

**FMA Fact Sheet 2021/1 – Dealing with ESG Risks**

Guidance regarding supporting supervised financial intermediaries with regard to dealing with sustainability-related risks in the company.

No new requirements are imposed by this guide. It is an aid for regulated financial intermediaries who need to integrate sustainability criteria (“ESG” criteria, referring to the keywords environment, social and governance) into their business or investment decisions due to new EU Regulation 2019/2088 on sustainability-related disclosure obligations in the financial services sector (Sustainable Finance Disclosure Regulation – SFDR) and EU Regulation 2020/852 on the establishment of a framework for facilitating sustainable investments (Taxonomy Regulation – TR). This information sheet is intended to support intermediaries with regard to dealing with sustainability-related risks in the company.

The guide is neither legally binding nor exhaustive.

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## 1. Starting situation

Studies by the organisations including the Intergovernmental Panel on Climate Change (IPCC) have shown that anthropogenic emissions, emissions caused by humans, are largely responsible for global warming. When compared to the conditions of the pre-industrial era, the earth has warmed by around 1°C, and according to scientific projections, a further increase of 1.5°C is likely by mid-century.<sup>1</sup>

The potential consequences of changes in the global climate give reason to believe that there is an urgent need for structural change that will be associated with highly significant costs. Capital should therefore be redirected to sustainable investments in order to enable a transition to a “green” economy. The need for active support to bring about a green economy is taken very seriously and promoted by the Financial Market Authority (FMA) Liechtenstein. In order to manage these new investments, sustainability factors and sustainability risks will be of vital importance in the financial sector of the future.

It is crucial to take sustainability into consideration not only on the product level but also on the company level. Sustainability should not be seen as a separate topic in isolation but always as a challenge that affects a company in a holistic manner. This means that successful sustainability management not only influences the business model but also affects matters such as the organisational structure of a company.

In order to support Liechtenstein financial intermediaries in integrating sustainability factors into their business activities, the FMA publishes this information sheet on dealing with sustainability risks.

## 2. The aim of this information sheet

The challenges posed by the financial sector by the sharp increase in sustainability-related regulation are considerable. The FMA would like to provide the financial intermediaries it supervises with an introduction to the content of this subject area, which is rapidly growing in importance. In addition, this information sheet is intended to provide guidance on the ways in which companies and the investments they make can build and enhance their resilience to sustainability risks.

In further addition, the FMA follows the binding European guidelines of the joint committee of the three European supervisory authorities, the European banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Securities and Markets Authority (ESMA) and takes guidance from the work of the Network for Greening the Financial System (NGFS). These specify that prudential supervision should be adapted to sustainability-related factors and risks and that supervisory expectations should be indicated with regard to the individual sustainability management of the company.

As a general rule for this information sheet, the principles, processes and methods discussed here are to be understood within the meaning of a *best practice* selection and are intended as a source of non-binding guidance. This information sheet is understood by the FMA as a resource for its supervised intermediaries that enables them to jointly and constructively address the crucial issue of sustainability risks in Liechtenstein.

However, it is also important to bear in mind that the binding requirements will increase in the coming years. This is caused by the incorporation of European legal acts into the European Economic Area (EEA) agreement along with the ongoing efforts of the European Union (EU) to promote sustainable financing through a variety of different packages of regulatory measures.

