Article 173-VI: Understanding the French regulation on investor climate reporting

The ESG-Climate approach: from reporting to strategy, a tool for better investing

October 2016

With testimonies by key stakeholders

FIR Handbook No. 1

Sponsored by:
Article 173-VI of France’s Law on Energy Transition for Green Growth (LTECV) represents major innovation in terms of regulation in the fight against climate change as well as for investors. The impact on investors’ integration of ESG factors will be seen as of this year.

As a committed stakeholder in the drafting of the regulation, FIR, or French Sustainable Investment Forum (hereafter the French SIF) aims via this handbook to address all investors with the goal to clarify the principles of this ESG-Climate approach, and help them to improve their investment strategies.

This handbook is complementary to the practical guides published by the various professional associations. It intends to facilitate investors’ reporting approach by respecting as best possible the incentive spirit of the law and by following the best available practices. This approach will not only reduce the risks associated with climate change and the Energy and Ecological Transition (Transition Énergétique et Écologique, or TEE), but also lead to opportunities.

The handbook is divided into two parts:

- **The spirit of the law:** what you need to know in terms of the objectives and principles of the law
- **A roadmap for investors:** to help investors initiate an ESG-Climate approach based on best practices

The document is intended to be an overview, and includes a glossary for understanding the new concepts introduced by article 173-VI, as well as links for further reading.

Happy reading!
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I. THE SPIRIT OF THE LAW

> THE SPIRIT OF THE LAW IS MORE IMPORTANT THAN THE LETTER

Article 173-VI and its implementing decree are particularly groundbreaking: they apply the “comply or explain” principle, providing investors with broad flexibility in choosing the best way to fulfil the law’s objectives. Therefore, all reportable data listed in the decree represent best practice and not an obligation: the spirit of the law is thus what is most important to understand.

“Elevator pitch: how to explain to your board of directors in 1 minute what article 173-VI will change for them.”

“In short, article 173-VI could change nothing, as it is based on the comply or explain principle. However, in reality it changes everything, as the ESG-Climate approach is set to become a new market standard!

It is thus a way for us to align ourselves with our competitors’ best practices and anticipate the growing expectations of end investors.

Whatever our convictions with regard to climate change, the exercise can also allow us to increase the performance of our funds. Indeed, it highlights a type of risk/opportunity trade-off that may not currently be under the radar of our asset managers.”

TESTIMONY FOR THE FRENCH SIF

Pascal Canfin, CEO of WWF France: “Article 173-VI is an example to follow in terms of producing intelligent and ambitious game-changing rules that correspond to the new climate context.”

“Article 173-VI is a good example of the way we can change the rules of the game. In September 2014, private investors made the commitment before the UN to carry out better analysis and better reporting of their climate risk exposure. The fact that investors made this commitment meant it was possible! But to be able to make the switch from a purely voluntary approach to the scale of action required by the climate challenge, policymakers had to transform the experiment by mainstreaming this new requirement, while at the same time maintaining flexibility with regard to method. Article 173-VI is thus also an example to follow in terms of producing intelligent and ambitious game-changing rules that correspond to the new climate context.”

Definitions on page 37
• Comply or explain
A. WHY ARTICLE 173-VI?

> IN FRANCE, RECOGNITION OF THE KEY ROLE OF INVESTORS IN THE ENERGY AND ECOLOGICAL TRANSITION

The Energy and Ecological Transition will not be made without investors

The fight against climate change, and more generally the Energy and Ecological Transition, is not only a human and technological challenge, but also, and perhaps above all, a financial one: it is not a question of finding new financial resources but of redirecting existing flows.

France at the forefront in terms of mobilising investors

France is a leader in facing this challenge, as proven on the occasion of the 2015 United Nations Climate Change Conference (COP21) and the resulting Paris Agreement, which recognised the necessity to “align financial flows with the energy transition”.

The “Law on Energy Transition for Green Growth” (LTECV) specifies the means by which these targets can be achieved, and article 173-VI focuses on the financial means, recognising the major and positive role (“contribution”) that investors must play.

While France becomes a pioneer by writing this reporting obligation into its regulation, it hereby launches an international movement in terms of new practices and new tools, strengthening the role of the Paris marketplace in the world of Green Finance.

ALL ASSET CLASSES CAN CONTRIBUTE TO THE ENERGY AND ECOLOGICAL TRANSITION

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Definitions on page 37

- Energy and Ecological Transition
- COP21
- Paris Agreement
- LTECV

Did you know...

The IEA estimates that on a worldwide scale, around €1,000bn p.a. will have to be mobilised over the period 2015-2050 to successfully carry out this transition and limit global warming to 2°C

TESTIMONY FOR THE FRENCH SIF

Nicolas Hulot, President of FNH: “The financial sector has a key role”

“The financial sector has a key role: it can direct financing both toward companies that make the Energy and Ecological Transition, and those that, despite a current high footprint, are making efforts to reduce their impact.

Article 173-VI will further the Energy and Ecological Transition as it obliges financial investors to ask themselves questions, find answers, and put pressure on the companies they invest in to provide better-quality information regarding their climate-related impact and actions”.

In conclusion, the recognition of the key role of investors in the Energy and Ecological Transition is a crucial step towards aligning financial flows with the energy transition. France’s leadership in this area not only sets an example but also opens up possibilities for other countries to follow suit, thereby contributing to the global effort to combat climate change.
**French SIF:** France is the first country to openly call on the financial sector to contribute to the Energy and Ecological Transition. What role do you wish to see investors play in this context?

**SR:** The financial sector has a very important role to play in the Energy and Ecological Transition. With article 173-VI of the Law on Energy for Green Growth, France becomes the first country in the world to ask investors to disclose information concerning their contribution to climate goals.

But, beyond this law, I am also counting on the mobilisation of the financial sector in favour of the Energy and Ecological Transition. I know that this commitment already exists, as demonstrated by the “Business dialogues” organised during the COP21. This is the aim of the competition for the International Award for Investor Climate-Related Disclosures I opened on the occasion of the last Business dialogue I held with the presence of President François Hollande.

I now expect investors to step up a gear, with investments directed toward low carbon companies. Momentum is underway. The “Energy and Ecological Transition for Climate” government label that I launched at the start of the year thus collected one billion euros in just a few months. Shareholder dialogue is an excellent tool for accompanying issuers towards a more sustainable business model.

Thousands of jobs are at stake, and I am convinced that France can become the centre of the world of green finance.

**French SIF:** To what extent can the implementation of the Paris Agreement reinforce the momentum initiated by article 173-VI?

**SR:** The Paris Agreement is the first universal climate agreement. It raises awareness of the risks related to global warming. In finance, this awareness needs to come hand in hand with commitment by investors to ensure the financial security of savers via investment in long-term assets that incorporate the environmental dimension. I note for that matter, that the central banks and G20 have integrated this dimension.

The Paris Agreement provided investors with the opportunity to speak as a single voice alongside large municipalities, local and regional authorities, and non-governmental players, all mobilised in the fight against climate change. This mobilisation must now lead investors to develop new models and experiment with best management practices that integrate the fight against climate change. These practices - such as “Scope 3” accounting, calculating the carbon footprint of portfolios or transparency on low carbon strategy - already exist and are being implemented by pioneers.

The Paris Agreement, and more specifically the Solutions Agenda, must now mainstream these good practices so that the entire financial world may take advantage of them.

**French SIF:** Could you come back on the state of mind in which you contributed to defining and implementing this innovative regulation that article 173-VI constitutes?

**MS:** Article 173-VI was drafted in the context of the “finance” strategy of the COP21 hosted by France. This strategy was based on three pillars: in addition to preparing the future Agreement and giving credibility to the financial commitments taken vis-à-vis less advanced partners, our ambition was to push the entire financial sector more broadly into the perspective of a low carbon strategy. The challenge of the transition is indeed one of redirecting investment, and hence of reallocating capital, in alignment with the climate goals reiterated in the Paris Agreement.

My conviction is that, along with ambitious climate policies, the appropriation of climate issues by the financial sector is a powerful lever for change for the low carbon transition. It is this strong conviction that we wanted to reflect in our national framework.

This appropriation requires understanding of the issues at stake and for this understanding to be conveyed to the strategy and activities of financial actors. From this point of view, article 173-VI forms a coherent ensemble: it provides financial players with relevant information on the companies they finance, and asks them to explain how they integrate this information into their investment decisions.

**French SIF:** France is the first country to incite institutional investors to analyse the risks related to climate change and disclose their contribution to the Energy and Ecological Transition. Is this the first step toward new prudential rules that recognise the systemic nature of the climate change risk?

