asset management companies also play an important role: 40% of investors rely extensively on their recommendations in regards to ESG, but also in regards to "173" reporting!

↓ **Source of ESG analysis**
Based on 69 reports



ESG INTEGRATION IN ASSET MANAGEMENT

Poor understanding: rule out the possibility
"Available data do not allow to ensure that such approaches are relevant with regard to the performance expected by our policyholders"
"We noticed a lack of homogeneity and reliability, as well as an obsolescence of data that thus do not allow us to define relevant goals.".
Extract from two reports

Good comprehension: support an institution's internal culture
"To promote communication and transparency, we seek to apply the best practices in place".
"Even though stock exchange standards are far from stabilized [...], we rely on existing methodologies to strengthen our expertise and progressively improve our pragmatic approach"
Extract from two reports

Several reports, one author: a false solution

Ten institutions of the panel outsource their asset management to the same company, also leaving this company in charge of their “article 173” reporting. As a result, the ten reports in question are drafted identically, except for a few optional sections. Although the content of these reports covers most of the intended subjects, this approach raises the question as to the level of real appropriation by investors concerning ESG and climate themes. Even if this turnkey solution allows for a few interesting metrics, it leaves little room for the investor to elaborate his decisions and positions on ESG and climate, except in a brief introduction or summary.

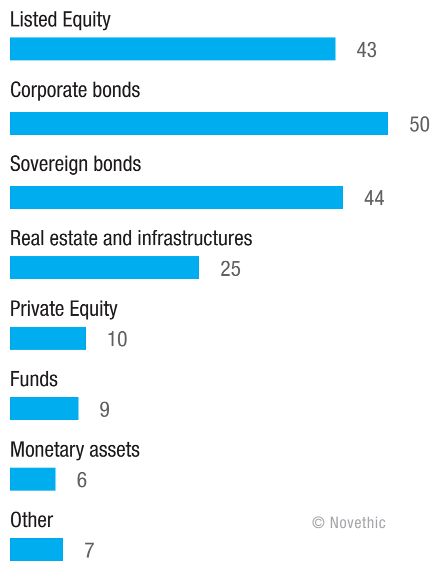
ESG controversies and reputation: a news-related risk

11 investors in the panel address controversies, either by providing a list of controversial companies present in their portfolios, or by mentioning the ones that are under special scrutiny. Reading the reports is the occasion to retrace some of the main corporate scandals that made the headlines in recent years, and illustrates the fear of being associated with major reputational backlash. For example, the case of the “dieselgate”, born from the practices used by Volkswagen to cheat emissions tests, gets the most mentions (8), followed by the business practice controversies at Deutsche Bank (4 mentions), the pollution caused by Shell in the Niger Delta (3 mentions), suspicions of financing terrorism by LafargeHolcim (2 mentions) and the scandals surrounding Glencore (2).

Scope of the ESG analysis

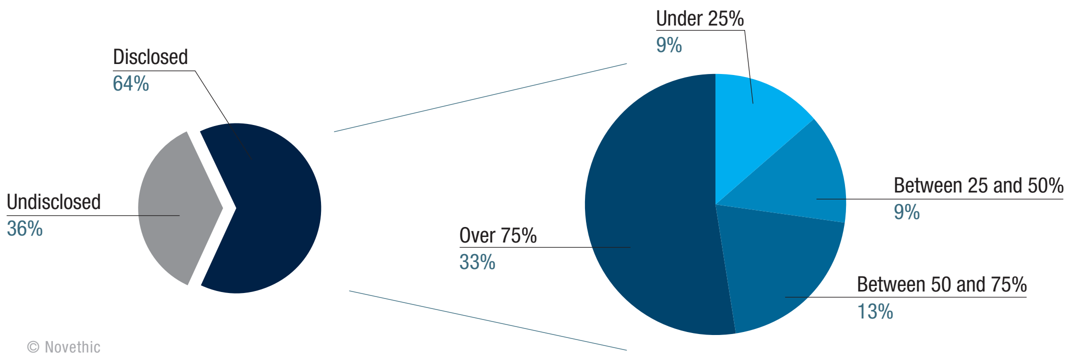
The deployment scope of ESG analysis is generally well specified, in 85% of reports, and largely covers the main asset classes in portfolios, beginning with corporate bonds (71%), sovereign bonds and stocks (more than 60%), meaning the majority of their assets. Real estate investments are the subject of an extra-financial analysis for 30% of investors.

↓ **Deployment scope of the ESG analysis (where available)**
Based on 58 reports



Over 60% of reports detail how widely ESG analysis is deployed in portfolios and this deployment is significant: half of these reports specify that ESG analysis covers at least 75% of their portfolios, regardless of the size of institutions.

