EU Sustainable Finance Regulation White Paper

Shifting Gears: Preparing for the new sustainable finance regulations in Europe

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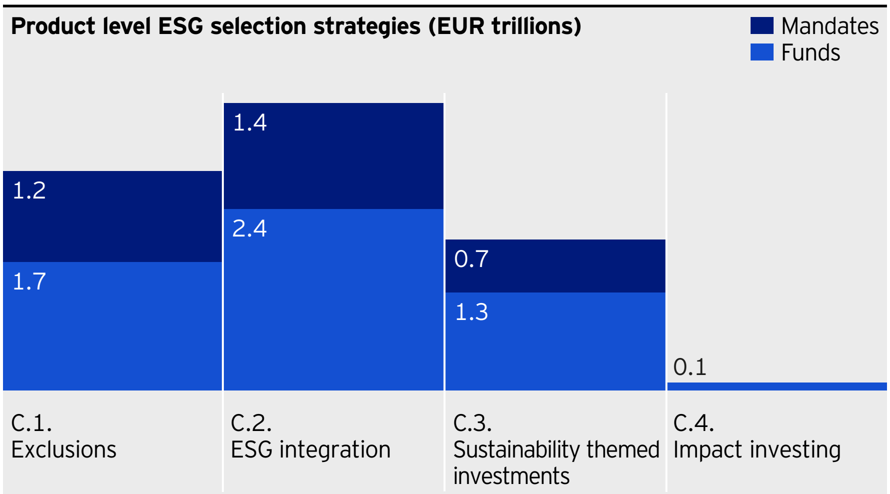
Introduction

Sustainable finance and sustainable investing continue to grow apace around the globe, with Europe in the vanguard of these developments. According to data collected by the European Fund and Asset Management Association (EFAMA), 45% of the total AuM managed in Europe totally 10.7 trillion EUR is managed responsibly (meaning that the firm applies responsible investing principles such as environmental, social and governance (ESG) integration, engagement or exclusions)[1]. Dedicated sustainable products are also growing rapidly, with 2 trillion EU AuM invested in sustainability-focused funds and mandates[2]. While the terminology used to define this trend lacks consistency at times, the direction of travel for the industry is clear.

Product level ESG selection strategies (EUR trillions)



Source: EFAMA Market Insights, November 2020

This growth in sustainable investing has taken place against a backdrop of increasing policy development in the area of climate change and sustainability, such as the EU's Green Deal and the global move towards Net Zero, as well as heightened public attention to environmental and social issues post-COVID. We expect these drivers will lead to an exponential increase in demand for sustainable and responsible investing solutions over the next 5 years. As sustainable finance becomes widespread, we also anticipate that approaches to sustainable and responsible investing will mature and deepen in their sophistication, in part driven by the new regulatory focus being placed by European regulators on sustainable finance.

In this White Paper, we will review the regulatory changes that are due to be implemented over the coming years and provide a framework to help firms prepare for the shift towards sustainability to address the challenges from regulatory change as well as the opportunities that this shift presents for firms.

1 EFAMA Market Insights 3: Sustainable Investment in the European Asset Management Industry: Defining and Sizing ESG Strategies, November 2020.
2 Idem.

SFDR = Sustainable Finance Disclosure Regulation
UCITS = The directive on undertakings for collective investment in transferable securities
MiFID = The Markets in Financial Instruments Directive
AIFMD = The Alternative Investment Fund Managers Directive
Solvency = Directive in European Union law that codifies and harmonises the EU insurance regulation
IORP 2 = Institutions for Occupational Retirement Provision

Mainstreaming sustainability in EU financial regulation

The Sustainable Finance Disclosures Regulation, which goes live on 10 March 2021, is by far the most immediate priority when it comes to the new EU sustainable finance regulations but it is just the tip of the iceberg when it comes to the EU's ambitions in this space.

Read more: see our short read on how to get ready for SFDR here.

The European Commission's Sustainable Financial Action Plan, launched in 2018, sets out 10 areas of action grouped under three themes that will lead to regulatory change across the financial services industry value chain:

- re-orient investments towards more sustainable technologies and businesses
- finance growth in a sustainable manner over the long-term
- contribute to the creation of a low-carbon, climate resilient and circular economy.