**MS:** It is important to bear in mind that, for a financial institution, climate change does not represent a new category of risk, or a new “systemic risk”. Climate-related issues are rather a global perspective that will have financial consequences, and the common factor of numerous developments in the energy, transport, agriculture and tourism sectors, etc.

The challenge of this approach - which is not only French, but is already beginning to stretch to other European and G20 countries - is to translate climate issues into the language of finance (market risk, credit risk, etc., but also investment opportunity). The regulator’s responsibility is to ensure that the risks linked to the effects of global warming are adequately recognised and managed – i.e., that the financial sector plays its role fully in terms of capital allocation.
A global initiative driven by civil society

Investors’ commitment to the energy and ecological transition was an initiative that began at the start of the years 2000, before accelerating in 2014 and 2015 (Climate Week, Portfolio Decarbonization Coalition, Montreal Carbon Pledge).

This initiative responds to the growing awareness of the general public, international organisations and policymakers of the impact of financial investments on the deterioration of the Earth. The highly-mediatised ONG Carbon Tracker and 350.org reports, for example, enlightened civil society and public authorities with regard to the consequences of certain investment decisions on the climate, notably in the energy industry.

Climate change – a factor of risk for financial stability

In addition to investors’ environmental responsibility, the new factor that emerged in 2015 was the recognition by a number of key players of the financial risk that climate factors create for investments. Mark Carney, Governor of the Bank of England, thus stated in September 2015 “climate change is the tragedy of the horizon” and could become “a defining issue for financial stability”. It was in this context that the Financial Stability Board decided at end 2015 to create the Task Force on Climate-related Financial Disclosures (TCFD).

Did you know...

Higher than Europe’s GDP, the 20,000 billion euros in European assets under management represent a considerable weight in the real economy, for which the opportunistic or strategic choices lead to very long-term impacts.

Definitions on page 37

• Climate Week
• Portfolio Decarbonization Coalition
• Montreal Carbon Pledge
• Financial Stability Board

ACCELERATION AND MASSIFICATION OF CLIMATE INITIATIVES

Carbon Disclosure Project

Investors Network on Climate Risk (US and Canada)

Principles for Responsible Investment

Regrouping of regional initiatives within the Global Investor Coalition

Montreal Carbon Pledge


Institutional Investors Group on Climate Change (European Union)

Investor Group on Climate Change (Australia and New Zealand)

Asian Investors on Climate Change (Asia)

Global Investor Statement on Climate Change

Finance Day at the Paris Business Climate Summit

TESTIMONY FOR THE FRENCH SIF

Philippe Desfossés, Vice-Chair, IIGCC-ERAFP: “Article 173-VI responds to the priorities defined by the IIGCC”

“Article 173-VI clearly constitutes an element of response to the investment priorities defined by the Institutional Investor Group on Climate Change (IIGCC). In this context, the IIGCC decided to form a task force, the objectives of which will be to follow the implementation of article 173-VI by institutional investors and reflect on extending this measure on a European scale. Given the diversity of the governance methods and investment policies of the IIGCC’s 123 members, such an extension would imply allowing for broad leeway for the different options and approaches in terms of climate risk reporting.”
Christian Thimann, Vice Chair, TCFD – AXA

“There are various ways to approach so-called “carbon asset risk”. For example, Limiting CO2 concentrations to 450 parts per million (ppm) should provide a 75% chance of avoiding +2°C. Achieving this CO2 concentration threshold requires limiting carbon emissions, hence burning only 1/3 of existing fossil fuel reserves by 2050, according to the International Energy Association. Enforcing this carbon constraint would result in a significant loss of value for a number of carbon-intensive assets, potentially impacting other industries as well. Current valuation models do not account for “unburnable carbon” risks adequately. This is what is now called “stranded assets”.

Long-term investors such as AXA (who, as an insurer observe climate risk also evolving on its liabilities and claims paid) have been sufficiently convinced by the severity of this risk to divest certain assets, such as coal-related industries, for which “asset stranding” risk is probably more acute.

However, measuring the level of financial risk created by climate risk and transition to a low carbon economy is a complex task. It involves assessing risks at regional, asset-class, industry, technology, company or even individual facility levels and across various time horizons. It also involves factoring in not only risks related to the energy transition itself (ie. identifying the long term winners and losers in all sectors of the shift to a low carbon economy depending on their strategies, R&D choices and investments), but also “physical” risks, namely understanding which “real assets” (buildings, infrastructures…) may be threatened by increasingly frequent and severe natural catastrophes such as floods or hurricanes. It can even, in some jurisdictions, require an analysis of potential litigation risks associated with climate change.

In brief, I would qualify this financial risk as complex, multi-faceted and work in progress – but sufficiently essential for the future of our living standards and economic functioning to warrant our full attention as investors.”
**SRI: PIONEERING APPROACHES HAVE PROVIDED FERTILE GROUND FOR THE INTRODUCTION OF ARTICLE 173-VI**

**French players are forerunners in SRI**

The maturity of the weight of SRI and ESG integration practices in France clearly supported and guided French policymakers toward the drafting of article 173-VI. Climate change reporting initiatives voluntarily implemented by large public and private investors showed that the exercise was not only possible, but also efficient, with convincing results in terms of the decarbonisation of their assets. It was also by capitalising on these best practices that France launched a government SRI label.

**Borrowing ESG research tools**

At the global level, SRI players, notably UN-PRI signatories, have developed a broad range of ESG integration methods that can be used in implementing article 173-VI.

**Extending the scope of SRI**

Article 173-VI is currently a formidable vector for extending SRI best practices to all eligible assets. In fact, it can be hoped that, by systematically asking the right questions regarding ESG issues, investors will increasingly aspire to giving positive answers. However, the mainstreaming of reporting as defined by article 173-VI will not transform all funds into SRI assets. The motivation of a positive social impact, which is a determining factor in conviction-based SRI management, remains the prerogative of funds with a clear mandate to invest by combining social, environmental and financial returns.

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**Did you know...**

At end 2015, France’s AUM incorporating ESG totalled 746bn euros, 20bn of which specifically geared to low carbon financing (Novethic with the French SIF)

**Definitions on page 37**

- SRI
- ESG

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**TESTIMONY FOR THE FRENCH SIF**

Curtis Ravenel, Secretariat member, TCFD – Bloomberg: "The Phase II Report should complement the work and guidelines established by Article 173-VI."

"The FSB Task Force on Climate-related Financial Disclosures is developing voluntary recommendations for companies to disclose their climate-related risks and opportunities in their mainstream financial filings. The Task Force is leveraging the related work of regulators, governments and NGOs, such as Article 173 in France. But it is important to note that the Task Force is industry-led and policy-neutral, guided by cross-sector industry experts that comprise its 32 members. The Phase II Report that released at the end of this year should complement the work and guidelines established by Article 173."
INVESTOR BEST PRACTICES

Marie-Sybille Connan, Senior SRI analyst, Allianz GI: “ESG is a ‘must have’”

“The French initiative opens up a new era for the investment world. An ESG policy is no longer considered ‘nice to have’, but a ‘must have’. Corporate governance practices have already proven their alpha and investors are finally starting to grasp the extent of the reality of climate change and its impact on their investments. Thanks to its pragmatic approach and two-year testing period, article 173-VI of the law on the Energy Transition for Green Growth could become the benchmark in Europe”.

SRI AND ESG EXPERIENCE: FERTILE GROUND FOR ARTICLE 173-VI

Experience in analysing the impact on investments

Experience in analysing the impact on investments

Experience in environmental analysis

ESG: INTEGRATION
- Analysis of the materiality of ESG risks
- Financial integration practices
- Publication of engagement reports

SRI: MOTIVATION
- Experience in reporting ESG impacts
- Already-existing SRI label
- Shareholder engagement practices

THEMATIC FUNDS
- Identification of the Green Tech universe
- Already-existing green fund label

For further reading
- Legislative texts
- Participatory platforms and initiatives
- Reports on ESG-Climate challenges for finance
B. WHO DOES ARTICLE 173-VI ADDRESS?

> **DIRECTLY-CONCERNED INVESTORS AND ASSETS**

Article 173-VI applies to two key components of the investment process: asset management companies (already targeted by article 224 of the Grenelle II law), and, for the first time, institutional investors (insurers, mutual insurers, etc.). The regulation concerns all asset classes: listed assets, venture capital, bonds, physical assets, etc.

**Eligibility thresholds**

The implementing decree provides for lighter obligations for investors with AUM or consolidated balance sheets below 500 million euros.

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<th>For companies &lt; 500 M€</th>
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<tr>
<td>Description of methods for incorporating ESG factors into investment strategy</td>
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<td>Description of means employed to support the Energy and Ecological Transition</td>
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For more details, please refer to the publications of the professional associations, notably the guides of the French Association of Institutional Investors (Association Française des Investisseurs Institutionnels (AF2I)) and the French Asset Management Association (Association Française de la Gestion financière (AGF)).