↘ **Share of the global portfolio covered by ESG analysis**
Based on 69 reports



ESG INTEGRATION, A DOMINANT TREND

With the exception of a few investors, those who detail their ESG criteria also detail how the criteria impact the way portfolios are managed. However, the details of implemented processes and their systematic deployment in portfolios aren't always clear.
The dominant approach is ESG integration, with 41 investors reporting its use, although only a few detail the precise methods they implement in connection to it (weighting, risk limits ...). This approach, mainly driven by long-term financial objectives, explains why large investors, and in general investors who employ an in-house asset management company, show particular interest in it.

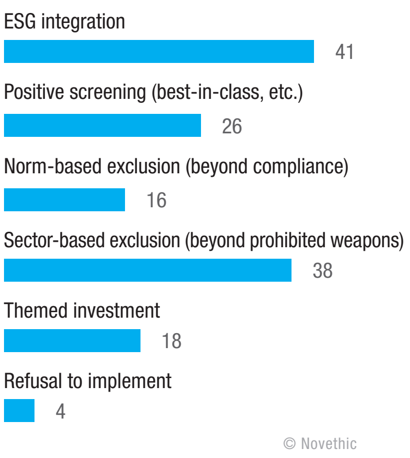
Best-in-class selection is still widely used

The French market for socially responsible investment funds has developed alongside the *best-in-class*, feature, which enables moderate deviation from market benchmarks. This type of selection progressively blends into ESG integration, but remains widely present: 26 institutions, in particular those who opt for delegated management, place it at the heart of their strategy, and 6 of them use it exclusively in their selection of certified UCITS funds, for labels such as SRI or the French "TEEC" label, without implementing it in all their assets. Exclusion and themed investment approaches complete the picture.

Europe, a continent immune to ESG risks?

A mention of low ESG risks on European listed stocks and bonds portfolios is found in 8 reports. Several investors point out that ESG ratings for European companies are generally higher than for North-American companies, note that controversies are more frequent on the other side of the Atlantic, or mention a low risk for sovereign European issuers. Many modest-size investors have little assets invested in emerging markets, while larger investors sometimes implement ESG evaluation at first only onto euro-denominated portfolios.
When it comes to climate, an investor even writes that physical climate risks are limited in Europe, which is a disputable assertion from a scientific point of view.

↓ ESG investment strategy
Based on 69 reports



ESG INTEGRATION

Poor understanding: no specific analysis of ESG criteria

"Extra-financial criteria come into play at the same level as financial criteria in our selection. […] Thus, we have not developed specific methodology and analysis of portfolios based on ESG criteria."
"A decision to exclude the issuers may be submitted to the senior management teams, provided that market conditions are favorable and do not undermine the performance of the portfolio".
Extract from two reports

Good understanding: progressive and interdisciplinary ESG integration

"We are currently developing additional indicators, in order to improve our global portfolio assessment and pave the way towards a dynamic vision of ESG challenges"
"ESG is a tool allowing an investor to identify growth opportunities for a company. In the medium and long-term, it is a lever of economic outperformance for the issuer"
"We do not carry out a breakdown by types of asset, as ESG approach is designed to be applied globally. Likewise, we do not use a segmentation by type of securities, as ESG analysis focuses on the issuer and not the security"
Extract from three reports

Exclusion strategies are on the rise

Exclusion strategies are no longer banned: in total, 49 investors, i.e. more than 70% of the 69-member panel, are implementing them, and 38 investors make use of sector-based exclusions. These approaches have seen a recent surge in interest, as concerns linked to the tobacco industry (excluded by 19 investors) and fossil fuels are on the rise, with coal at the forefront of these concerns. However, only 15 investors clearly describe a normative exclusion strategy.

Energy transition: support rather than exclusion

Many institutions state that they address the E pillar of ESG via a double environmental analysis viewed against the background of the energy transition. Even if a list of shares held in companies linked to ESG controversies and high-carbon footprints is included in about 15 reports, nearly all investors of the panel choose to support and encourage companies in their transition towards low-carbon activities, via engagement or shareholder dialogue. In this regard, Engie is a textbook case: although the company is mentioned twelve times as part of the brown share of portfolios, it is also mentioned five times as part of the main companies who provide energy transition solutions.