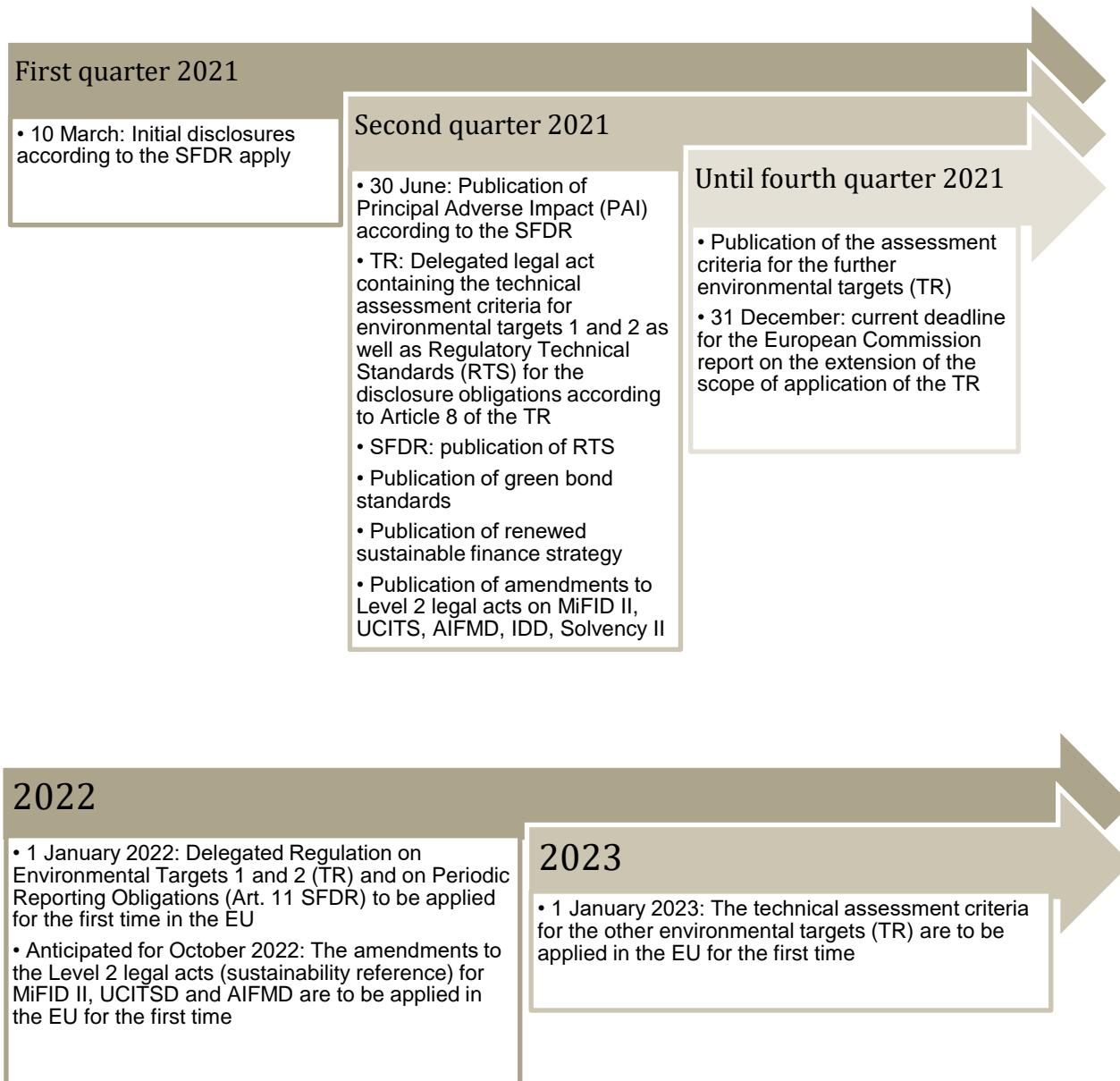
The FMA therefore suggests to its supervised entities that they implement the recommendations of this information sheet to the best of their ability and that they monitor further trends and developments as they unfold. The recommendations can be implemented based on risks.

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<sup>1</sup> See IPCC Report 2018: Global Warming of 1.5°C, Summary for Policymakers.

It is suggested that each company's internal discussion of sustainability risks be documented so that evidence of implementation can be provided at a later date if required. The specific design of the substantive review of the topic of sustainability in the context of risk management on the product and company level is the responsibility of the individual companies.

The following timetable currently applies to the regulatory development in Europe:



### 3. Introduction

#### 3.1 Market Report on “Sustainable finance”

In October 2020, the FMA commissioned an expert opinion on the topic of sustainability. This report certifies that the Liechtenstein financial centre has the potential to take on a global pioneering role in sustainable finance. To make this possible, it is essential that the FMA plays an active role as a supervisory authority.

The report identifies various locational advantages of the Principality of Liechtenstein, including high client confidence, financial as well as technological know-how, adaptability and specialised expertise. If these conditions coincide with optimised regulation, a competitive advantage on the international stage could arise. The challenge of increasing the sustainability of the financial centre could also be transformed into the basis of a competitive edge over other locations. There are also opportunities for adding sustainable finance as another factor of the excellent reputation of Liechtenstein as a location, leading to promote the further development of the financial centre. Furthermore, financial intermediaries can open up new business areas by developing innovative ESG financial solutions. Ultimately, the aspect of reducing risk over the long term should also be emphasised in particular, as systematic consideration of ESG risks in the financial sector helps to minimise sustainability risks and to identify negative effects on returns at an early stage.