> **AN OPPORTUNITY FOR MANY OTHER ACTORS IN THE INVESTMENT CHAIN**

In addition to the regulatory requirement, the ESG-Climate approach promoted by article 173-VI represents an opportunity for all investors: the “comply or explain” method allows each player to adapt the exercise in order to incorporate the factors that are useful to their own investment and marketing strategies.

The service providers of eligible investors will also have to enhance their ESG-Climate practices in order to meet their clients’ demands.

The ripple effect of article 173-VI will thus reinforce the ESG-Climate policies of all players in the investment value chain (institutional investors, asset managers, rating agencies, consultants), both in France and internationally.

> **AN OPPORTUNITY FOR ISSUERS**

For investors to be able to analyse the risks and opportunities related to climate change as stipulated by article 173-VI, issuers must provide them with the information that is adapted to their needs: this is the focus of article 173-IV of the LTECV.

Beyond this regulatory obligation, investors are increasingly asking companies about their climate strategy. The quality of companies’ own climate reporting has thus become crucial for attracting investors that follow a climate approach.
**Article 173-IV and the corresponding decree**

Article 173-IV is to companies what article 173-VI is to investors. It asks companies to provide “information on the way they take account of the social and environmental consequences of their activity - including the effects of climate change resulting from their activity as well as from the use of the goods and services they manufacture - and of their social commitments in favour of sustainable development, the circular economy, the fight against food waste, and the fight against discrimination and promoting diversity”. The implementing decree stipulates that the scope of information looked for includes “significant items associated with direct and indirect emissions, over the company’s entire value chain, i.e. upstream and downstream of its activity”. The SIF is very pleased that indirect emissions will be incorporated, as this is something for which we had made a stand.


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**WHAT THE EXPERTS SAY**

The ACT project (CDP-ADEME) by Romain Poivet, ADEME

“The ACT (Assessing low Carbon Transition) project aims to assess to what extent companies’ pathways are aligned with the scenarios of a transition toward a low carbon economy. It is jointly led by ADEME and CDP on an international level, in partnership with the European Investment Bank, 2°Investing Initiative and Climate Check. Based on solid principles such as the use of low carbon scenarios and strong verifiability requirements, the methodologies, produced by sector and using a common base, aim to become the foundation of corporate climate reporting of the future. The raw data collected and the company benchmarks of each of the indicators used in the method will constitute a powerful tool for both companies and investors that wish to adopt a climate approach, or those with ambitious climate policies. The results of the pilot project will be presented at COP22”.

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**TESTIMONY FOR THE FRENCH SIF**

Nicolas Hulot, President of FNH: “The way companies will use this data to reorient their medium-term strategies will be an important focus of attention”

“The decree relative to company reporting on greenhouse gas effects was published during the summer. Up until now, companies were required to disclose the GHG emissions for which their activity was directly responsible (production processes, office emissions, etc.). They must now also provide information on their indirect emissions. This is significant, as, depending on the sector, most of the climate impact can come from upstream of the company’s activity (this is the case of the food industry for example) or the use of products sold (for the automotive industry, for example). Although companies have less means for action than in the case of direct emissions, it would be false to say that they have no room for manoeuvre, either because they are the purchaser, or because they design the product. This decree thus marks a significant step forward. It remains to be seen how companies will use this data to set emission reduction goals and switch the direction of their medium-term strategies.”

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For further reading
- Legislative texts
- Guides for implementing article 173-VI published by the various associations (AF2I, AFG, etc.)

To ask a question, post a comment or share good practices, visit the French SIF’s interactive space dedicated to article 173-VI
C. THE MAIN PRINCIPLES OF ARTICLE 173-VI

> 4 KEY PRINCIPLES TO RETAIN:

From voluntary to regulatory for institutional investors
With ESG practices having proven their worth, the obligation to integrate ESG factors - previously limited to asset management companies - has been both reinforced and extended to institutional investors.

Climate is at the core of ESG:
Within the reinforced ESG analysis, the urgent nature of the environmental challenge and its financial materiality justify the focus being placed on the environment, and, more specifically, climate change issues.

The impacts “on” and “of” investment:
Article 173-VI encourages investors to incorporate the ESG-Climate approach into their investment strategy in two ways: the impact “of the investment” on ESG-Climate factors and the “impact on the investment” of ESG-Climate factors.

Flexibility and experimentation:
According to the “comply or explain” principle, investors choose the analysis tools and levers for action that are best adapted to their strategy.

CLIMATE AT THE CORE OF ESG

"Integration of ESG criteria"

“Contribution to the objectives of the Energy and Ecological Transition”

"Integration of climate change-related risks…and contribution to 2°C alignment"
A pivotal concept of article 173-VI, the notion of impact is addressed on the one hand in terms of management of the risks for invested assets (impact on the investment), and on the other hand in terms of the contribution of these assets to ESG factors (impact of the investment).

Its two sides thus presented, the principle of impact is broken down within the law into the three cardinal virtues of SRI: precaution (risk analysis), moderation (reducing impacts), and action (contribution and engagement).

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**THE PRINCIPLE OF COHERENCE AT THE CORE OF THE ESG APPROACH**

**Encouraging self-reflection…**

The best way to respect the spirit of article 173-VI is to interpret its openness and flexibility as a way of inciting investors to reflect on the methods and objectives of their investment policy as well as on the social and environmental issues they consider to be a priority in light of these objectives. Drawing a parallel between these two thought patterns leads to factors of convergence and divergence, which can be used to establish a series of ESG objectives in the analysis process, the choice of assets and the ways voting rights are exercised. These are all tangible elements that can be materialised in an investment charter, a true gateway to reporting under article 173-VI.

**… and appropriation**

It would be almost deceiving to propose a guide for article 173-VI due to the specific nature of the situation of each investor (time constraints, prudential rules and the expectations of the beneficiaries, etc.). This legislative text is thus intended more as a source of inspiration with regard to the potential issues at stake and available methodologies. It also constitutes a framework for structuring ESG communication in both an intelligent and intelligible way.
The principle of coherence is what defines the main issues

Although the decree focuses strongly on climate risk, it is not necessarily mandatory to systematically make climate risk a management priority; climate issues must be approached in a more holistic manner with regard to the issuer’s challenges. For example, for a company that manufactures products with a low carbon footprint in underdeveloped countries, it seems logical to focus the analysis on S (labour laws, etc.) or G issues (contractual relations, etc.). In all cases, the principle of coherence prevails and is what must structure the elements of reporting.

INVESTOR BEST PRACTICES

Philippe Dutertre, Head of SRI at AG2R LA MONDIALE: “Coherence and materiality”

“AG2R LA MONDIALE is a company, an issuer, an asset manager (notably via its asset management company) and an investor. Article 173-VI, throughout its various paragraphs, thus addresses us in all these aspects. In addition to our contribution to the energy transition, we see in the spirit of this text the opportunity and necessity to ensure coherence between the way we carry out both our corporate and investor responsibilities. The definition of investment criteria and operating objectives, in terms of financing companies to support employment and contribute to the vitality of the French economy, whether via mutual funds or general funds, must correspond to our stakeholders’ expectations. Their implementation must contribute to the emergence of a sustainable and inclusive economy that is as local as possible and to fulfilling our fiduciary responsibility.”

INVESTOR BEST PRACTICES

Yves Chevalier, Member of the Board of Directors, Fonds de Réserve pour les Retraites (FRR): “Article 173-VI reflects a profound change that now places ESG factors at the heart of financial management”.

“Article 173-VI of the law on energy transition will lead to a rise in the level of awareness of all investors with regard to ESG risks. At the top of the list, the climate change risk constitutes both a threat weighing on the valuation of assets in the medium and long terms, and an opportunity to progressively reorient investments toward a pathway that is in line with the objectives of the Paris summit. The investor obligations stipulated in article 173-VI are part of this worldwide momentum via the transparency and quality of information, dialogue concerning method, and the responsibility of players. Article 173-V1 thus reflects a profound change that now places ESG factors at the heart of financial management. For the FRR, which has incorporated ESG factors since its creation, the pioneering and positive aspect of article 173-VI constitutes an opportunity to improve the communication and content of its strategy and mobilise the companies that manage its assets.”
Example of a Responsible Investment Charter

The purpose of an investment charter is to highlight the key guiding principles investors follow with regard to the different issues. In the case of ESG factors, we talk about a Responsible Investment Charter.

For the French mutual insurer MAIF, the charter marks its commitment to an investment approach that is consistent with the Principles for Responsible Investing (PRI). Via its charter, the MAIF highlights its own vision for incorporating ESG factors into its asset management methods.