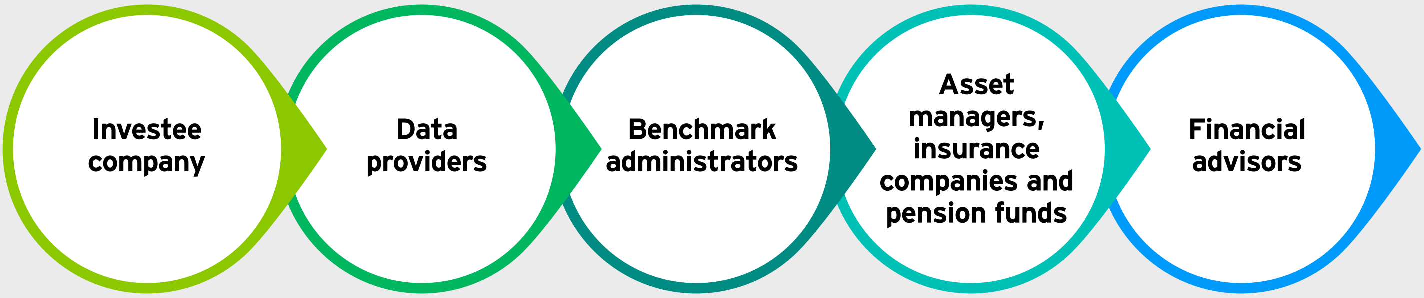
In our view, it is only by looking across the broad agenda and seeing how the different pieces of the jigsaw fit together that firms can take a strategic approach to the shift towards sustainability.

EU Sustainable Finance Action Plan

To help navigate the increasingly complex regulatory landscape, moving beyond the alphabet soup of regulatory initiatives towards a thematic view across the following four pillars can help firms to take a consistent view across the board and understand the interconnectivity between the disclosures required under the Sustainable Finance Disclosures Regulation and upcoming regulatory changes that will embed sustainability in the way firms operate:

- Integration sustainability risks across financial firms and products
- Consideration of principal adverse impacts
- ESG product design and distribution
- Green finance

Overview of EU regulatory changes across the investment value chain



Investee company

- Enhanced sustainability reporting under Non-Financial Reporting Directive and Taxonomy
- Embedding sustainability in corporate governance
- Optional EU Green Bond Standard for green issuance

Data providers

- Increasing focus on data quality and conflicts of interest, which could lead to regulation of ESG data providers and ESG rating providers

Benchmark administrators

- ESG Benchmarks Disclosures will enhance transparency of ESG benchmarks to investors.
- Voluntary new EU Climate Transition and Paris-Aligned Benchmarks

Asset managers, insurance companies and pension funds

- SFDR and Taxonomy will enhance transparency on ESG issues at firm and product-level
- Changes to sectoral legislation will embed sustainability in organisational requirements, investment due diligence and risk management
- Changes to MiFID 2 product governance will impact ESG product landscape
- Optional EU "ecolabel" for green investment products

Financial advisors

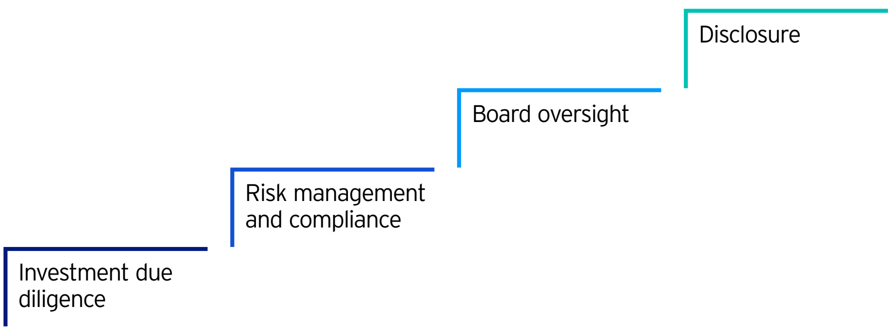
- SFDR will enhance transparency on ESG issues for advisers
- Changes to MiFID 2 will mandate the consideration of sustainability factors in advice and portfolio management, as well as introduce a requirement for advisers to assess a client's sustainability preferences as part of suitability and product governance

Integration of sustainability risks across financial firms and products

The Sustainable Finance Disclosures Regulation will mandate all asset managers, insurance companies, pensions funds and financial advisers to disclose how they consider sustainability risks, i.e. financially material ESG risks, in their investment decision making both at a firm-wide level but also for each of the products that it provides (where firms consider that sustainability risks are not relevant for a particular product, they will need to disclose why). As part of the product disclosure, firms will be required to provide details regarding the "likely impacts of sustainability risks on the returns of the financial product". Firms will also be required to disclosure how their remuneration policies are consistent with the integration of sustainability risks. These disclosures will be required by 10 March 2021, on websites (for firm-level disclosures) and in product pre-contractual disclosures (for product-level disclosures).

While the Sustainable Finance Disclosures Regulation does not prescribe how such integration should take place, the European Commission is preparing amendments to fund and insurance regulation (under UCITS, MiFID, AIFMD and Solvency 2- occupational pensions already have obligations under IORP 2) that will make it explicit that firms are expected to consider sustainability risks across the firm, making ESG integration the new normal in the EU. The rules are expected to require firms to consider sustainability risks in their investment due diligence, their risk management processes and in their conflicts of interest policy, all of which needs to be overseen by the Board or senior management. Rules for the consideration of ESG risks by banks and investment firms are also under development by the European Banking Authority, with a first report expected in June 2021.

