Green is the new black

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In the world of finance, green is the new black. Yes, you heard me right. Green finance is the colour of choice for the fashionable crowd.

As Treasurers, you will need to open new columns in your ledger. You will need to add new inks to your traditional black and red. It will no longer suffice:

- To be in the black
- To write black numbers
- To avoid bleeding red ink.

Thinking about just income and expenses is no longer enough. You also need to reflect on your impact: positive or negative, to reflect on green and brown.

How will your firm be affected by the environment and, vice versa, what is the impact of your firm on the environment?

Now you may think, this is not for me!

- Climate change is not an issue
- Climate change is not an issue for my organisation
- Climate change is not an issue for the treasury

And while I would disagree on all three counts, you do not have to believe me ☺. However, you will be confronted by this issue, whether you like it or not!

- Both the EU and the Dutch government are committed to the Paris Agreement, so you will be forced to commit yourself as well. Because they do not only talk about it, they also take action: with regulations, subsidies, pricing, standards *and* transparency or reporting requirements. And this will affect all of you.
- The Dutch financial sector (banks, pension funds, insurers and asset managers) has committed itself to the Paris Agreement as well. And the Minister of Finance monitors this commitment closely.
  The focus of the financial sector goes beyond its own emissions. It specifically includes the services they provide to their clients, to you! Are you aligned with the Paris goals? Are you best in class? If not, If not, it's time to start considering your impact.
- Your customers may raise difficult questions with regards to your impact. And this may affect your bottom line.
- Your employees may question practices that were deemed normal until recently. And labour is scarce.

- Shareholders, especially institutional investors, are devoting more attention to impact. I know that people say that in analyst meetings impact is a B-list item, but Dutch pension funds are taking clear positions in shareholder meetings. Some have even taken steps to dispose of 'brown' holdings.
- NGOs may urge you to take bigger steps. And they do not favor backroom talk, they aim for the front page. This may affect your reputation for a broader audience.
- And finally, your supervisors – the AFM, your accountant – will check up on you. Are you going to live up to the new reporting standards that will become effective from 2024 onwards?

So, green is the new black. But going green does not mean that sound finance is no longer necessary. It means that black is not the only test that you need to apply or that people will apply to you. It implies a broader, more robust approach to the concept of sound finance: sustainable finance.

Now for those of you who think: what am I listening to here? Has this workshop been hijacked by a green activist? A proponent of XR? Let me assure you, no. This is a talk by a supervisor who is committed to ensuring compliance. We all know that knowledge, willingness, and ability are key for any organisation to comply, and this talk is meant to help improve your chances of compliance.

In the remainder of my talk, I will discuss three items:

- what do I mean by impact?
- how does this affect your reporting (something your financers will be interested in) and
- how does this affect your own investment / cash management strategies?

1. <u>Impact</u>

We cannot discuss impact without talking about ESG, Sustainable Development goals and such. This talk focuses on climate because regulation and thinking has progressed furthest in this area. Think of it as a shorthand for things to come.

Let me give some examples in the area of climate, to tickle the imagination:

1. *Physical risks:*

- How vulnerable is your commercial real estate to subsidence (something you can no longer insure against in the Netherlands)?
- How vulnerable is your firm to the risk of flooding? We live below sea level, and we actually saw floods in Limburg in 2021
- How vulnerable is your firm to drought? Think about the low water levels in the rivers last year, or crop failures

2. *Transition risks*

- To what extent does the success of your business depend on cheap gas? Cheap energy is a comparative advantage that the Netherlands stands to lose.
- What kinds of new policies can you anticipate in view of the energy and climate transition, particularly with regards to housing, transport, agriculture and industry?
- Are climate concerns likely to cause changes in market sentiment or technology development?

Double materiality

Some may say: this is nothing new. Thinking about long-term value creation is key to any organisation that wants to stay relevant. You already think about future trends that will affect your present business model. And in scanning the future, you are continuously monitoring developments that may affect your bottom line.

<u>True</u>! But you have to look beyond traditional cash flow predictions. You need to expand your horizons to include climate and other ESG considerations. Your corporate policy should take these risks into account, and your company should report accurately on them. Not just regarding the future, it may also mean revaluation of past investments and resources. Climate risk is something your bank or insurer will consider, when you apply for a loan or insurance. Not because they are green by inclination, but just out of simple business sense.

However, looking at the impact of the climate transition on your firm is not enough. In the world of financial reporting, we also want to know how your firm may affect climate change in return. This is what we call double materiality. How green or brown is your footprint? And we do not stop at your immediate impact, we also want to know more about the impact of your energy suppliers and your clients. For instance, financial service providers tend to have a limited footprint as an organisation (personal, transport, buildings), but they also have an effect through the energy they use and the industries they finance. In fact, their strongest impact is through their clients. Are they involved in brown industries (fossil fuels, chemicals) or in green sectors?