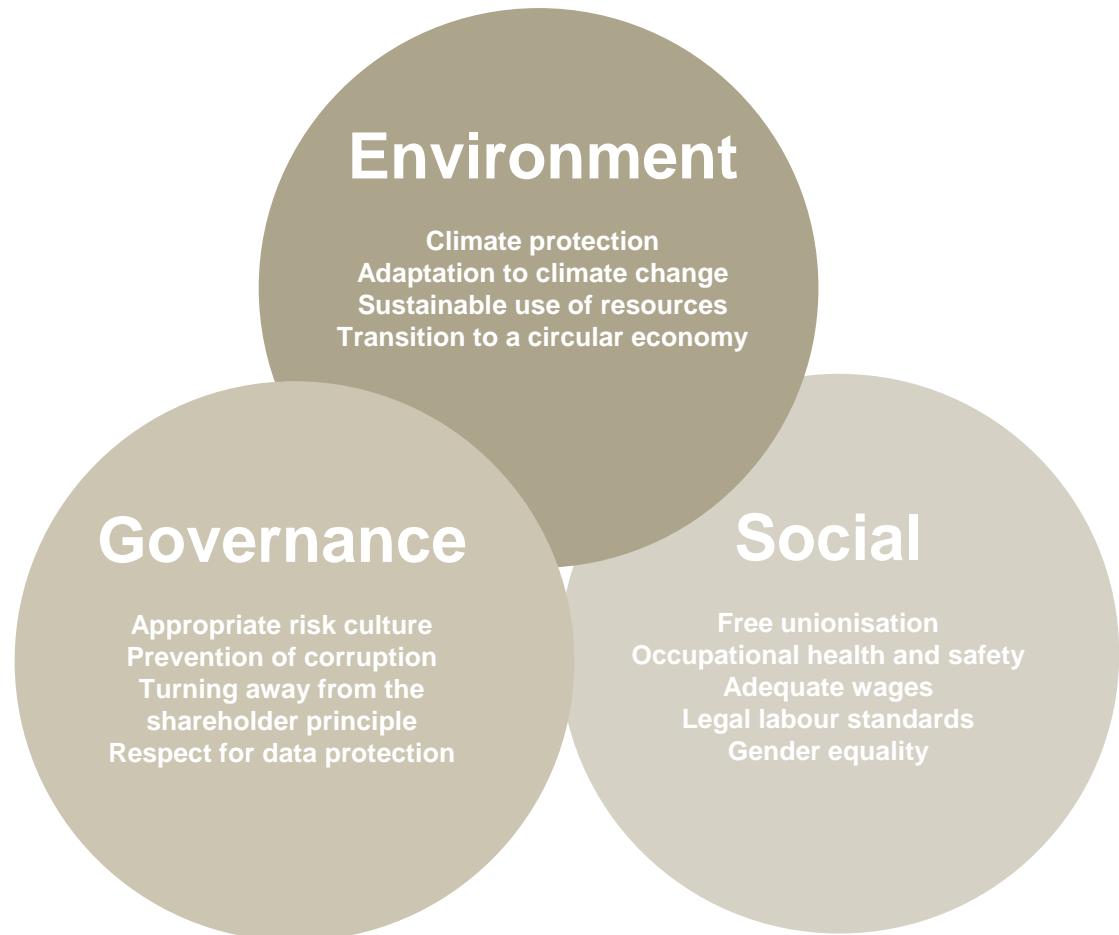
Measures to fulfil the sustainability requirements relate to the following seven subject areas:



It should be emphasised that the increasing density of regulation has an impact on the front, middle and back offices, but the front office is disproportionately affected. Companies need to be prepared for the front office to be widely affected by new regulatory developments and for client management, product management and investment management to be adapted to new sustainability requirements.

### 3.2 The concept of sustainability

In accordance with the EU's<sup>2</sup> understanding of sustainability, sustainability should not be limited to ecological aspects but should rather consider the entire ESG spectrum (made up of environmental, social and governance factors).



### 3.3 Sustainability risks

The Principality of Liechtenstein has embraced the fulfilment of the *17 Sustainable Development Goals* of the United Nations, which are to be implemented by 2030. The following objectives were identified as priorities: high-quality education, gender equality, clean water and sanitary facilities, affordable and clean energy, industry, innovation and infrastructure, less inequalities, responsible consumption and production and measures to protect the climate.<sup>3</sup>

Within the framework of the “Measures for climate protection” objective, it is also necessary to control and limit sustainability risks in the financial sector. For the purposes of this information sheet, sustainability risks are considered factors that influence ESG aspects, the occurrence of which may have actual or potential negative impacts on the value of an investment. Generally, sustainability risks can be broken down into physical risks and transition risks.

<sup>2</sup> See COM: Why is sustainable finance important?, [www.ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance\\_en#what](http://www.ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance_en#what).

<sup>3</sup> See Government of the Principality of Liechtenstein (2019): Nachhaltigkeit in Liechtenstein: Bericht über die Umsetzung der Agenda 2030 für nachhaltige Entwicklung, <https://www.llv.li/files/aaa/aaa-regierungsbericht-uno-de-inhalt.pdf>.

### 3.3.1 Physical risks

Physical risks can affect the financial system primarily by means of two causes: First, through an increase in extreme weather events that result in direct damage to infrastructure.<sup>4</sup> For example, the total economic losses due to extreme weather events from 1980 until the present day are estimated at more than USD 5,2 trillion. In 2005 alone, the year in which Hurricane Katrina hit the North Atlantic mainland in the United States, damages of some USD 60 billion were incurred.<sup>5</sup> Second, the concept of physical risks also includes long-term, gradual changes to the climate, such as rising sea levels that will make current coastal regions uninhabitable. This results in further indirect consequences, such as the supply chain disruptions and/or deindustrialisation of arid regions as a result of the abandonment of water-intensive economic activities.

### 3.3.2 Transition risks

Transition risks arise from policy and legislative measures that bring about an economic transition in the direction of a mode of operation that is low-carbon and resource-efficient.<sup>4</sup> Due to the artificial supply shortages of certain economic goods, such as in the context of fossil energy sources due to the phase-out of coal, increased investment costs can occur, which then jeopardise businesses and financial products that do not adapt. The interdependence between transition risks and physical risks requires special consideration. Physical risks can sharply increase when so-called “tipping points”<sup>6</sup> are reached.<sup>7</sup> Such developments can make a faster transition of the economy necessary, which in turn increases transition risks. The scenario to be avoided is one in which political inaction causes a rapid increase of the pressure to act, making it necessary to suddenly and radically restructure the economy.<sup>8</sup> This is associated with problems that include increased adaptation costs, among others.