ESG integration process from the bottom up



While many firms may have processes in place for the integration of ESG risks in their investment process, the upcoming rules are likely to lead to many firms reviewing their internal processes to deepen and formalize their approaches, including greater involvement of the second and third lines of defence in the form of risk management, compliance and internal audit.

Consideration of principal adverse impact

One of the more novel elements of the Sustainable Finance Disclosures Regulation is the introduction of the concept of "principal adverse impact". While the concept is ill-defined in the regulation, it is generally interpreted at the negative impact that an investment has on climate change, the environment, social and employee matters, human rights and anti-bribery and anti-corruption. Firms will be required to disclose their due diligence policies in relation to principal adverse impact or explain why they do not do so- unless the firm has more than 500 employees, in which case they will be required to publish this information by 30 June 2021. The European Supervisory Authorities have elaborated more detailed requirements that firms will need to comply with, including a list of mandatory indicators that firms will need to disclose.

Mandatory principal adverse impact indicators

Corporate issuers

- Total GHG emissions, plus GHG emissions split by Scope 1, Scope 2 and Scope 3
- Carbon footprint
- GHG intensity of investee companies
- Share of investments in companies active in the fossil fuel sector
- Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage
- Energy consumption in GWh per million EUR of revenue of investee companies, per high impact climate sector
- Share of investments in investee companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas
- Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average
- Tonnes of hazardous waste generated by investee companies per million EUR invested, expressed as a weighted average
- Share of investments in investee companies that have been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises
- Share of investments in investee companies without policies to monitor compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises or grievance/ complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises
- Average unadjusted gender pay gap of investee companies
- Average ratio of female to male board members in investee companies
- Share of investments in investee companies involved in the manufacture or selling of controversial weapons

Sovereign issuers

- GHG intensity of investee countries
- Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law

Real estate

- Share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels
- Share of investments in energy-inefficient real estate assets

Firms that comply with the above requirements at firm-level (either voluntarily or due to their size) will also be required to disclose at product-level in their pre-contractual disclosures whether and if so, how their products consider principal adverse impact and provide information in periodic reporting by 30 December 2022. Firms that opt-out of these requirements at firm-level will need to include a disclaimer in their pre-contractual disclosures that they do not comply with these requirements.

Similar to the integration of sustainability risks, the European Commission has announced its intention to turn this disclosure obligation into a binding obligation as part of firms' investment due diligence.

Compliance with these requirements is likely to required significant data gathering and aggregation across portfolios in order to comply with the disclosure requirements and, eventually, any due diligence requirements, as well as reviewing existing engagement and proxy voting policies where firms wish to rely on such activities to demonstrate that principal adverse impacts have been taken into account.

ESG product design and distribution ESG product design and distribution

The Sustainable Finance Disclosures Regulation will mandate enhanced transparency for ESG products as well as introduce a differentiation between broad ESG products and impact products:

Products promoting environmental and social characteristics, sometimes referred to as "Article 8 products", are products where environmental and social considerations are a binding element of the investment strategy, alongside financial and other characteristics.

Products that have sustainable investments as their objective, sometimes referred to as "Article 9 products", are products that aim to have a positive and measurable impact on sustainability objectives such as climate change, water scarcity and gender equality.

The precise scope of these categories is currently subject to a certain amount of interpretation, which the European Supervisory Authorities have sought to clarify with the European Commission. Pending such clarification, it is currently left to firms to categorise their funds as either "Article 8" or "Article 9" products, which is likely to lead to a lack of consistency in the market. Where a firm considers that a product falls within one of the above categories, it will need to comply with the detailed disclosure obligations and templates set out in the Regulatory Technical Standards.

Beyond the disclosure elements of SFDR, the European Commission intends to go further and embed this new classification system into existing product governance and suitability requirements under MiFID. In doing so, it would require product manufacturers and distributors to clearly articulate whether a product was designed for clients with sustainability preferences and require advisors providing investment advice to assess their clients' sustainability preferences. However, we would highlight that earlier drafts of these requirements went beyond the SFDR classification by tightening the criteria for "Article 8" products by requiring such products to either invest a minimum share in "sustainable investments" (defined as investments in economic activities that make a contribution to an environmental or social objective) or to take into account principal adverse impact (see section above). Should these draft rules be adopted, it may lead to firms and advisers having the review their product offering to ensure that they still meet the definition to fulfil a client's sustainability preference.

Green investing

Combating "greenwashing" is a central pre-occupation of the European Commission alongside channelling investments into sustainable and green investments. The cornerstone of this drive for clear standards on what can be considered as green comes in the form of the EU Taxonomy, which will set out clear rules and thresholds sector-by-sector for an activity to be considered as making a significant contribution to one of the 6 environmental objectives under the Taxonomy. In addition, such investments will need to be screened to ensure that they do not do significant harm to any of the other environmental objectives and meet minimum social safeguards under the OECD Multinational Guidelines.