70% of the reports mention the implementation of exclusion strategies

IMPACT OF ESG PROCESSES ON PORTFOLIO PERFORMANCE

Poor understanding: skepticism…
"The fiduciary responsibility of asset managers is at stake. It is first and foremost about preserving the long-term financial interests of customers who entrust us with their savings."
"Future performance may be hampered, should restrictive ESG policies be activated"
Extract from two reports

Good understanding: conviction
"The resale of 12 shares following the downgrading of their ESG ratings did not have any negative impact on the performance".
"Monitoring of the performance since the first SRI mandates were launched shows that the stock portfolio exhibits a clear outperformance compared to the reference index."
"We consider that high quality governance is often an advanced risk indicator: companies who have poor governance expose themselves more to risks"
Extract from three reports

SHAREHOLDER ENGAGEMENT IS STILL INDECISIVE

Nearly 60% of the institutions who published information mention ESG engagement practices, but only a handful of investors have developed a specific strategy. Voting policies and shareholder dialogue are mentioned respectively in 51% and 42% of the 69 reports respectively, while around twenty investors practice both approaches. The most active are also the largest in asset size. *(see diagram)*.

It can also be noted that insurers and reinsurers practice engagement comparatively less (50% of a 42-member sample) than other investors (70% of 26 other institutions within pension, providence, supplementary social protection and other domains).

Investors rely mainly on proxies for their voting policies, either their asset managers or specialized service providers (mainly ISS and Proxinvest). Only a handful of them report on their own policies or plan on implementing one. Naturally, this limits their ability to voice clear positions regarding ESG risks, and the extent to which these positions are taken into account by corporate leaders. Furthermore, general assembly votes almost do not address ESG thus far, except for governance issues, while the rise in climate resolutions over the past two or three seasons of assemblies remains unnoticed.

Impact investing, a topic still rarely mentioned

Sustainable Development Goals (SDG) are still a rare topic (mentioned only in 7 reports), while a mention of impact investing (social and solidarity-oriented investments) is found in a dozen reports.

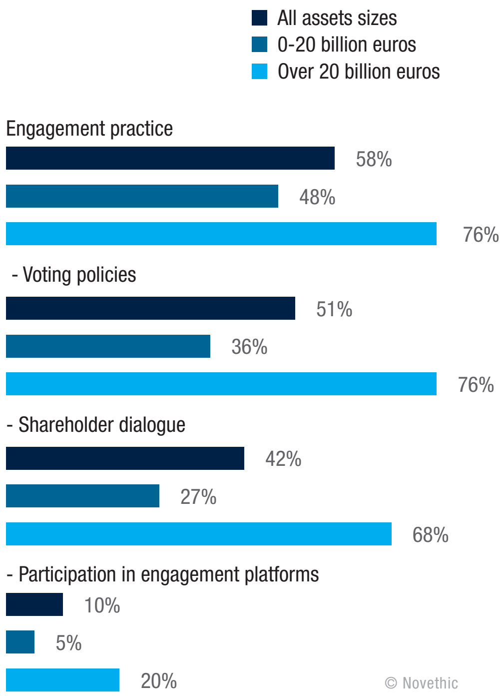
Social investments can be evaluated at €293m in the reports analyzed for this study. The amounts mentioned are invested via various Social and Solidarity Economy funds, including the NovESS fund.

Novethic also counted €2,25bn invested in funds aimed at sustaining the real economy, i.e. SMEs (notably via the “Prêtons Ensemble – Lending Together” fund) and innovative start-ups. Other initiatives such as patronage, support for microfinance, social real estate, or niche investment linked to some institutions’ core activities are also mentioned. Furthermore, four institutions mention the presence of Finansol-certified investment products in their portfolios.

In general, these types of investments are still in the development phase. For example, the concept of “social bonds” is only mentioned in English in two reports, while the Anglicism “green bonds” gets 24 mentions in the reports.

↓ Engagement practices

Based on 69 reports



SHAREHOLDER ENGAGEMENT

Poor understanding: not doing enough

“We deem the size of our assets as too little to allow us to initiate efficient engagement actions with issuers”.

Extract from a report

Good understanding: participation in investor coalitions

“We participated, via the collaboration platform of the PRI, in an action which sought to raise the mining companies’ awareness of human rights violations”

“We wish to pursue our engagement strategy until every fossil fuel company will have published a report on the long-term viability of their business model in a +2°C world”