However, transition risks also arise from the fact that the market capitalisation of certain companies can change drastically.<sup>4</sup> Market price risks come about when investors' expected returns are affected by anticipated regulatory measures. In the context of fossil fuels, this includes coal-fired power generation becoming increasingly unprofitable in view of the shortage of CO<sub>2</sub> certificates and increases in the number and severity of the EU's environmental regulations.<sup>9</sup> This means that due to political measures, it will be impossible to fully utilise stocks of fossil fuels, which could presumably lead to share price losses for companies operating in these sectors.<sup>10</sup> Due to long-term investments such as those initiated by private investors or pension funds, assets of USD 1 to 4 trillion could be wiped out if global prices were to collapse in the oil and gas industry. The risk of a sudden devaluation of securities of the issuers of corresponding industries is thus also borne by investors who hold shares in these companies in their portfolios.<sup>11</sup>

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<sup>4</sup> See *Bank of England*, Climate change: what are the risks to financial stability?, <https://www.bankofengland.co.uk/knowledgebank/climate-change-what-are-the-risks-to-financial-stability>.

<sup>5</sup> See *Munich RE*: Risks posed by natural disasters, <https://www.munichre.com/en/risks/natural-disasters-losses-are-trending-upwards.html>.

<sup>6</sup> A tipping point is understood to be supra-regional components of the global system associated with threshold behavior. These components can be brought into a new state through external climatic influences, and examples of this would include sea ice and permafrost soils.

<sup>7</sup> See *Solarify* (2019): Kipp-Elemente: Zu riskant, um gegen sie zu wetten, <https://www.solarify.eu/2019/11/29/594-kipp-elemente-zu-riskant-um-gegen-sie-zu-wetten/>.

<sup>8</sup> See *Schoenmaker* (2016): Financial risks and opportunities in the time of climate change, p. 16, [https://repub.eur.nl/pub/93228/pb\\_2016\\_02.pdf](https://repub.eur.nl/pub/93228/pb_2016_02.pdf).

<sup>9</sup> See *Euractiv* (2019): Studie: 6,6 Milliarden Miese für Kohlekraftwerke in der EU, <https://www.euractiv.de/section/energie-und-umwelt/news/studie-66-milliarden-euro-miese-fuer-kohlekraftwerke-in-der-eu/>.

<sup>10</sup> See *Deckert et al.* (2016): Kapitalrisiko Stranded Assets, [https://www.researchgate.net/publication/307882673\\_Kapitalrisiko\\_Stranded\\_Assets/link/57d03dd208ae0c0081dea59e/download](https://www.researchgate.net/publication/307882673_Kapitalrisiko_Stranded_Assets/link/57d03dd208ae0c0081dea59e/download).

<sup>11</sup> See *Makower, Joel* (2019): The growing concern over stranded assets, <https://www.greenbiz.com/article/growing-concern-over-stranded-assets>.

### 3.3.3 Other sustainability risks

However, less attention is usually paid to sustainability risks that affect areas such as social services or corporate governance. Developments and events that can be assigned to these areas can also affect the asset and earnings situation if the corresponding risks have not been sufficiently considered in advance. One example could include claims for damages that find their way into the public discussion and have negative repercussions on the public's perception of the company. The associated reputational risks therefore represent a financial risk that can also have an indirect impact on the company, such as if a business relationship is maintained with a company that is exposed to a sustainability risk. There are also reputational risks if a company pays insufficient attention or no attention at all to ESG criteria.

In order to control and limit sustainability risks, it is of fundamental importance to integrate sustainability criteria into financial decision-making processes. Sustainability risks and their impacts are not some abstract scenario of the far-off future but are already affecting our financial system today:<sup>12</sup>

Sustainability risk	Impact
Climate change	Costs of some 3% of the global gross domestic product (GDP) by 2060.
Air pollution	In 41 countries included in the study, air pollution caused a total of 3.2 million deaths and resulted in costs of some USD 5.1 trillion.
Water pollution	Annual costs of USD 2.2 billion from groundwater pollution due to the application of too much fertiliser in the United States.
Modified land use (e.g. deforestation)	The annual cost of land degradation is USD 231 billion.
Drought	Regions in which water is scarce could experience reduced economic growth of up to 6% by 2050, followed by further decades of permanent negative growth.
Loss of biodiversity	Certain business areas (e.g. agriculture) directly depend on healthy and functional ecosystems for the production of goods and services. Throughout the world, the value of business areas that directly depend on healthy ecosystems is some USD 140 trillion.

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<sup>12</sup> See NFGS (2020): Guide for Supervisors: Integrating climate-related and environmental risks into prudential supervision, p. 11, [https://www.ngfs.net/sites/default/files/medias/documents/ngfs\\_guide\\_for\\_supervisors.pdf](https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf).