The Taxonomy as a tool to identify green opportunities

6 Environmental Objectives
Climate change mitigation
Climate change adaptation
Water and marine resources
Recycling and waste management
Pollution prevention and control
Recycling and waste management

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

The EU Taxonomy is operationalised through two distinct disclosure requirements: firstly, large listed companies that currently report under the Non-Financial Reporting Directive will be required to disclose the percentage of revenues, CapEx and/or Opex that complies with the Taxonomy criteria. Secondly, ESG products classified as Article 8 or Article 9 will also be required to disclose the share of investments that are Taxonomy-aligned as part of the SFDR disclosures.

Additional uses for the Taxonomy come in the form of a new EU Green Bond Standard, which corporate issuers looking to issue green bonds with a regulatory seal of approval may choose to apply for and where the use of proceeds would need to be aligned with the Taxonomy, and a new retail investment product label that would mandate a minimum share of investments in Taxonomy-aligned investments.

Aside from any regulatory requirements, firms may wish to explore the investment opportunities that can be derived from the Taxonomy, for example by considering how the Taxonomy could provide an additional data point in their analysis of ESG risks and opportunities or in explicitly seeking to align their investment products to the Taxonomy criteria. For those wishing to offer products with a focus on carbon reduction, the new EU Climate Transition Benchmarks and EU Paris-Aligned Benchmarks will offer a investors a clear methodology for such benchmarks to follow, including a portfolio-level carbon reduction targets and minimum exclusions.

Timeline

23 December 2020

Implementation of Climate Benchmarks and ESG Benchmark Disclosure Regulation

10 March 2021

Implementation of Sustainable Finance Disclosures Regulation (based on Level 1 Regulation; except principle adverse impact for firms with more than 500 employees which applies from 30 June 2021 (Article 4(3) &(4) and product-level principal adverse impact disclosures (Article 7) which applies from 30 December 2022)

Q1 2021

Commission to adopt final rules on integration sustainability in for funds, insurance firms and financial advisers and integration sustainability preferences into target market and product governance requirements for product manufacturers and distributors (UCITS, AIFMD, Solvency 2, IDD and MiFID 2) (expected)

Q2 2021

Adoption of Sustainable Finance Strategy and accompanying legislative proposals

June 2021

EBA report on integrating sustainability for banks and investments firms

December 2021

Implementation of Taxonomy disclosures for climate change

January 2022

Implementation of Sustainable Finance Disclosures Regulation Regulatory Technical Standards

December 2022

Implementation of Taxonomy disclosures for the remaining environmental objectives

ESG around the world

While the EU is currently a leader when it comes to developing its sustainability regulatory framework, other jurisdictions are not far behind. However, a lack of consistency between different jurisdictions is likely to make the sustainable finance landscape increasingly complex. To address this issue, we are now seeing a number of international initiatives underway to foster convergence and global consistency.

United Kingdom

Post-Brexit, the UK will not apply the EU's Sustainable Finance Disclosures Regulation, but it has onshored the Taxonomy and Climate Benchmarks Regulations. The UK has announced that it aims to match the ambition of the EU when it comes to Sustainable Finance, starting with a core focus on climate issues in the run up to the COP26 Climate Change Conference. This will include:

- mandating TCFD disclosures across the economy by 2025,
- implementing a UK Taxonomy, based on the science-based metric set out in the EU regulation; and
- Issuance of Green Gilts.

United States

With the election of President Biden, there are high hopes that the new administration will reverse many of the Trump-era rules aimed at curtailing ESG investing. It is expected that the new administration will focus on introducing new disclosures including:

- Corporate disclosure mandates for public company issuers on material ESG issues
- Asset manager disclosures mandates and enhanced due diligence for funds
- Disclosure mandates for other market participants, including credit ratings agencies, proxy advisory firms, index providers and exchanges
- Standards and Taxonomy to enhance comparability of disclosures.

Australia

Australia's Sustainable Finance Roadmap was published in November 2020 and includes 37 recommendations around four themes:

- embedding sustainability in leadership,
- embedding sustainability in practice,
- building sustainable financial markets and
- enabling resilience for all Australians.

Canada

The Final Report by the Expert Panel on Sustainable Finance published in 2019 included 15 recommendations falling under three pillars:

- Defining the Opportunity,
- Foundations for Market Scale, and
- Financial Products and Markets for Sustainable Growth

The aim of the actions is to mainstream sustainable finance in Canada and develop and scaling market structures and financial products that could offer transformative economic benefit to Canada in building a low-emissions, climate-smart future.

Hong Kong

Hong Kong has established a Cross-Agency Steering Group on Green and Sustainable Finance and in December 2020 set out its 6 strategic focus areas:

- strengthening climate-related financial risk management;
- promoting the flow of climate-related information at all levels to facilitate risk management, capital allocation and investor protection; enhancing capacity building for the financial services industry and raising public awareness;
- encouraging innovation and exploring initiatives to facilitate capital flows towards green and sustainable causes; capitalising on Mainland opportunities to develop Hong Kong into a green finance centre in the Guangdong-Hong Kong-Macao Greater Bay Area; and strengthening regional and international collaboration.

