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Standard setter per l'analisi finanziaria

Financial analysis and ESG integration

Point #1 - Where does this document differentiate from all reports we see every week/month published at the local level (France, Germany, Nordics….) or European level on ESG integration? Where is the extra input?

The position paper "*Financial analysis and ESG integration*" addresses the main issues related to the integration of environmental, social and governance factors (ESG) into the financial analysis used to assess a corporate security: it is a compass for professionals who start to deal with this subject more deeply and in practice. The essay focuses on extra-financial principles and information underlying sustainable business strategies with long-term sources of value and measurable financial impacts.

To make the ESG data more readable, we propose the analysts to use the rationale at the base of Model 3R, born for the Circular Economy, applying the model to the broader concept of Sustainable Economy based on ESG metrics. It will return a three-dimension view of each ESG metrics in terms of risk, revenue, and reputation. Any kind of standard, framework and ESG metrics can be read under these triple aspects and regardless of the methodology, the resulted triple vision will help to understand and identify which metrics are material or which ones to consider critical in the future.

These are significant factors for the evaluation and sustainability of a company. This three-dimensional conceptual analysis allows us to better understand if the sustainable strategy for a company with its developments and benefits and the three dimensions fit perfectly with the broader concept of Sustainable Economy:

- **Risk** - may be due to company-specific factors or negative externality costs (fines and penalties/supply chain blocks),
- **Revenue** - can be generated by disruptive new business opportunities for the market (product or process innovation).
- **Reputation** - can be supported, creating shared value, through policies and practices that strengthen the competitiveness of a company (resource attraction, standard working conditions even along the supply chain), but also the economic and social conditions of the communities in which it operates.

Our position paper aims to be a simplified, clear and useful guide for financial analysis practice designed, above all, for giving shape and integration to analysis methodologies, not only from an economic point of view, now focused on financial materiality. For each KPI we analyze the multiple points of view and the many questions related to them to help understand how to identify the ESG dimensions that yesterday were considered non-material, today are held relevant and tomorrow perhaps there will be a different vision following a logic of dynamic materiality.

Point #2 - Why supporting the ESG KPI's / metrics proposed by AIAF?

Waiting for the effective standardization and recognition of best practices in the detection of E, S and G data we hold useful to pay attention to the project "Model Guidance on Reporting ESG information" done by the World Federation of Exchanges (WFE) along with the United Nations Sustainable Stock Exchanges (UN SSE) for more than 48,000 listed companies worldwide.

These guidelines deal with 30 indicators relevant for all sectors as a concise, robust and solid starting point for communicating non-financial information that have so far been overlooked for reliability and degree. Each of 30 indicators observed in our guide takes inspiration from the effective, practical and compact Nasdaq ESG Reporting Guide but adds those aspects that may be helpful for an in-depth financial analysis about risk, results and reputation (3R). While a company is interested in understanding how to communicate a piece of data and what data, investors and financial analysts will be interested in understanding the importance of the data itself, its magnitude and potential impact on the overall evaluation of the business.

Our document is intended as a due diligence on KPIs that can be changed according to the standards that will be adopted and are considered useful for understanding how companies integrate sustainability into business processes.

The purpose of this document is to be useful for European analysts who evaluate investments globally around the world.

Point #3 - A short update to show the connection between your paper and the acceleration of what's going on in Europe in 2020 and 2021 (EFRAG, NFRD, Taxonomy…)

The role of financial analysts is pivotal for the integration of environmental, social and corporate governance (ESG) issues in the corporate and investment evaluation processes.

The multitude of voluntary reporting standards and the fact that these have different targets, users and scope, as well as using different formats and metrics, can make it difficult for investors to compare such information across the different standards. Therefore, it is necessary to coordinate, rationalize and harmonize the many existent non-financial reporting initiatives, create a core set of global metrics for non-financial information and also provide an effective connection between financial and non-financial reporting, aiming to assess the aptitude of companies to create profit and secure the future of people and the planet.

Our approach wants to be as broad as possible, and therefore we have set up our position paper by referring to the indicators used by the stock exchanges UN SSE and we give ideas for a due diligence approach in accordance with the vision of financial analysts focused on Risk, Return and Reputation that have an impact on the company's assessment and its governance. Our position paper complies with the implementation in the European Union of regulatory frameworks such as the revised Non-Financial Disclosure Directive (NFRD), the Taxonomy Regulation 2020/852 and the Sustainable Financial Disclosure Regulation (SFDR) 2088/2019. Some of the indicators in the Annex 1 of the SFDR are already included and, as said above, the KPIs used can be changed according to the standard taken as reference.

The European Commission, through the mandate to EFRAG, is carrying out the greatest effort on dimension E, which is also the most urgent one, considering that also the European regulation 2088/2019 (SFDR) pays great attention to the assessment of climate-related financial disclosure. Climate issues are progressing very rapidly and will soon be consolidated into the "European climate law".

By considering the structure of the EU Taxonomy, it is highlighted that an activity cannot be judged sustainable if there is no good governance and a "*minimum social safeguard*". European climate taxonomy is therefore based also on essential S and G conditions covering the entire spectrum of the ESG landscape.

Point #4- Other points you judge important to emphasize

Europe is at the forefront of promoting a change that has an impact not only in financial area (Action Plan: Financing Sustainable Growth) but also in the real economy (A European Green Deal to make the

EU’s economy sustainable). Nevertheless, EU policy-making will not be enough. A positive outcome will be related to an efficient exchange of environmental, social and corporate governance or ESG data and information between companies, financial analysts and investors. However, current metrics often seem insufficient and companies face many difficulties while disclosing non-financial information. That is why it is important to test these metrics and keep the dialogue between companies, financial analysts and investors open and we believe it is important to start a collaboration between financial analysts on these issues to define precise due diligence questions with which it is possible to go beyond the regulations and enrich the financial analysis with the understanding also of the sustainable dimensions of the business. This allows better informed financial assessments.
From our point of view, the 3R (risk, revenues and reputation) is a kaleidoscope through which to observe the business, governance and risks of the company that operates in sustainable areas, in different countries, with different regulations and different reporting standards and frameworks.

This position paper, in line with EFFAS paper “*KPIs for ESG: A guideline for the integration of ESG into financial analysis and corporate valuation*” version 3.0 is designed i) for the role that EFFAS could play in supporting progress towards the international development of standard metrics for non-financial reporting and ii) for the structural and content changes that will be made for the CESGA certificate in the year 2021.
We believe that our position paper could be used to define a specific new module dedicated to support the ESG legislation and as a first step to embed ESG metrics into the different parts of the fundamental analysis: qualitative and quantitative steps, analysts’ opinion and engagement activities.

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