## 4. Business model, strategy and governance

Structural adjustments are necessary in the company in order to be able to control and limit sustainability risks. Such requirements relate to the business model, strategy and governance.

### 4.1 Business model

The occurrence of physical risks as well as transition risks may change the business environment and thus affect the business model. The business environment must also be monitored and analysed with regard to ESG factors. Monitoring is also to provide information on trends in sustainability effects. Within the scope of ESG monitoring, all areas related to sustainability that affect the business model in its functionality need to be assessed. This requires a change of perspective in which forward-looking trends are primarily assessed.

In the context of sustainability-related environment analysis, an understanding of the future development of the variables that determine the business model must be developed. In particular, these relate to key macro-economic trends, competitive conditions, regulatory trends in legislation, technological trends relevant to the business model and societal developments.<sup>13</sup> Factors of sustainability can also have an impact on each of the above-mentioned variables. In particular, it is necessary to be aware that the time horizon required here clearly exceeds the normal planning time frame of three to five years.

At the same time, it is important not to neglect short-term sustainability risks, as these can also have a major impact on the business environment (e.g. risks resulting from political decisions). It is necessary to take into consideration that different temporal assessment parameters need to be applied to the various sustainability risks. Reputational risks can occur and then also be perceived by the public immediately, even if the reputational loss ultimately stems from a business decision made on a long-term basis. An example of this might be the debasement of the company's reputation occurring immediately after a decision is made to achieve a certain climate target later than the market average.

**The supervisory view:** Financial intermediaries are made aware of short-, medium- and long-term changes in their operating environment due to sustainability risks. Relevant trends are recorded and monitored, and conclusions are drawn from the analysis in order to better understand what impact the relevant sustainability factors will have. The results are to be documented and reported internally.

### 4.2 Strategy

If a need for changes in the business model caused by sustainability risks is identified, the long-term strategy must be updated in order to better limit sustainability risks. This makes it necessary to carefully review the business and risk strategy and adjust where necessary, with the changes either building on existing strategies or resulting from the development of new procedures. The development of a new strategy offers the advantage of a possible reputational gain. It also sends a positive signal to stakeholders that there is an awareness of sustainability risks. As an alternative, it is also possible to use existing strategies. However, this may not do justice to the complexity of new challenges in sustainability management.

When reviewing the business strategy with regard to the consideration of sustainability risks, the following questions can provide assistance in particular:

- Which business areas are exposed to transition risk? Can the risk be classified as substantial?
- Should the affected business areas be continued, restricted or reshaped?

<sup>13</sup> See EBA/GL2014/13; <https://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+%28Guidelines+on+SREP+methodologies+and+processes%29.pdf>.

- Do sustainability risks need to be considered in all business areas and processes due to their materiality, or is it sufficient to concentrate on particularly jeopardised or exposed business areas and processes?
- Should you enter into a dialogue with clients with substantial sustainability risks regarding how ESG risks can be mitigated or reduced in future?

When reviewing the risk strategy, the following questions in particular can provide guidance:

- If sustainability risks were to become a reality, would it have a negative effect on key performance indicators specified on a binding basis, such as capital ratios?
- What stress tests, including scenario analyses, were conducted on sustainability risks?
- How are physical risks and transition risks to be assessed on the timeline?
- Can the processes for identifying, measuring, controlling and reporting sustainability risks be improved systematically or on a selective basis?

**The supervisory view: Financial intermediaries use long-term strategy to limit sustainability risks. To do this, they subject the business and risk strategy to a comprehensive review and adjust where necessary. The review is to be documented.**

## 4.3 Governance

To ensure that organisations function well, it is absolutely essential that responsibilities are clearly allocated. This also means that areas of authority must be clearly defined and regulated if sustainability risks are to be dealt with effectively. These areas of responsibility are also to be integrated into the organisational structures that already exist.

### 4.3.1 Involvement of the management level

It is particularly important to involve those on the management level, that is, the bodies responsible for the strategic direction of the company. If there is no commitment on the part of the management level, it is impossible to implement an ambitious sustainability agenda. To make sure that management pays the necessary attention to the topic, you can assign responsibility for managing sustainability risks to a member of the management level, for example. This member of the management level then bears responsibility for the implementation of the strategy and provides leadership in regard to implementation of the strategies, thus ensuring that the implementation has sufficient backing within the company. This means that the executive level is involved within the framework of existing bodies without the need to create new structures. It is also the responsibility of the uppermost governance body to verify that the responsibility for the strategy for dealing with sustainability risks is clearly defined and implemented within the operational management level.

#### **4.3.2 Definition of responsibilities**

Responsibilities and areas of authority must always be defined in writing in order to ensure that they can be traced. The ultimate responsibility lies with the body of the management level with a controlling role, usually the Board of Directors. If a company decides to create a special sustainability unit, it is necessary to ensure that such a unit is fully integrated into the existing structures. This should be done without forgetting to make arrangements for process workflows and interfaces to other internal units. A sustainability unit like this can be useful to consult when it comes to reviewing a potential investment, for example.