WHAT THE EXPERTS SAY

“It is possible to reconcile Environmental and Social objectives”, by Alexis Masse, Confederal Secretary, CFDT, and Administrator at the French SIF

“The first victims of companies that pollute are often its employees. Companies that base their production model on the exhaustion of natural resources often also exhaust their human resources.

The CFDT demands an economy of quality, in which companies draw their comparative advantage not only from their environmental excellence, but also their unity and the inventiveness and expertise of their collective work. There is thus no contradiction between the E and S factors. The vital question is to accompany men, women and companies toward this new production model, by securing workers’ career paths so that they can benefit from all the opportunities – including those of the green industry”.

> FOCUS ON ENVIRONMENTAL ISSUES, AND MORE SPECIFICALLY CLIMATE CHANGE

Environment and climate: major issues at stake

Article 173-VI advocates focusing on environmental factors, and notably climate risk, for two main reasons: the need to finance the Energy and Ecological Transition, and the financial risks that climate change creates for investors.

The Energy and Ecological transition at the core of the approach

In order to do this, it is necessary to properly grasp the concept of the Energy and Ecological Transition that is at the centre of the approach. This concept applies to the four main environmental issues as normally classified by environmental evaluation methods: global warming, depletion of resources, ecosystem decline and threat to human health. For each of these categories, the current impact of human activities is not sustainable.

Focus on climate: transition toward a low-carbon economy and the pathway to 2°C

Regarding global warming, this signifies a transition toward a “low-carbon economy”, i.e. lower greenhouse gas effects and warming limited to 2°C above the pre-industrial era. This transition, also called the “2°C pathway” or “2°C scenario”, provides the basis for understanding the main concepts of article 173-VI: Physical risk, Transition risk, Contribution to the Energy and Ecological Transition, Carbon strategy.
Risks and opportunities…

Beyond the factors mentioned in the decree, investors must be wary of a “partial” vision of the Energy and Ecological Transition. While both climate change and the Energy and Ecological Transition produce risks, they also provide opportunities to be seized by investors if they give themselves the means to do so.

… and difficulties to surmount!

It nevertheless may be said that this climate analysis is new and demanding. The “comply or explain” approach enables investors to express the difficulties they encounter in implementing this new objective. These accounts are a source of progress for investors and will aid future adjustments to regulation.

TRANSITION TOWARD A LOW CARBON ECONOMY:
ONE OF THE FOUR PILLARS IN THE ENERGY AND ECOLOGICAL TRANSITION

<table>
<thead>
<tr>
<th>Threat</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment</td>
<td>Energy and Ecological Transition</td>
</tr>
<tr>
<td>Global warming</td>
<td>Transition to a low carbon economy</td>
</tr>
<tr>
<td>Depletion of resources</td>
<td>Development of a circular economy</td>
</tr>
<tr>
<td>Ecosystem decline</td>
<td>Halting of biodiversity loss</td>
</tr>
<tr>
<td>Threat to human health</td>
<td>Prevention and protection of populations</td>
</tr>
</tbody>
</table>

INVESTOR BEST PRACTICES

Jean-Guillaume Peladan, Fund Manager and Director of Environmental Strategy and Research, Sycomore AM: “Incorporate all environmental factors that are critical for the issuer”

“...A single-factor approach is dangerous, as it could miss major issues and conceal a transfer of pollution. For example, a diesel engine reduces a car’s CO2 emissions compared to a gasoline engine, but increases emissions of fine particles and NOx, significantly impacting the quality of air in urban areas and thus human health. Likewise, nuclear energy produces low carbon electricity, but creates major risks in the event of an accident and transfers the waste management to future generations. Thus, an approach focused on climate change would favour diesel and nuclear, leading to serious errors. A multi-issue approach is vital.”
The Energy and Ecological Transition: a necessity

This concept arises from the observation that the environmental footprint of human activities has exceeded the threshold of sustainability: in 2015 it equalled “1.6 planets” (i.e. the resources of one and a half planets would be required to meet the needs of our current model).

Each year, the “overshoot day”, i.e. the day of the year from which human activities run “on credit” moves up: in 2016 it was on 8 August!

(http://www.overshootday.org/)

To ensure the sustainability of our economic model, we have no choice but to transform it in order to lower the environmental footprint to one planet; this is what we call the Energy and Ecological Transition.

INVESTOR BEST PRACTICES

Luisa Florez, Head of ESG Fundamental Research, AXA IM: “Apply the know-how of insurers to the evaluation of the physical risk for investors.”

“AXA has developed models for assessing and anticipating physical risks for the evaluation of NatCat risks and the calculation of insurance premiums, among other things. These models currently integrate some climate risks, such as wind velocity, flooding, hail, etc. For a fund manager like AXA IM, we hope to be able to reconcile this “insurance” data with real assets held in the portfolio in order to determine an approximation of the “physical” risk related to climate. The objective would be to obtain an average estimated “destruction rate” based on climate risks. We could eventually evaluate the link between this risk and financial materiality, bearing in mind that this would represent a technical and intellectual challenge for ESG analysis”.

WHAT THE EXPERTS SAY

The question of the timeframe for incorporating climate risk, by Ian Cochran, Finance, Investment and Climate Program Director, I4CE

“Article 173-VI drives a movement toward improving the climate-related data required by financial players. This data will enhance the perception of the risks investors are exposed to, thereby contributing to correcting the risk premium associated with the assets.

I4CE also highlights the importance of remaining vigilant with regard to the conditions that will allow the financial system to sustainably manage its exposure to climate risks. Information can in fact lead to a small correction in the premium, if it reflects a gap between the expected timeframe of the materialisation of the risk and the timeframe incorporated by the investor. Sustainable management will in fine require the Energy and Ecological Transition to rapidly become credible and competitive on the scale of the entire financial system.”
The dual climate transition

While the physical risk stemming from climate change will continue to rise over the 21st century (gradual increase in global warming), the challenge is to limit this risk by contributing to the 2°C target by participating in the transition toward a low carbon economy.

Unfortunately this transition in turn generates a specific risk called the transition risk.

This transition will lead to a reduction in companies’ GHG emissions, which can be driven by investors thanks to a low carbon strategy.

### The Physical Risk and Its Impact on Issuers

The physical risk produced by climate change has three main types of financial impact on the different asset classes:

- More frequent extreme events, which can lead to damage or higher insurance costs
- Gradual change in weather conditions that can modify economic balances
- Policies set up to adapt to climate change require additional investment

### The Different Concepts of Article 173-VI Structured Around the Dual Climate Transition

The Energy and Ecological Transition (TEE) and especially the 2°C target, means financing high environmental performance technologies and economic models. This includes low carbon technologies of course (renewable energies, alternative drive systems, etc.), but also activities that help the environment in broader ways (recycling, organic farming, etc.).

The contributing activities of issuers vary from one asset class to another: hence, while in the case of a State, the focus would be on policies for the public financing of the TEE, for companies, it would mainly be on the analysis of their products and services in order to assess their contribution to the TEE.

### The Transition Risk and Its Impact on Issuers

The Energy and Ecological Transition generates 3 types of specific risk during this period:

1. A market risk, linked mainly to contrasting price trends for energy and natural resources.
2. A regulatory risk, linked to the implementation of taxation systems and/or subsidies intended to favour the TEE.
3. A reputational/behaviour risk, linked to the preferences of clients and other stakeholders in terms of TEE activities.

### Contribution to the Energy and Ecological Transition and the 2°C Target

<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Contribution to the TEE Objective</th>
<th>Contribution to the 2°C Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPANIES</td>
<td>+ Low carbon products + services + Public financing of the TEE + Climate price signal</td>
<td>+ Renewable energy infrastructure + Electric railway + New energy-plus buildings</td>
</tr>
<tr>
<td>STATES</td>
<td>- High environmental performance activities</td>
<td>- Renovation of existing buildings</td>
</tr>
<tr>
<td>INFRASTRUCTURE</td>
<td>- Renewable energy infrastructure + Electric railway + New energy-plus buildings</td>
<td>-</td>
</tr>
<tr>
<td>REAL ESTATE</td>
<td>- Recycling + Organic farming + Circular economy + Electric or hybrid engines + Renewable energies + Energy efficiency</td>
<td>-</td>
</tr>
</tbody>
</table>

### Analysis

<table>
<thead>
<tr>
<th>GHG emissions/Kyoto (GtCO2-eq./yr)</th>
<th>Contribution to the 2°C Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference</td>
<td>Transition toward a +2°-4° economy</td>
</tr>
</tbody>
</table>

### Physical Risk

- Cost of damage
- Costs linked to the change in climate conditions
- Cost of investment linked to adaptation works

### Examples of risk for issuers

<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPANIES</td>
<td>Threats to supply chains + Rise in insurance costs + Increase in sensitivity to climate</td>
</tr>
<tr>
<td>STATES</td>
<td>Costs for guarantees funds (ex. CATNAT Period) + Devaluation due to damage + Cost of adaptation works</td>
</tr>
<tr>
<td>INFRASTRUCTURE</td>
<td>Cost of investment linked to adaptation works</td>
</tr>
<tr>
<td>REAL ESTATE</td>
<td>Devaluation linked to expected damage (ex. areas at risk of flooding)</td>
</tr>
</tbody>
</table>

### Focus on the Concept of a Low Carbon Investment Strategy

- GHG emissions - responsible for climate change - are an interesting parameter of analysis for investors wishing to contribute to the TEE. We use the term “low carbon strategy” when an investor analyses the change in the GHG emissions of invested assets over time and sets quantified targets for lowering the GHG emissions of their portfolio.
With regard to the climate impact of the investment, the investor must distinguish between the positive impact (contribution to the 2°C target) and the negative impact (contribution to climate change).