ESG around the world

Global initiatives and relevant organisations:

1. **Taskforce on Climate-related Disclosures (TCFD)**
   The Financial Stability Board established the TCFD to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks. The TCFD's recommendations have quickly become a best practice standard for climate-related disclosures and we are increasingly seeing moves by regulators to adopt the standards as a mandatory requirement.

2. **International Organisation of Securities Commissioners (IOSCO)**
   As sustainability issues become increasingly relevant to the effective functioning of capital markets, IOSCO established a Sustainable Finance Task Force which is takes with developing recommendations on: the alignment of frameworks and requirements; the identification of relevant components of disclosure; increased public accountability and assurance standards; and increased ESG integration, including exploration of risks relating to ESG ratings.

3. **International Financial Reporting Standards (IFRS)**
   As consensus regarding the need for a globally consistent approach to ESG corporate disclosures has grown, in September the IFRS Trustees launched a consultation regarding whether the IFRS should establish a Sustainable Standards Board (SSB) to develop sustainable reporting standards. In February, the Trustees announced that work on the SSB would go ahead and would provide a roadmap by September 2021.

4. **Network for Greening the Financial System (NGFS)**
   The Network is made up of central banks and supervisors from around the globe with the purpose to help strengthening the global response required to meet the goals of the Paris agreement and to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development. To this end, the Network defines and promotes best practices to be implemented within and outside of the Membership of the NGFS and conducts or commissions analytical work on green finance.

5. **International Platform on Sustainable Finance (IPSF)**
   The IPSF includes representatives from 16 countries with the ultimate objective to scale up the mobilisation of private capital towards environmentally sustainable investments by providing a multilateral forum of dialogue between policymakers that are in charge of developing sustainable finance regulatory measures to help investors identify and seize sustainable investment opportunities that truly contribute to climate and environmental objectives. The IPSF workplan includes developing work on a ''common ground Taxonomy'' led by the EU and China.

Responding to the ESG regulation challenge: four strategic areas of focus

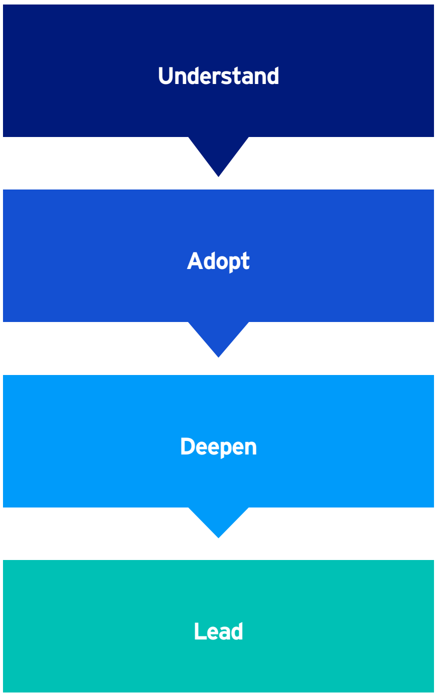
The incoming regulations will accelerate the paradigm shift towards sustainability that is already underway in the investment industry. Getting ready for these new regulatory requirements will require significant changes for firms but these are likely to be quickly supersede by new market standards, with firms seeking the position themselves as leaders going beyond these minimum requirements in order to position themselves for success.

Responding to this dynamic market and regulatory landscape will require firms to take a holistic review across the following four strategic areas of focus:

1. **Redefining leadership, purpose and culture**
2. **Reassessing the firm's strategic value proposition**
3. **Embedding ESG are a core pillar of risk management**
4. **Addressing the reporting and data challenges**

We believe ESG is a journey and would like to bring our clients on this journey with us.

Leadership, purpose and culture



Source: Invesco, building on the A4S ESG Maturity Map Example Behaviours for Pension Trustees

One of the main take-aways from the regulatory changes underway is that it will require a concerted effort across the entire organisation, from the Board room down and across every facet of the organisation, rather than being a niche discipline.

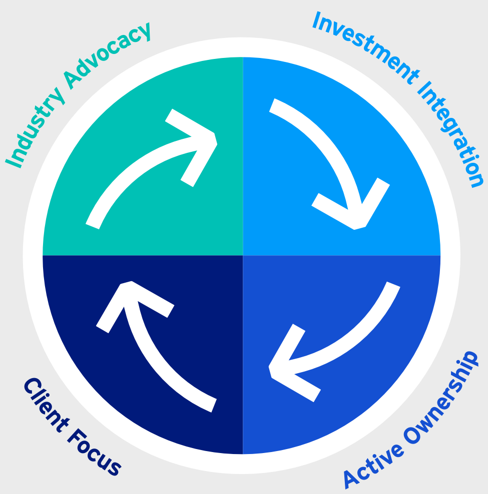
The new regulatory requirements will create a new baseline of minimum requirements, with those firms that may currently be at the early stages of "understanding" shifting to the "adoption" phase of maturity. For those firms wishing to go beyond the regulatory minimum standards, we consider that there remains ample room for firms to differentiate their offering through deepening ESG integration holistically across their firms. For those looking to go a step further, leaders will likely look to set aspirational targets and seek continual improvements in this rapidly evolving landscape, for example in relation to climate change and social equity issues.