#### **4.3.3 Staff training**

The issue of sustainability and its associated risks cannot be viewed in isolation but is always subject to a holistic perspective, as it affects the company in its entirety. This means that additional training of existing staff must also be made possible so that targeted knowledge in this area can be imparted to employees whose task profile touches on sustainability risks. Training and additional education measures (internal and/or external) that are appropriate to the target group are to be implemented.

#### **4.3.4 Compliance function**

As the requirements related to sustainability increase, the importance of a company's compliance function increases along with them. This makes it crucial to address the following areas with regard to sustainable finance:

- Compliance with new sustainability-related requirements must be monitored.
- Sustainability risks must be considered when carrying out activities.
- The internal audit department (if existing) places sufficient emphasis on the consideration of sustainability risks as part of the audit.
- Measures must be taken to ensure that greenwashing practices are prevented.
- A client's sustainability preferences should always be respected.

#### **4.3.5 Remuneration policy**

Article 5 of the SFDR stipulates a requirement to disclose the remuneration policy. Financial market participants and financial advisors within the meaning of the SFDR are to demonstrate the extent to which the internal remuneration policy takes sustainability risks into account. It is recommended that you comprehensively review the remuneration policy and consider sustainability risks in order to prevent misaligned incentives and communicate responsible corporate governance both internally and externally.

**The supervisory view: Financial intermediaries clearly define and allocate areas of authority. Where necessary, they adjust the organisational structure in order to effectively implement the sustainability strategy and ensure that the management level is involved. Since sustainability risks affect internal company task profiles across all areas, reviews are carried out in all units and adjustments are made where necessary.**

## 5. Risk management

### 5.1 Introduction

You cannot avoid adjusting the risk management if you want to be able to ensure adequate identification, monitoring, control and limitation of sustainability risks. As previously explained in section 4.3.2, the responsibilities and areas of authority for the processes must be clearly allocated. It should be noted in general that sustainability risks are not an independent risk category and instead must be subsumed under the existing, conventional risk types. For example, transition risks should not be introduced as a new risk category in risk management processes; instead, the impact of transition risks on existing risk classes is to be reviewed. The following table<sup>14</sup> shows an example of the possible impact of sustainability risks on conventional risk categories.

Financial risk	Physical risks	Transition risks
<b>Credit risk</b>	Loss of value of collateral due to natural disasters Sustainability of debt is reduced by natural disasters Loss of biodiversity reduces productivity and income	Excessive depreciation on CO <sub>2</sub> -intensive systems/facilities Lower revenue from debtors/asessments due to CO <sub>2</sub> tax More investments in new, riskier technologies
<b>Market risk</b>	Natural disasters increase price volatility Natural disasters lead to high property damage in populated regions Capital outflow from regions with increased occurrence of extreme weather events Rising sea levels increase the risk associated with certain countries	Initiating a trend reversal in the direction of climate-neutral systems/facilities Rising inflation expectations due to CO <sub>2</sub> taxes Devaluations of countries that produce large amounts of CO <sub>2</sub> Greater uncertainty in regard to future technologies/laws
<b>Liquidity risk</b>	Sudden outflows due to disasters Sudden request for emergency loans	Stranded assets <sup>15</sup> can no longer be traded

<sup>14</sup> See Pointner, Wolfgang (2019): Klimawandel als Finanzrisiko, [https://www.oenb.at/dam/jcr:17be6cce-5e03-454e-a64ca7eb190b8f69/3\\_session\\_1\\_pointner\\_klimawandel\\_als\\_finanzrisiko.pdf](https://www.oenb.at/dam/jcr:17be6cce-5e03-454e-a64ca7eb190b8f69/3_session_1_pointner_klimawandel_als_finanzrisiko.pdf).

<sup>15</sup> "Stranded assets" are generally understood to be assets (e.g. company shares, technical systems/facilities or (raw material) inventories) whose earning power or market value unexpectedly drops drastically to the point where they are largely or completely worthless.

<b>Operational risk</b>	Destruction of infrastructure for business operations  Rising insurance costs  Rising costs of adapting to climate change  Lack of access to data and costs due to data uncertainty	Increases in prices due to CO2 taxes  Additional reporting obligations in regard to emissions
<b>Legal and reputational risk</b>	“Infection” due to proximity to affected regions  Increase in litigation (“strategic/climate litigation”)	Lack of engagement with sustainability risks  Stigmatisation of business owners by consumers  Sale or distribution of financial products that are supposedly presumed to be sustainable (“greenwashing”)
<b>Actuarial risk</b>	Elevated losses due to frost, storm, floods and hail  Risk that higher losses will not be appropriately reflected in the actuarial provisions or premium risks	Changes in underwriting risk, especially due to selection effects

The time horizon over which it is necessary to anticipate the impact of sustainability risks is challenging, with this horizon often extending beyond the term of a regular business plan. It is therefore recommended that you define suitable risk indicators, which can support the assessment of the temporal scope of a relevant sustainability risk. The indicators should reflect risk-bearing capacity as well as risk appetite, with the NGFS recommendations also being used to develop such indicators.<sup>16</sup>

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<sup>16</sup> See NGFS (2019): Macroeconomic and financial stability: Implications of climate change, [http://www.ngfs.net/sites/default/files/media/documents/ngfs-report-technical-supplement\\_final\\_v2.pdf](http://www.ngfs.net/sites/default/files/media/documents/ngfs-report-technical-supplement_final_v2.pdf).