Likewise, regarding the climate impact on investment, although article 173-VI highlights mainly the risks, this “risk” vision must be balanced by a vision of ‘opportunity’, notably generated by Green Growth momentum.

### INVESTOR BEST PRACTICES

Marie-Claire Abadie, SRI Portfolio Manager, Allianz GI: “Go beyond the risk approach and seize opportunities”

“Measuring and reducing the carbon footprint currently appears to be the chief solution, but it must not mask the other key points of this transition toward a lower carbon economy, i.e. determining which companies offer products and services that will contribute to a scenario of limiting global warming to 2°C. These companies will most likely be the most resilient in the face of climate risks. It is in this vein that Allianz GI, in keeping with its SRI expertise, created a “climate transition” policy that aims to be more dynamic and evolving, with two main points of focus: controlling exposure to climate-related risks and benefiting from the opportunities linked to the transition.”

For further reading

- The risks addressed by article 173-VI
- A few figures to better understand the climate-ESG risk for investors
II. ROADMAP FOR INVESTORS: DRAWING INSPIRATION FROM GOOD PRACTICES

AN ESG-CLIMATE APPROACH TO IMPROVE INVESTMENT STRATEGY

AN OPEN APPROACH BASED ON GOOD PRACTICES

Article 173-VI and its implementing decree do not impose any specific method, based on the principle that no one method could adapt to the diverse situations of investors.

The aim is to draw inspiration from current best practices, as well as develop new practices in line with the law's objectives. Article 173-VI thus invites investors to undertake a real exercise in innovation and experimentation.

An assessment of the implementation will be carried out after two years, at end 2018, and, if necessary, this will allow the most relevant methodological tools to be specified.

PROPOSAL OF AN ESG-CLIMATE ROADMAP

A roadmap to help investors initiate an ESG-Climate approach

In the absence of a regulatory framework for method, the French SIF wanted to provide investors with a simple and concrete ESG-Climate roadmap they can use to initiate an ESG-Climate approach.

This roadmap is meant solely as a framework for reflection, to help investors ask themselves the right questions throughout the investment process.

From Assessment to Reporting: the steps to start taking action

1. **Assessment:** making the right assessment of the ESG-Climate risks of an investment strategy is key to defining a relevant ESG-Climate approach
2. **Objectives:** once the assessment has been carried out, it is up to the investor to strategically define the objectives to be set, both in financial terms and with regard to ESG-Climate, and to explain the reasons (risks, reputation, commercial interest, etc.) for choosing them
3. **Levers:** depending on the objectives, there are very diverse levers for action, which can be complementary
4. **Reporting:** lastly, describe the ESG-Climate strategy that has been implemented, as well as its impacts, both on investment and ESG-Climate factors
Define your own approach based on your investment strategy

The key point of the ESG-Climate roadmap proposed by the French SIF is to start from the current investment strategy and finish with an enhanced investment strategy, to avoid ending up with a “groundless” ESG-Climate approach. This going to and fro between investment strategy and ESG-Climate strategy must be carried out at each phase of the roadmap.

Faced with the diverse ambitions and approaches, it is up to the investor to define the level of ESG-Climate integration in each phase in the process. The most relevant methods and tools are then to be chosen according to this degree of integration and the investor’s own stance.

A roadmap to be enhanced by best practices

This roadmap is illustrated by investor best practices: the list of best practices is not exhaustive and is intended to be enhanced by feedback from your experience during the two years of experimentation of article 173-VI. Join us in the French SIF’s collaborative space dedicated to article 173-VI!
A. ASSESSMENT TOOLS

> ESG ANALYSIS: IDENTIFYING THE CRITICAL ISSUES

Setting up a hierarchy: the materiality grid applied to investors

It is advisable to limit ESG reporting to less than 10 key factors that are in keeping with both the strategic lines of the investment policy (and voting policy) and the main risk factors of the portfolio. The aim of ESG analysis is thus to identify these factors, and then express each of them according to their own specific criteria, the latter in turn being defined by one or more KPIs that are objectifiable, comparable and, when possible or relevant, quantifiable in financial terms.

It is important to emphasize that a risk factor - whether systemic, aggregate at the portfolio level, or specific to an asset - cannot in principle be offset by an opportunity or an exposure to assets benefiting from better practices. An inventory of the main risk factors should, as suggested in the decree, be established separately from the exposure to opportunities linked to ESG factors and the Energy and Ecological Transition.

INVESTOR BEST PRACTICES

Bertille Knuckey, Fund Manager and Head of ESG Research, Sycomore AM: “Focus on the key ESG factors”

“Examining the relations a company maintains with its stakeholders enables to identify the relevant ESG issues. For example, analysing the environmental impact of a company that produces electricity from coal is of interest when evaluating its economic model. Conversely, this topic is much less significant in the case of a manufacturer of ophthalmic materials. Likewise, assessing the labour conditions of a manufacturer of goods and services with a high labour component is essential, whether within its operations or its supply chain. The first step in an ESG analysis therefore consists of understanding the positioning and functioning of an issuer to determine the factors and stakeholders most greatly concerned: environment, employees, suppliers, clients, civil society, institutions. The key ESG issues be to investigated ensue from the process.”

> CLIMATE ANALYSIS: DIFFERENT TOOLS FOR DIFFERENT OBJECTIVES

There is no harm in the wealth of tools

Recent investor demand has led to the creation and marketing of numerous tools that analyse climate issues from many different angles. In addition to the carbon footprint, we find indicators such as “climate risk”, or “green share”, for example. Although most of these tools are not yet standardised, they are operational and allow for experimentation as stipulated in article 173-VI.

Take your pick!

Faced with the large variety of tools, investors must begin by defining their objectives before choosing which one(s) are the most adequate for them. Depending on whether you wish to analyse the impact on climate or the impact on investment, or if you are focusing on a positive or negative impact, the tools are not necessarily the same. For example, while the “carbon footprint” provides information on the negative impact on climate, “avoided emissions” enable an evaluation of the positive impact on climate, as does the “green share” indicator. However, if you are looking for an indicator to assess the risk of climate change to the investment, you will need to use other tools. These tools are thus not exclusive of each other, but rather complementary, as they enable to achieve different objectives.
We distinguish three main families of tools

- The first groups together “carbon” metrics, which assess the impact of climate change on issuers via an evaluation of their GHG emissions (see section on Carbon indicators)
- The second includes tools used to identify the “impact drivers”, upstream from the impact itself and closer to the economic activities (fossil or low-carbon activities)
- The third groups together the tools used to assess several climate-related aspects by creating a scoring system

INVESTOR BEST PRACTICES

Nicolas Blanc, Deputy Head of Strategy, Caisse des Dépôts et Consignations, “Extend the analysis to all asset classes”

“It is necessary to extend the analysis to all asset classes, as some of the indicators that will now have to be disclosed by investors concern very macro factors such as investment policy or risk management. Beyond the legal requirement, an SRI or Climate approach must not be limited to asset management, despite the latter being an interesting “pilot” area for initiating climate policies methods, due to the relative availability of data. Infrastructure, real estate, unlisted companies and even States are just as sensitive to ESG factors, but methodologies are more complex to create and develop for these asset classes”.