<u>New reporting standards</u>

You may think 'This is all well and good, but it doesn't apply to me'. But again, I have to disappoint you. You will face these issues, either directly, because your firm is covered by upcoming EU regulation, or indirectly because your partners – financial or otherwise – will require that information.

As part of the FitFor55 drive, the EU has come up with a whole new set of reporting legislation, a true letter soup.

- The SFDR (Sustainable Finance Disclosure Regulation) entered into force in 2021, requiring financial service providers to present information on the purpose of their investment products.
- The CSRD (Corporate Sustainable Reporting Directive) will enter into force from the 2024 financial year onwards, requiring firms to provide information on both their impact on the environment (plus social and governance matters) and vice versa. It is a big operation. Therefore, the EU has taken a step by step approach. As of the 2024 financial year, all listed firms with 500+ employees will need to comply, followed by all large firms in 2025 and all listed SMEs in 2026.
- The Taxonomy (defining what is sustainable and what not).
- The CSDDD (Corporate Sustainability Due Diligence Directive) is on the horizon which will likely require active measures by large companies to identify, prevent and mitigate negative environmental and social impacts in their value chains (and that they report on those impacts and measures faithfully).

For listed companies, reporting on sustainability is not a completely new phenomenon. Already – under the NFRD – you are required to report on so called non-financial information. And, while assurance on this information is not yet required as it will be under the CSRD, auditors can already engaged by these companies on a voluntary basis to provide limited assurance on these reports. Alas, this is no reason to be optimistic.

The AFM recently looked at the 2021 financial reports of 27 listed companies. Our conclusion is that progress is mixed at best.

- Yes, some companies made serious efforts, but many seem to have only just started – if at all. Even the frontrunners need to take major steps to live up to the CSRD standards.
- Information on risks to the company may be present, but information on the effect of corporations on the environment – the double materiality – is patchy or absent.
- IT systems and processes to produce reliable sustainability data need to be beefed up.
- Information on scope-3 emissions (the emissions of suppliers and clients) is limited.
- Audit reports are prone to misinterpretation often caused by scoping and misunderstood qualifiers in the assurance statement. These factors can result in people giving too much weight to the audit report's findings or drawing incorrect conclusions.

Now the good news is, there is still time. And yes, there are good practices. And yes, more sustainability data will become available with time. And yes, as a supervisor we understand that you will not be able to score 10 out of 10 the first time around. But nevertheless, you will need to step up your game. You need to get your systems in place from the *start* of your financial year, not the end.

And even if you are not covered by CSRD, you will face the implications. Your bank may demand this type of information, your partners in the value chain may need this information. Will we meet? It depends on the type of your company. But even if your sustainability reporting does not fall under the AFM's supervision, your auditor's assurance will be within the scope of our mandate.

Impact on your investment of deposits

Let me turn to the last item of my talk: the treasurer as a depositor of funds. As a treasurer you may have excess liquidity or even funds to invest. In this regard, you have a choice to make: Is ESG or climate a topic of consideration for you? What is your color of choice? Green, dark green or brown?

- Do you want to invest your money in funds that promote environmental or social characteristics?
- Do you want to invest your money in funds that aim to have a positive impact on climate or social characteristics?
- Or are you indifferent?
- Do you specifically exclude investments in certain activities?
- Do you invest in the transition, want to help firms to make the change?
- Or do you prefer engagement? Getting firms to see the light?

Thanks to the SFDR, asset managers, banks and other financial market participants need to provide information on the sustainability characteristics or objectives of their investment products. And as AFM, we monitor whether they provide the information you need. In other words, if you wish to invest sustainably, there is more and more information available to guide your choices.

Conclusion

Green is the new black. And if something is in fashion, it is difficult to avoid. Green is all around you.

Now the energy and climate transition is not easy. This holds true for society, this holds true for your firm and this holds true for treasurers and financial reporting.

Adapting to climate change is a sine qua non in a low-lying delta like the Netherlands. Doing our bit to mitigate climate change is no more than living up to the worldwide commitment to the Paris Agreement.

Policies that give direct incentives are an efficient way to produce results. But transparency has a role to play as well: To Measure is to Know. So what is your color of choice?

Green is the new black. In the golden age, the rich and famous were dressed in black. We all recall Rembrandt's paintings of Marten and Oopje. Black with a white collar. This was not a sign of modesty, but of opulence. Getting at true black was complex and expensive. Your everyman was dressed in gray. Nowadays, black is a standard item in any wardrobe. From chic and fashionable parties to leisure and counterculture Gothic events, black is always appropriate. And hopefully, green finance will see a comparable rise in popularity. But it will need to be quick. Going by the IPCC, we do not have 400 years to spare.