## 5.2 Methods

Various instruments are available for identifying, controlling, assessing, and limiting sustainability risks, which will be explained below. The methods differ in their approach and are therefore not arbitrarily interchangeable, but the application of each specific method must always be reviewed with regard to the company's particular business area. This chapter is not an exhaustive explanation of all methods but instead aims to show a selection of methods and to encourage people to go into the subject matter at greater depth on this basis.

### 5.2.1 Determination and assessment of sustainability risks

There are various approaches to determining the exposure of assets to sustainability risks, with each of the approaches differing in granularity as well as in the trends they indicate. The granularity ranges from the assessment of general indicators to a sectoral analysis. The trends that can be mapped refer either to the current level of CO<sub>2</sub> emissions or attempt to map material value risks that are emerging for certain assets, for example.

#### (a) Environmental risk heat map

A *heat map* helps to make the exposure to transition risks visible<sup>17</sup>, with the risk position determined and classified on a sectoral basis. The higher the value, the more assets are exposed and at risk from transition risks. After an initial assessment on the basis of a *heat map*, further risk analyses are to be carried out to gain insight into how to strategically deal with sustainability risks.<sup>18</sup>

#### (b) CO<sub>2</sub> footprint and CO<sub>2</sub> intensity

CO<sub>2</sub> footprint and CO<sub>2</sub> intensity measure the environmental impact of a portfolio across the companies in which it is invested. These indicators are by far the most common method investors can use to measure the environmental impact of their portfolio.

The CO<sub>2</sub> footprint is calculated in tonnes of CO<sub>2</sub> equivalents per million USD invested, and expresses the amount of annual emissions that can be attributed to the investor per million USD invested in a portfolio.

In turn, the CO<sub>2</sub> intensity relates the total greenhouse gas emissions attributable to an investor to the total share of revenue attributed to an investor. It is expressed in tonnes of CO<sub>2</sub> equivalents per million of USD turnover. By introducing turnover, the key performance indicator is adjusted for the size of the company, transforming it into a measurement of how climate-efficient the portfolio is. Although the two indicators do not measure climate-related risk, they are approximate values that provide valuable information for investors. This works by identifying assets that are potentially exposed to climate-related risks in the future.<sup>19</sup>

#### (c) Carbon impact analysis

This control instrument makes it possible to assess the CO<sub>2</sub> impact of investment portfolios. It is a tool for calculating and measuring the CO<sub>2</sub> impact of portfolios as well as for assessing the extent to which they contribute to the transition to a low-carbon economy. On this basis, it can also be used as a tool for identifying the extent of the risk of *stranded assets* arising in conjunction with fossil fuel energy sources. You can find more detailed explanations at the link specified in the footnote.<sup>20</sup>

<sup>17</sup> For an exemplary design: See: Moody's Investors Service: Environmental Risks Global Heatmap Overview at [www.moody's.com/sites/products/ProductAttachments/Infographics/Environmental-Risks-Global-Heatmap-Overview.pdf](http://www.moody's.com/sites/products/ProductAttachments/Infographics/Environmental-Risks-Global-Heatmap-Overview.pdf).

<sup>18</sup> See Moody's Investors Service (2018): Moody's approach to climate risk, <https://www.mainstreamingclimate.org/wp-content/uploads/2016/10/Moody's-Presentation-Climate-Risk-Trends.pdf>.

<sup>19</sup> See Swiss Sustainable Finance (SSF): Measuring climate-related risks in investment portfolios, [https://www.sustainablefinance.ch/upload/cms/user/2019\\_03\\_04\\_SSF\\_Focus\\_Measuring\\_Climate\\_related\\_Risks\\_in\\_Portfolios\\_final.pdf](https://www.sustainablefinance.ch/upload/cms/user/2019_03_04_SSF_Focus_Measuring_Climate_related_Risks_in_Portfolios_final.pdf).

<sup>20</sup> Detailed explanations can be found at the following link: [www.carbone4.com/wp-content/uploads/2016/08/CarbonImpactAnalytics.pdf](http://www.carbone4.com/wp-content/uploads/2016/08/CarbonImpactAnalytics.pdf).

#### **(d) Climate value at risk**

This type of risk assessment helps to assess future costs associated with climate change and to understand what these future costs might mean for the current valuation of securities. The basic assumption of climate value at risk is to aggregate the costs associated with certain sustainability risks over the next 15 years and to estimate how high the maximum loss in value of a portfolio can be due to sustainability-related risks. For detailed information on this method, we recommend you read the publication “Climate value at risk” of global financial assets”.<sup>21</sup>

#### **(e) Stress tests and scenario analyses**

Stress tests should also be put to the test as part of a comprehensive review. It is necessary to verify whether these also consider the impact of sustainability risks on the company. If necessary, the company's internal stress tests must be adjusted.