In our view, a critical success factor will be firms' ability to embed ESG in their corporate culture to ensure seamless collaboration across the business to deliver client-centric sustainability solutions. A bottom-up approach based on firm-wide education and training to build ESG knowledge and expertise will be foundational to complement a top-down strategic vision and to enable for firms to move up the ESG maturity scale:

- **Understand:** all business functions will need to understand the buildings blocks of ESG factors and strategies and how they relate to their role and responsibilities.
- **Adopt:** firms will need to begin adopting and embedding ESG principles in their way of working, in particular to enable compliance with EU rules. This may start with high-level qualitative approaches or a focus on specific issues (e.g. climate) or asset classes.
- **Deepen:** firms wishing to move beyond the regulatory minimum will gradually need to progress towards more quantitative and forward-looking approaches that puts sustainability at the core of the process.
- **Lead:** as a leader, firms are likely to embrace sustainability as foundational to their purpose and philosophy that transcends all dimensions of the business internally, while also being a strong advocate for change externally to lead the transformation beyond their own business.

Our Commitment To ESG – A Trusted Partner In Responsible Investment

Invesco is committed to being a responsible investor through four key approaches



We aim to develop industry-leading ESG investing practices fully aligned to our purpose of helping people get more out of life

Source: Invesco ESG team as of 31 January 2021.

Working with an asset manager that has a strong ESG philosophy and can support firms' transition towards integrating sustainability through collaboration. At Invesco, our commitment to environmental, social and governance (ESG) investing is a key element of our ambition to be the most client-centric asset manager. Invesco's purpose is to deliver an investment experience that helps people get more out of life. Sustainable value creation and effective risk mitigation are fundamental to achieving that goal.

As a result, our focus is on integrating ESG into the heart of our investment process, with our investment teams taking decisions every day on how to manage this integration and how to use our leverage in important areas such as client engagement and proxy voting. We also flex this work around more specific client needs, providing the right ESG solutions through designing most appropriate ESG focus investment products in various asset classes and guiding their selections. Our dedicated global ESG Team act as a center of excellence to guide, support and inform all our work in this area.

For more details about our approach, please see our Statement of ESG Investing Beliefs

Reassessing the firm's strategic value proposition

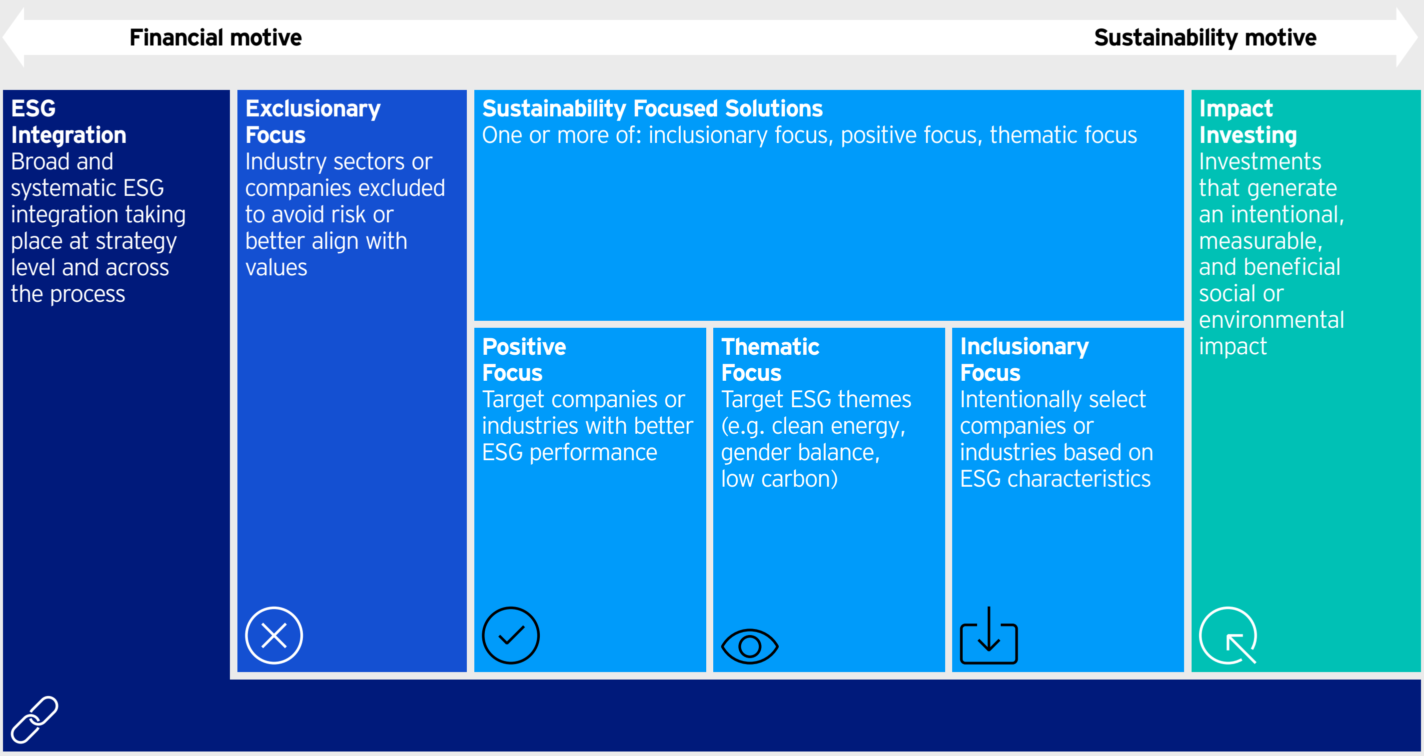
Market demand and regulatory drivers will increasingly drive investment flows into sustainable investment products in the years ahead. In the first instance, firms will want to review their product range according to the SFDR classification to assess which funds will fall under Article 8 and Article 9.