INVESTOR BEST PRACTICES

Luisa Florez, Head of ESG Fundamental Research, AXA IM: “There are several methods available for evaluating contribution to the Energy and Ecological Transition”

“In order to assess a portfolio’s contribution to the Energy and Ecological Transition (or “green share”), asset managers, including bond managers, can choose from many different methods. Green Bonds offer the possibility to focus a part of financing on projects aligned with the Energy and Ecological Transition. For those who do not issue green bonds, it is possible to evaluate the share of activities that are in line with the Energy and Ecological Transition. Three options exist to guide issuers in their choice: the sales generated by this activity, avoided emissions or the technological choices made by each company.”
INVESTOR BEST PRACTICES

Pauline Lejay, Head of SRI, Erafp: “Sovereign bonds: evaluating the climate policies of issuing States”

“Because we cannot manage what we do not measure, ERAFP started calculating the carbon footprint of its equity portfolios as of 2013.

In 2015, it broadened its scope to sovereign and private bonds, thereby covering 87% of global assets. ERAFP’s best in class approach often enables it to obtain better results in terms of carbon intensity compared to its benchmark indices. Thus, its portfolio of government bonds shows carbon intensity 2.1% below that of its index. This positive gap is mainly due to the overweighting of the portfolio in bonds issued by the French State, whose greenhouse gas emissions to GDP are among the lowest of the euro zone.

In addition to the carbon footprint, several criteria aiming to better define the degree of exposure of issuers to climate risks have been incorporated into ERAFP’s SRI process. Measuring the limitation of GHG emissions enables, for example, to assess the commitments made, the means implemented, and the concrete results obtained by States to contain and reduce these emissions. With regard to measuring the management of the physical risks relating to climate change, ERAFP assesses issuers based on prevention of impacts on water supply, contribution to biodiversity preservation, or management of pollution risks”.

INVESTOR BEST PRACTICES

Jean-Guillaume Peladan, Fund Manager and Head of Environmental Investments & Research, Sycomore AM: “Assessing the positive contribution of companies”

“An analysis limited to negative impacts (pollution, harmful substances, nuisances, social externalities, dumping, etc.) is insufficient. The object of the issuer’s activity and positive externalities provided by the goods and services it produces must also be incorporated. This aspect is known and recognised with regard to social factors, but less so with regard to the environment. In fact, an approach that is limited to pollution automatically rules out activities that have a positive environmental impact despite significant consumption of resources, such as recycling, purification, and the renovation and insulation of buildings. There are two sides to every activity, Yin and Yang, positive and negative, solution and pollution. Neither article 173-VI obligations nor ESG analysis escape from this reality in general. Thus, the contribution to the Energy and Ecological Transition follows this vision: a company that produces electricity from coal is a negative contributor to the TEE, while a supplier of local organic products or metal recycler has a positive contribution.”

WHAT THE EXPERTS SAY

The need for indicators in line with the 2°C target, by Thomas Braschi, Director for France, 2 Degrees Investing Initiative

“Many methods are currently being developed to guide and set objectives for investors’ commitment to climate issues. In the long term, they will probably be reduced in number in order to lower costs and facilitate global comparisons. These methods must be able to assess the alignment of portfolios with climate objectives and measure the associated risks with a high level of reliability.

The 2° Investing Initiative, mandated by the European Commission, and in partnership with eight institutions, is currently finalising a free open source methodology that is intended to be exhaustive while ensuring high reliability based on connecting the field data of a million industrial and energy units, something that never been done before. Its usefulness for investors is currently being tested by over 70 international financial institutions with very positive technical feedback.”
Jean-Pierre Costes, President of the Board of Directors, Ircantec: “Experimentation for a collective learning process”

“Taking into consideration that in 2016 there is no single standardised method to assess the GHG emissions of a portfolio, Ircantec, a signatory of the Montreal Pledge, decided this year to simultaneously experiment with three different methods on the same portfolio in order to form its own opinion on the contributions and limits of each method. This experiment revealed that the methods were complementary and that they enabled the climate challenge to be studied from different angles. This is precisely the spirit of article 173-VI – to undergo this collective learning process collectively.”

<table>
<thead>
<tr>
<th>Tool</th>
<th>Impact of the investment</th>
<th>Impact on the investment</th>
<th>Negative impact</th>
<th>Positive impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carbon footprint</td>
<td>✓ ✓ ✓</td>
<td>-</td>
<td>✓ ✓ ✓</td>
<td></td>
</tr>
<tr>
<td>Carbon performance</td>
<td>✓ ✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Avoided emissions</td>
<td>✓ ✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Green / Brown share</td>
<td>✓ ✓</td>
<td>✓</td>
<td>✓ ✓</td>
<td>✓</td>
</tr>
<tr>
<td>Exposure to fossil energies</td>
<td>✓ ✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>2°C alignment</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Rating of climate risk management</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td></td>
</tr>
<tr>
<td>Rating of exposure to physical risks</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td></td>
</tr>
<tr>
<td>Rating of climate-related financial risks</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td></td>
</tr>
</tbody>
</table>

ADEQUACY OF THE TOOLS WITH REGARD TO OBJECTIVES

> FOCUS ON CARBON INDICATORS

The carbon footprint of issuers: different indicators for different perspectives

Issuers have used carbon footprint indicators for 5 to 10 years now, and they have become increasingly standardised. Two main points need to be retained:

- **What “scope” to apply?** While scope 1 and 2 emissions represent reliable and reported data, scope 3 data, stemming mainly from modelling, enables better understanding of the issuer’s level of responsibility and the associated risk. Avoided emissions enable to evaluate issuers’ contribution to lowering GHG emissions.

- **Which indicators to use?** In addition to GHG emissions in absolute terms, more advanced indicators can be used such as carbon performance and carbon intensity, which enable comparisons among issuers.

From the carbon footprint of issuers to the carbon footprint of investors

There are several possible methods for aggregating the emissions of issuers to obtain the emissions of an investor’s portfolio. As in the case of companies, it is interesting to shift from emissions in absolute value terms (the carbon footprint of the investor) to emissions in relative value terms to qualify the portfolio’s carbon performance. Like for companies once again, these different indicators are complementary and provide different perspectives on a same reality.
CARBON INDICATORS: THE DIFFERENT ‘SCOPES’

SCOPE 1 and 2
- GHG emissions linked to the issuer’s energy consumption
- Mainly reported data
- Low share of GHG emissions with the exception of specific sectors (ex. utilities)

SCOPE 3
- GHG emissions from the issuer’s activity
- Mainly modelled data
- Main share of GHG emissions for most sectors

AVOIDED EMISSIONS
- GHG emissions avoided by an issuer thanks to their carbon performance
- Modelled data
- Relative to a benchmark scenario

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Unit</th>
<th>Definition</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>GHG emissions in absolute value</td>
<td>tCO2</td>
<td>Total GHG emissions of the issuer’s activity</td>
<td>Universal indicator, Non-performance indicator</td>
</tr>
<tr>
<td>Carbon efficiency</td>
<td>gCO2/m2</td>
<td>The issuer’s GHG emissions divided by a relevant physical indicator (sq. m, km, KWh, occupant, etc.)</td>
<td>The most relevant indicator for assessing carbon efficiency, Limited to certain specific activities</td>
</tr>
<tr>
<td>Carbon intensity</td>
<td>€ CO2/€m</td>
<td>The issuer’s GHG emissions divided by a relevant financial indicator (sales, GDP, value, etc.)</td>
<td>Relevant indicator for evaluating the carbon intensity of the economic activity, Universal indicator</td>
</tr>
</tbody>
</table>

INVESTOR BEST PRACTICES

H. Guez, Director of Responsible Investment Research, Mirova: “Carbon footprints: the good the bad and the ugly!”

Assessing the impact of a company’s activity on the climate has become vital in making the right investment decisions. However, like other things, when dealing with climate issues, inaccuracies can range from the ‘pretty much acceptable’ to being guilty of negligence, possibly leading to counter-productive decisions. Therefore, in order to properly measure all risks and capture investment opportunities at the same time, it is essential for companies facing a significant climate challenge to measure all emissions generated and all avoided emissions, both in the production cycle and by the use of products and services sold. It is also useful to have an assessment method that incorporates the factors relating to the company’s climate strategy (target figures, R&D, etc.).

France has the top experts on the subject - we should be proud and take advantage of this to truly decarbonise our investments!
INVESTOR BEST PRACTICES

Luisa Florez, Head of ESG Fundamental Research, AXA IM: “The carbon footprint: necessary information, but not always sufficient for stock picking”

“Measuring GHG emissions is an efficient indicator for managing the impacts generated by companies and for making sector comparisons. It also enables to identify and improve the company’s level of transparency with regard to this issue. However, CO2 emissions clearly cannot be the only tool used for stock picking in a portfolio, as this can notably create unwanted sector biases.”
B. AFTER THE ASSESSMENT, ACTION!