Extract from two reports

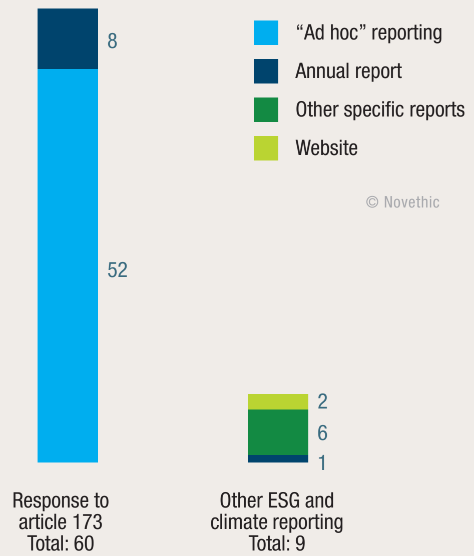
ASSESSMENT

ASSESSMENT OF THE FIRST REPORTING EXERCISE

INCONSISTENTLY COMPLIANT REPORTS

Nearly 70% of the main French institutional investors published a report in response to article 173, with an average of 15 pages per report. The most detailed information is found in the reports for pension schemes, reinsurers, and more generally, large investors who had more experience in responsible investment. The reports confirm a willingness to comply with the now famous law - a third of institutions even named their reports after the law, which is detrimental to the pedagogical purpose of their content. Many investors also cover the requirements of article 173 in their climate reporting, where they explicitly refer to the Energy and Green Transition. For the rest, reporting is found in more traditional documents, whose contents are not necessarily aimed at the general public, such as responsible investment or annual reports.

↓ **Choice of reporting type**
Ouf of 69 reports



LIMITED “POLICYHOLDER” INFORMATION

Information is easily available on the internet for 39 institutions, and more difficult to find for 25 others. Most “article 173” reports can be accessed online in the values and commitments section of company websites, or in sustainable growth and CSR sections. Reports are also frequently accessible in the “annual reports” section, and more seldom in the “legal information” section or in newsfeeds. Finally, four investors made the quest for extra-financial information extremely difficult. In an extreme case, a mutual insurance company hosts a “article 173” report on its website but not a single page links to it. Some institutions in the panel are rather reserved in their communication towards clients and use caution when handling figures and indicators. Others exhibit, however, a more voluntary approach to making information available by also using quarterly bulletins (4 mentions), newsletters (3 mentions), and the help of asset management advisers in local branches (1) or mobile applications (1). In about 10 reports published in response to article 173, investors take the liberty to include a glossary in the appendices, using between one and seven pages.

SUGGESTED IMPROVEMENTS

FOR INVESTORS

A better appropriation of the ESG and climate topics is both necessary and desirable. It would allow for more innovative approaches and less explanations as to why the integration of extra-financial criteria needs to be postponed. Only the 15% of engaged investors in the panel have defined further steps they want to implement (systematic integration of ESG criteria into risk profiles, alignment with the 2°C scenarios, decarbonization strategies, or assertive shareholder engagement), and a further 20% of investors reinforced pre-existing processes. This first assessment calls for more momentum among other asset owners. Rating agencies and asset management companies cannot carry out ambitious ESG processes alone, as it is up to their institutional clients to define such strategies.

A clarification of the objectives assigned to their ESG and climate strategies would be a plus. Such clarification could involve an explicit link between impact objectives (echoing the social contribution of institutions) and/or prudential approach (for example via an alignment with the climate recommendations of the TCFD).

Further work on methodology is needed for the carbon footprint of portfolios, climate scenarios, and more generally on a methodology to guide investment towards an energy and environment transition that is socially just. Investors should take part in the debates to avoid the use of turnkey expert solutions, which limit the extent of their appropriation of the topics and expose them to the use of black boxes.

Article 173 has the potential to encourage the implementation of recommendations from the TCFD, on condition that investors effectively take ownership of the assessment of climate risks. They must contribute to ensuring that the entire stakeholder chain, intermediaries and companies, strive to shed light on physical risks, transition risks, and use 2°C roadmaps as management tools for their portfolios... Progress still needs to be achieved, even for the most proactive actors.

FOR THE REGULATOR

While the immediate impact of article 173 is undeniable, the implementation decree will probably need to be strengthened in order to maintain the dynamic of the Paris financial center.

The first version of the text leaves a few institutional investors in the dark as to whether they are subjected to the reporting requirements or not. Additional specifications may help bring the absentees along.

The text is designed as an open framework to allow new investors to join, but this also introduces a difficulty, for without a clear framework little methodological consensus is achieved, and comparison between different reporting proves very difficult.

On a more general note, institutional investors remain cautious, pending a strong political and economic resonance to support their strategies. The One Planet Summit in Paris in December 2017 should give a second wind to the 2015 momentum and allow investors to move from the warm-up to the long-distance phase, in order to shift the trillions towards a low-carbon and inclusive economy, in accordance with their role as long-term investors.