However, as clients become more discerning and in anticipation of further regulatory pressure to prevent "greenwashing", we expect that the bar for what can be considered an ESG product will rise over time. While regulators are often focused on setting quantifiable criteria that are easy to enforce, we believe that those wishing to stand out from the competition will need to deliver against the three following principles:

- **Sustainable at its core:** the sustainable philosophy as the driving force of the way the fund is managed that is seen as an inclusive and intrinsic to the way the product adds value, rather than seen as merely a constraint.
- **Transparent and measurable:** a transparent investment process that provides demonstrable and measurable sustainability improvements or outcomes as part of evaluating ESG alignment and progress.
- **Globally engaged:** engagement with investee companies as a powerful tool to drive change and sustainable outcomes.

At Invesco, we have been implementing ESG strategies for over 30 years, and today deliver through equities, fixed income, multi-asset, alternatives, real estate, ETFs and bespoke solutions. Each of our investment centers has a unique approach defined in their investment process as well as the respective asset class.

Invesco ESG Investing - Spectrum



Source: Invesco Ltd.

For more details, please see our Investment Stewardship Report

Embedding ESG into risk management

The transition to sustainability will require firms to adopt increasingly sophisticated approaches to risk management. The need to capture ESG risks is likely to galvanize firms to from qualitative to quantitative approaches that measure risk rather than exposure based on forward-looking rather than historical data.

While approaches to broad ESG risks are currently constrained by data gaps, this shift is already well underway in the area of climate risk analysis, with new tools and methodologies being developed to enable firms to measure the long-term climate risks of their portfolios as well as the temperature alignment.

At Invesco, as part of our Climate Change report in 2019, we undertook a pilot project to assess our equity and bond holdings against various climate scenarios as part of our commitment to addressing climate risks. Our scenario analysis exercise offered evidence and clear directions to address climate change risks and opportunities for our clients and their investments.

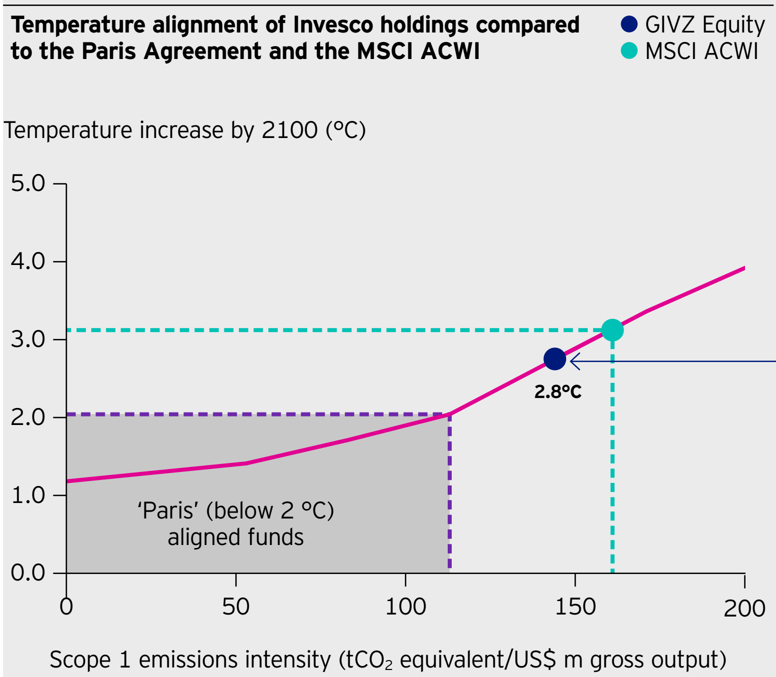
- **Identify overall risk from climate change across Invesco portfolios using a suitable scenario analysis approach**
  Based on the analysis from Vivid Economics, Invesco developed a view of the overall risk of climate change to key portfolio holdings. This forms a useful first step as it allows Invesco to put the overall risk into context and prioritise where to focus further efforts.