DEFINE THE RELEVANT TARGETS OF YOUR ESG-CLIMATE STRATEGY

Rendering the assessment of a portfolio transparent is a simple and honest way to comply with article 173-VI. It does not satisfy the spirit of the law, however, which clearly pushes for action by at least indicating the practical consequences of this assessment on the investment strategy and the composition of the fund.

Three steps in determining the desired scope of an ESG-Climate policy:

- The first step consists of identifying the ESG-Climate factors that most clearly echo the management strategy.
- For those with management constraints, a second step consists of determining the room for manoeuvre in terms of standards such as the risk/reward trade-off (for example, the obligation to minimise the gap to the benchmark would make a thematic approach more complicated).
- The last step, often taken alongside the first two, is to select the assets and levers for action (engagement for example) that are most likely to optimise responsible performance with regard to the factors and criteria retained.

ESG-Climate objectives and levers for action

Overall there are two types of objectives in an ESG approach: to reduce the ESG-Climate risk of the portfolio and reduce the ESG-Climate impact of the portfolio.

The entire range of ESG levers can be activated to achieve these objectives: exclusion (or divesting), best in class, a thematic approach or impact investing. An exclusion policy can reduce both the impact of the portfolio and the financial risk associated with the materiality of the criteria for which the issuer was excluded.

EXAMPLES OF LEVERS FOR ACTION AGAINST THE CLIMATE RISK

Here are a few illustrations of levers (the list is non-exhaustive) that can be activated according to the objectives set.

Reduce the climate risk of the portfolio

- Carry out a forward-looking analysis of the change in “own” consumption and the risk of devaluation of assets that have become obsolete, called “stranded assets”
- Adapt the portfolio by reducing the position on sectors and issuers that carry a high transition or physical risk
- Favour a best in class approach by sector for issuers that best manage the climate risk
- Factor the climate-related financial risk into the valuation

Reduce the climate impact of portfolios, by lowering the carbon footprint of the fund

- Divest from carbon-intensive assets (“brown share”)
- Carry out a gradual decarbonisation of portfolios
- Implement a portfolio carbon optimisation strategy
- Incorporate avoided emissions
- Achieve a yearly reduction target aligned with the 2°C pathway
Increase the portfolio’s contribution to the Energy and Ecological Transition for Climate (TEEC), by increasing exposure to ‘green’ solutions, as defined in the taxonomy of the TEEC label.

- Exposure to green solutions among blue chips
- Stock picking for “green chips” (pure green players)
- Exposure to green bonds

**REDUCING THE CARBON IMPACT OF INVESTMENTS: TWO COMPLEMENTARY METHODS**

**Low carbon Portfolio**
- Exclusion of issuers with high carbon intensity
- Focus on low carbon solutions (induced or avoided emissions)

**Carbon transition Portfolio**
- More difficult financing for issuers with high carbon intensity

**Investor Best Practices**

Hervé Guez, Director of Responsible Investment Research, Mirova: “Financial innovation at the service of new environmental challenges: green bonds.”

“Financing the necessary environmental transition obviously requires new analysis tools (ESG analysis, carbon footprint, etc.), but it will also involve developing new financial tools. By linking savings and the financing of environmentally friendly investments, green bonds emerge as a powerful tool for mobilising capital and energy in favour of a more sustainable economic model. By participating in the development of this market - in which French players are among the global leaders - investors can efficiently play their role by putting pressure on the companies in which they are creditors, and ultimately will be able to steer the share of their allocation of bond assets dedicated to financing the ecological transition.”
Divestment initiatives

The international movement toward divestment encourages investors to divest their assets in oil, carbon and gas companies. Led by organisations such as 350.org or the association Divest-Invest, the movement announced in 2015 that total assets managed by investors committed to divestment reached 2,300 billion euros. This represents more than 430 institutions, among which government pension funds (Norway), universities (Oxford), and private investors. In France, AXA announced in 2015 at the Climate Finance Day that it had divested 500 million euros in assets, based notably on sales from electricity generated from coal or coal mining of over 50%. Several other players have followed this movement.

The TEEC label

The French Minister of the Environment, Energy and Marine Affairs created the Energy and Ecological Transition for Climate (TEEC) label at end 2015. It addresses broad categories of funds: funds invested in the equities or bonds of listed and non-listed companies, funds made up of green bonds or infrastructure funds.

It has three main objectives:
- Highlight investment funds that finance the green economy;
- Encourage the creation of new green funds;
- Favour company reporting on the green share of their activities.

The specifications of the label provide for the exclusion of companies directly linked to the nuclear and fossil fuel sectors, as well as those that severely violate the main international standards for human rights and protection of the environment.

INVESTOR BEST PRACTICES

Frédéric Samama, Co-founder of the Portfolio Decarbonization Coalition (PDC) – Amundi:
“The spirit that guided Article 173-VI is very close to the vision promoted by the PDC”

“Article 173-VI is fully in line with one of the main missions of the Portfolio Decarbonization Coalition, which is to mobilise investors toward better integration of climate factors in their risk management and investment policy in general.

The same spirit that guided the article and its implementing decree is in fact very close to the vision promoted by the PDC, i.e. that we are at the beginning of a long road, and while it is essential to establish a framework that encourages the adoption of good practices, it would be counterproductive to impose a single model.

More concretely, the PDC dialogues with many regulators worldwide - notably in Europe and emerging countries - that are interested in the different solutions at their disposal for mobilising investors. Solutions like article 173-VI are very efficient for rallying the entire ecosystem.”
LEVERS FOR PUTTING PRESSURE ON COMPANIES WITH A HIGH ENVIRONMENTAL RISK: SHAREHOLDER ENGAGEMENT

No matter which levers for action have been implemented, shareholder engagement and voting policy are key ways to put pressure on issuers to change. Investors thus can:

- Join existing engagement initiatives: IIGCC, PRI, CDP, Share Action, CorDial
- Disclose the climate-related commitments of their voting policy
- Meet with issuers and guide them on their climate pathway
- Exercise their voting rights in alignment with targets set

Example of an institutional investor’s engagement policy report and communication initiative

ERAFP has formalised its shareholder engagement strategy since 2012. Its 2015 annual report notably includes:

- An overview of its voting policy for the general meetings of the companies in which ERAFP is a shareholder as well as of the themes covered in its dialogue with shareholders;
- The investor coalitions ERAFP joined during the year, of which the Portfolio Decarbonization Coalition. This coalition places shareholder dialogue within a collective approach, leading to greater impact;
- The recognition obtained for its shareholder engagement strategy;
- 2015 contribution to the long-term support provided to the organisms ERAFP invests in.


Collaborative Platform (UNPRI)

The UNPRI Collaborative Platform (formerly the Clearinghouse) allows PRI signatories to join forces and pool resources to carry out initiatives in favour of ESG issues. Initiatives may include:

- Invitations to sign joint letters to companies;
- Joining investor-company dialogues underway;
- Calls to foster dialogue with policymakers.

To ask a question, post a comment or share good practices, visit the French SIF’s interactive space dedicated to article 173-VI

For further reading

- ESG methods for action
- Shareholder engagement platforms
- Divestment initiatives
C. REPORTING: AN OPPORTUNITY TO CREATE VALUE

> AN OPPORTUNITY TO COMMUNICATE TO SAVERS

Protect and give meaning to savings

Article 173-VI provides a simple and intelligible framework for communicating to savers or beneficiaries: the ESG-Climate approach both protects savings (impact on the investment) and gives it meaning (impact of the investment). This balanced approach mirrors the responsible communication policies of companies, which are more and more clearly combining the economic benefit and environmental performance of products.

Climate: indicators for communication

Citizens are now aware of the climate challenge, which has the double advantage of being part of the international agenda and can be communicated via indicators using consolidatable figures expressed in metric tonnes of CO2-eq.

> ORGANISING THE REPORTING

Institutional investors must face the task of organising their reporting and consolidating indicators. They must deal with the absence of standards for ESG and climate indicators and the flexibility offered by the regulator. The exercise thus consists of finding a balance and a coherent line between the need for a clearly defined and harmonised reporting framework, which will be transmitted to its asset management companies, and the possibility for the latter to propose, within general reporting principles, a series of indicators that are more relevant, even innovative, and better aligned with the specific characteristics of each mandate.

INVESTOR BEST PRACTICES

Jean-Pierre Costes, President of the Board of Directors, Ircantec: “Organising reporting in a coherent manner”

“At Ircantec, faced with the difficulty of harmonising ESG-Climate reporting methods and defining impact measures, we deemed it necessary to follow a pragmatic approach. As in the case of the carbon footprint, these measures - although we are convinced of their usefulness - are not yet mature. This is why we approach this subject from two sides. On the one hand, in the aim of ensuring reporting that can be easily deciphered, and as from the first financial year, we entrusted the task of calculating the impact measures to our service providers (agencies specialised in social ratings and carbon footprint measurement) for all of our assets, in order to be able to communicate in a consolidated manner. On the other hand, in keeping with a momentum of progress, we are working alongside these same agencies and our asset managers to study the diversity of approaches proposed by the latter. We will thereby form our own opinion with regard to the core indicators that we wish to see adopted by all our partners and that can be aggregated, as well as the indicators that will remain specific to certain approaches and mandates.