VIEWPOINT: THE INSURERS' PROFESSIONAL ORGANISATION

Antoine Lissowski, chair of the Economic and Financial Standing Committee of the French Insurance Federation

What role can a professional federation like the French Insurance Federation (FFA) play in the context of Article 173 obligations?
FFA plays a key role in supporting the sharing of good practices within the profession, including on reporting, and in contributing to methodological research.

In practice, how did the FFA rally around for this first exercise?
Two how-to guides were published to help the member institutions: the first one deciphers the requirements of article 173, while the second one focuses on methodologies in use to measure the carbon footprint of assets. A working group, with members of both the Investment and Sustainable Development Departments, was also set up to discuss the challenges encountered and share solutions and good practices. This group put together a roadmap with 18 suggestions of operational recommendations to boost the integration of ESG and climate criteria into investment strategies.

What is the next focus for the insurance trade?
Strengthening the appropriation of ESG-climate effects through governance, developing internal expertise to deal with the technical complexity of these topics and improving the reporting are the areas of progress identified in the roadmap, which was validated at the highest level by the governing bodies of the Federation. The insurance trade also wants to work together with issuers and investors to improve the accessibility and relevance of data.

VIEWPOINT: THE FRENCH ASSOCIATION OF INSTITUTIONAL INVESTORS

Jean-François Boulier, President of AF2i

How did you help your members prepare their article 173 report?
Af2i has the capacity to federate its members, 82 French institutional investors which together manage more than 2300 billion euros, and is aware of climate issues and supportive of a surge in responsible investment. The association has set up a working group to help its members draft the new report. This group of 14 wrote a 50-page guide, published in July 2016, which, by categorizing the essential components of article 173, aims to explain the objectives of the legislator, and to provide concrete assistance in drafting the report.

How can your association help harmonize the reporting standards related to article 173?
Af2i pays attention to the analysis of various experts, such as Novethic, who will examine the first reporting exercise. Alongside other actors, including other professional organizations desirous of collaborating, Af2i will mobilize to bring out the best practices and progressively develop standards where it will be deemed relevant.

In what framework do your ESG actions fit?
Investors' responsibility in terms of environment, social impact and governance is at the heart of the concerns and investment processes of more than 80% of our members, according to our latest annual survey. For this reason, we are preparing another guide to help them implement investment schemes and policies that meet these ambitions.

THE PANEL OF 100 FINANCIAL INSTITUTIONS

Institutions who declared that they were not subjected to article 173 are marked with a *

ADREA Mutuelle
AFD
AFI-ESCA
AG2R La Mondiale
AGEAS France
AGIRC-ARRCO
AGPM
AGRICA
ALLIANZ France
ANCV
APGIS
APICIL
APRIL
AREAS
Assurances Crédit Mutuel
AVIVA France
AXA
B2V
Barclays Vie
BNP Paribas Cardif
Bpifrance
Caisse de Retraite des Notaires
Caisse des Dépôts
Caisse des Retraites du Sénat
CAMACTE
CAPSSA
CARAC
CARMF
CAVAMAC/PRAGA
CAVP
CCR
CNAVPL
CNETP
CNP Assurances
CNRACL
COFACE
COVEA
Crédit Agricole Assurances
Crédit Logement
CRPN*
EDF*
Eovi MCD
ERAFP
Euler Hermes France
FGAO
FGDR
Fondation de France*
FRR*
GARANCE
Generali France
Groupama
Groupe Unéo
Harmonie Mutuelle
Helvetia
HSBC Assurances
Humanis
IPECA Prévoyance
IRCANTEC
IRCEM
IRP Auto Prévoyance Santé
KLÉSIA
La France Mutualiste
La Mutuelle Générale
L'Auxiliaire
Le Conservateur
MACIF
MACSF
MAE
MAIF
Malakoff Médéric
MATMUT
Médicis
MGEN
MIF
Monceau Assurances
MUTEX
Mutuelle de Poitiers Assurances
Mutuelle Epargne Retraite
Natixis Assurances
NEA (ACMN Vie)
Neuflize Vie
OCIRP
Optimum Vie
Pasteur Mutualité
PREFON*
PREPAR Assurance
PRO BTP
SACRA
SCOR
SHAM
SMA
SMACL
SOGECAP
Suravenir
Swiss Life
Thélem Assurances
UMR - COREM
Uniprevoyance
UNOFI
Zurich France

173 SHADES OF REPORTING

Focus on French Institutional Investors

An analysis by Novethic's research center, conducted by Nicolas Redon and Dominique Blanc, with the contribution of Anne-Catherine Husson-Traore

Media and research centre, Novethic fosters global understanding of the economy and its transition to a more responsible business model. The research centre supports the implementation of best practices in sustainable finance and trains decision-makers and managers within corporations and financial institutions.

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