- **Isolate sources of risk within individual portfolios by examining individual security results**
  In order to gain insights into the sources of risk for individual portfolios, Invesco will then aim to drill down to the security level. This will include isolating the assets most exposed to physical and transition risk, as well as more granular categories, such as the risks from demand destruction. Invesco plans to conduct security level analysis of climate change risk over the coming year.

- **Action remaining sources of risk where appropriate**
  Following the analysis of security level risks over the next year, Invesco will determine the appropriate actions to take on high sources of risk within portfolio holdings. This may include engagement with issuers of relevant securities, or reduction of exposure to segments associated with high levels of climate risk.

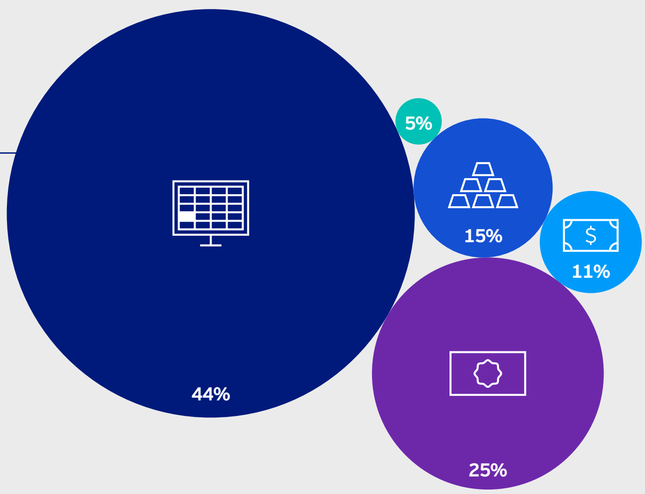
Scenario Analysis
Invesco temperature alignment of our investments

Temperature alignment of Invesco holdings compared to the Paris Agreement and the MSCI ACWI



By asset class (US$ bn)

Equity	459.4
Fixed Income	259.8
Alternatives	162.2
Money Market	117.5
Balanced	54.5



44% our Invesco AUM, represented by our Equities holdings, are positioned on a trajectory towards 2.8°C warming

Source: Invesco and Vivid Economics.

For more information on our approach to climate risk and scenario analysis, please see our Climate Change report

Addressing the reporting and data challenge

Underpinning all of these changes is the ever-increasing need for reliable and comparable ESG data across the organisation, from investment analysis to product structuring and client reporting. Incoming regulatory requirements such as the EU Taxonomy and the Sustainable Finance Disclosures Regulation will also drive ESG data demands in order to comply with these disclosure obligations, making data management and assurance an increasingly important element of ESG integration. Improvements in corporate reporting are likely to provide new insights and data sources for investors but capturing and aggregating this information remains challenging.

ESG data workflow

Data input
- Select and gather external ESG data and analysis

ESG analysis
- Perform security-level ESG analysis and rating
- Evaluate third-party funds against criteria

Portfolio construction
- Construct ESG portfolio using clear and consistent methodology
- Transparent and measurable process for ESG alignment

Reporting
- ESG and impact reporting to clients, including KPIs and process

External providers are increasingly relied upon by the industry to provide the necessary data and reporting tools for investors, but the regulation is likely to drive firms to enhance their oversight and understanding of the ESG data they consume and reconsider how they measure and report on their sustainability performance to clients. For those looking to deepen their approach to ESG integration, this may include developing proprietary view on ESG issues to support sustainability risk integration and potentially product development.

At Invesco, we recently launched Invesco ESGintel, a proprietary tool built by our Global ESG research team in collaboration with our Technology Strategy Innovation and Planning (SIP) team providing environmental, social and governance (ESG) insights, metrics, data points and direction of change. ESGintel provides users with an internal rating, a rating trend, and a rank in sector using the GICS sectors. The approach takes a sector materiality focus to select indicators to ensure a targeted focus on the issues that matter most for sustainable value creation and risk management. This provides a holistic view on how a company's value chain is impacted in different ways by various ESG topics which each individually have around 3-4 supporting data points.

Invesco ESGintel – A Proprietory ESG Research Platform

ESG Value Chain

ESG Input
- Business ethics
- Board composition
- Capital allocation
- Compensation and alignment
- Audit and shareholder rights
- Social Supply Chain Management

ESG Operations
- Energy Management
- Environmental Management System
- Circular Business Model
- Toxic Emissions
- Water Management
- Human Capital Management
- Data Privacy Security
- Health and Safety

ESG Outputs
- Low Carbon transition/ Climate Change strategy
- Product quality and safety

Source: Invesco. For illustrative purposes only.

For more information about our views on addressing the ESG data challenge, please see our ESG data White Paper

Risk warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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Data as at 08 February 2021, unless otherwise stated.

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