Moreover, the diversity of contribution from our experts has enabled us to build and support Ircantec’s position with regard to coal divestment that will soon be disclosed to the public.”
> SOME REPORTING PRINCIPLES TO FOLLOW

Simplicity is key
As far as ESG-Climate impact reporting is still under experimentation, it is preferable to limit the number of indicators and keep in mind that these indicators could evolve in the future.

The trend is profile rather than snapshot
ESG (and particularly climate) reporting is part of a pathway to reducing impact; beyond the “snapshot” provided, it is thus necessary as of the first reporting effort to reflect on the future evolution of these indicators and the monitoring that could be done over the long term. Some indicators can evolve very rapidly and independently of ESG-Climate factors (notably due to financial weightings), while others are, conversely, very stable and may not account for the progress made by issuers. Note also commitments to align with the pathway to 2°C will only be reflected in impact indicators over the medium term: you thus must look at yearly changes from the perspective of expected theoretical pathways on a regular basis.

Tell a story rather than just communicating figures
As pointed out in the roadmap, it is crucial to be able to explain the evolution of indicators, but also the main investment/divestment decisions. This implies going to and fro between the motivations behind these decisions (ESG-Climate policy) and the impact (not necessarily always visible) of these decisions on the impact indicators used.

TESTIMONY FOR THE FRENCH SIF

Pascal Canfin, CEO of WWF France: “We will also assess the engagement of investors and companies with regard to the clarity of their reporting for savers”

“Investors require relevant, precise and readable information about how companies contribute to financing the transition, reduce their climate risks, and gradually set upon the investment pathway provided for in the Paris Agreement and which limits global warming to well under 2°C. The mistake of CSR reporting must be avoided at all costs, i.e. having a hundred boxes ticked by specialists and a lack of visibility. This is why we also assess the engagement of investors and companies on the clarity of their reporting for savers”.

To ask a question, post a comment or share good practices, visit the French SIF’s interactive space dedicated to article 173-VI

For further reading
- Reporting challenges, reports and studies
The aim of France's 2015 Law on Energy Transition for Green Growth (Transition Énergétique pour la Croissance Verte – LTECV) is to enable the country to contribute more efficiently to the fight against climate change and strengthen its energy independence. The law must create positive environmental momentum that lifts barriers, frees up initiatives and brings immediate tangible benefits to all.

The Montreal Carbon Pledge is an initiative supported by Principles for Responsible Investment (PRI) and the United Nations Environment Programme Finance Initiative (UNEP-FI). Investors who are signatories of the pledge commit to measuring and disclosing the yearly carbon footprint of their investments.

The Portfolio Decarbonization Coalition (PDC) is an initiative that aims to reduce GHG emissions by mobilising investors committed to gradually decarbonising their portfolios.

Socially responsible investing (SRI) is an investment method that aims to combine economic performance and positive social and environmental impact by financing companies and public bodies that contribute to sustainable development across all sectors of activity. By influencing governance and behaviour, SRI favours a responsible economy.

Green Bonds raise capital for financing activities with environmental benefits. The guidelines for the issuance of Green Bonds are provided by the Green Bond Principles.
FOR FURTHER READING

On the International Context

- The International Energy Agency's 2015 World Energy Outlook, which assesses the investment needs of the energy transition
  https://www.iea.org/Textbase/npsum/WEO2015SUM.pdf
- The Investors on Climate Change platform, which groups together investors' climate initiatives.
  http://investorsonclimatechange.org/initiatives/
- Report by I4CE presenting the various initiatives and tools available to help guide investors toward a "climate-friendly" approach: I4CE et al. (2015) Shifting Private Finance towards Climate-Friendly Investments:
- Phase I Report of the TCFD:

On the French context (French only)

- Legislative text relating to the government SRI label:
  https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000031800644&categorieLien=cid
- Legislative text of article 173-VI:
  https://www.legifrance.gouv.fr/affichTexteArticle.do;jsessionid=96FE72033C0BC7A3D195F5A493F285DF5?cidTexte=JORFTEXT000031045547&idTexte=JORFTEXT000031044368&dateTexte=29990101&categorieLien=id
- Help guide for implementing article 173 written by a working group at AF2i.
  http://www.af2i.org/investisseurs-institutionnels/af2i-publication-guide-article-141.html
- Guide of the French Asset Management Association (Association Française de la Gestion financière - AGF) relating to article 173.

On the risks addressed by article 173-VI

- Issue 11 of Allianz Global Investors’ quarterly review mapping climate risk by asset class: (2015) ESG matters: Climate Special Issue
- Detailed analysis of the different types of climate and ESG risks for investors (French only): Association d’Economie Financière (2015) Changement climatique et finance durable, Revue d’Economie Financière, n°117
  https://books.google.fr/books?id=v0lGcCwAAQBAJ&pg=PT137&dq=climat%20ESG&source=bl&ots=BlhG0o0HwC&sig=yqK76gh26cYyQvQK-v0d9Godd3w+6k9a+Xk&ved=0ahUKEwi3-rHCooTOAhWC5xoKHbGQdOQo&usg=AOvVaw1eEpYbg2cJjKbNoKSn6A--
- Statistics on the cost of physical risks for insurers and reinsurers, Munich Re

On climate tool guides

  http://www.bafu.admin.ch/klima/13877/16632/index.html?lang=de&download=Nb9b9pZeq7t1np9fNTU4d0l2dn1n1acy4Zt42az0zn02YvocZ6GzJeweRf4Gyvm161w2np3yo2p. Jk4nK30nEAI--
- List of resources on the Montreal Pledge website: tools, service providers, carbon indicators, etc.
  http://montrealpledge.org/resources/

On initiatives for action

- Article presenting the diverse actions investors have committed to in order to incorporate climate change into their portfolio management: Silvent, F. Charrier, H. (2015) Climate change in asset management? Paris Tech Review
- Website of the Divest-Invest campaign
  http://divestinvest.org/

On reporting methods

- Report by PwC and the Association Française des Investisseurs pour la Croissance (French only): Premières approches pour le reporting et la due diligence ESG : une Production du Groupe de Travail n°2 de la Commission ESG (2014)
- Website of the NGO Asset Owners Disclosure Project. Improving investors’ reporting.
  http://aodproject.net/
ACKNOWLEDGMENTS

When article 173-VI of France’s Law on Energy Transition for Green Growth (LTECV) came into being, and its implementing decree was published a few months later, we were extremely pleased to see such an ambitious text emerge in France, accompanied by an open and incentivizing implementation method.

Now, those concerned by the law would like to have a better understanding of the stakes at hand, as well as help in implementing it. This Handbook is an initial response to this need. In addition, our European colleagues and partners quickly understood the impact of such a text, and expressed interest in gaining a better grasp of it. This was another reason for launching the initiative to compile the Handbook, which has been published in both French and English.

We would like to thank all of those who participated in the working group meetings and who contributed both via their expertise and their questions, as well as the members of the review panel - Hervé Guez, Éric Loiselet and Pascale Sagnier, the French SIF Administrators – for their participation in the exchanges with I Care & Consult and Stéphane Voisin in order to make the Handbook both a constructive and educational tool.

Lastly, we would like to thank our sponsors, the SIF members without whom the publication of this first edition of the Handbook would not have been possible in its current form and in both languages.

The French SIF (FIR) is a French multi-stakeholder association that was founded in 2001 in the aim to promote Socially responsible investing (SRI) and its good practices. The Forum groups together all the different players in the SRI value chain: investors, asset management companies, brokers, non-financial rating agencies, investment consultants, market organisations and labour unions, as well as qualified experts.

Each year in the fall, the French SIF organises “la Semaine de la Finance Responsable”, a week of events focused on responsible finance. In 2010, it launched CorDial, a discussion platform with listed companies on sustainable development. In addition, each year since 2005, and in partnership since 2010 with the United Nations-supported Principles for Responsible Investment (UNPRI), it has awarded prizes and grants for the best European academic research in “Sustainable Development Financing”.

Along with the AFG (Association Française de Gestion financière) and Eurosif, the French SIF is a supporter of the Transparency Code for publicly distributed SRI funds in France.

The Forum is a member of the national CSR platform in France and a founding member of Eurosif.
This Handbook was published with the support of I Care & Consult