The stress test programme should also consider scenarios that simulate the impact of sustainability risks on the business model. For example, you might analyse the impact of political measures in a variety of different time frames (e.g. early-stage versus late-stage transition). Within the scope of a comprehensive risk assessment, the stress test programme and the analysis of different scenarios should take the following questions into consideration:

- What physical and transition risks are relevant to us?
- What is the influence of various scenarios on the development of these risks?
- How does the influence of these risks develop over time (the short, medium and long term) and are there interactions between them?

### **5.2.2 Control and limitation of sustainability risks**

A variety of different approaches is available for controlling and limiting sustainability risks. These approaches differ in the extent to which ecological aspects are to be considered in the investment decision, ranging from the exclusion of certain business areas to the integration of ESG factors.

#### **(a) Negative screening – the exclusion procedure**

The *negative screening* approach aims to completely exclude certain sectors or business activities. Using “negative lists”, thematically selected securities that “violate certain values, ethical principles or policies” are to be phased out.<sup>22</sup> It is often the case that fossil fuels, armaments, corruption, nuclear energy and environmental destruction are excluded from portfolios.<sup>23</sup> The aim of such exclusions is to reduce sustainability risks by refusing to engage in business activities that are not in line with the company's mission statement, which also minimises the emergence of reputational risks to a large extent. Negative lists can thus be used to exclude undesirable investment assets. This method is used to exclude economic activities related to the extraction of fossil fuels, for example, with the aim of preventing the creation of stranded assets.

#### **(b) Positive screening**

The positive screening approach aims to select for the portfolio only those investment objects that stand out as positive examples within a business area by meeting the standards of the assessment according to

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<sup>21</sup> Dietz, Simon/Bowen, Alex/Dixon, Charlie et al. (2016): “Climate value at risk” of global financial assets”, Nature Climate Change 6, p. 676–679, <https://www.nature.com/articles/nclimate2972>.

<sup>22</sup> Bruns, Christoph/Meyer-Bullerdiek, Frieder (2020): Professionelles Portfoliomanagement, p. 327, <https://www.beck-eibrary.de/10.34157/9783791045290/professionelles-portfoliomangement>.

<sup>23</sup> Horlacher, Jonathan (2016): Ausschlusskriterien, p. 28; [https://www.sustainablefinance.ch/upload/cms/user/SSF\\_Handbuch\\_Nachhaltige\\_Anlagen\\_2016\\_11\\_28\\_einseitig\\_Web.pdf](https://www.sustainablefinance.ch/upload/cms/user/SSF_Handbuch_Nachhaltige_Anlagen_2016_11_28_einseitig_Web.pdf).

sustainable investment criteria. In addition, companies that consider ESG criteria in particular when it comes to corporate decision-making processes in a specific sector and set high standards without regulatory constraints are selected. The aim is to create a diversified portfolio that is globally representative of exemplary companies and that places particular emphasis on sustainability.<sup>24</sup>

#### **(c) Best-in-class**

The best-in-class approach can be understood as a special case of positive screening. In this case, the sustainability performance of a company within an industry is reviewed. However, it is necessary to exercise caution here, as no sector or business area can be generally excluded from the very outset. It is first necessary to analyse each company for its individual sustainability performance and then rank it in comparison with other companies in the same sector. However, there are also industries – such as coal power – where even companies with the highest environmental standards are generally not considered to be sustainable.

#### **(d) ESG integration**

The ESG integration approach takes ESG criteria directly into account in the investment decision or the traditional financial analysis. The integration of sustainability data can take place in both quantitative and qualitative form as well as in the selection of individual securities and in portfolio structuring.<sup>25</sup> With the growing significance of passive asset management, the importance of index-based ESG approaches is also increasing. It is crucial to note that the measurable impact of ESG factors only occurs with a time lag of several financial years. This can be seen in particular in the areas of risk management and cost efficiency. For example, higher cost efficiency due to sustainable environmental management can result in lower capital costs and thus a higher company valuation. Compared to the previously mentioned approaches, the sustainability performance is lower due to sustainability criteria being integrated into financial models. However, there is the advantage of resolving the trade-off between financial performance and sustainability performance.

#### **(e) Active ownership**

As a representative of the shareholder (e.g. the asset manager), the aim is to influence the positioning of the company and the consideration of sustainable criteria in the company by exercising voting rights or through dialogue with the responsible individuals.

#### **(f) Divestment**

The divestment approach is the strategic disposal of company shares from business areas that damage the climate. But in contrast to negative screening, the selections made here are in regard to investment assets already held, whereas negative lists are applied before an investment decision.

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<sup>24</sup> De Halleux, Bernard/Peeters, Ben (2016): Best-in-Class Ansatz, p. 34, [https://www.sustainablefinance.ch/upload/cms/user/SSF\\_Handbuch\\_Nachhaltige\\_Anlagen\\_2016\\_11\\_28\\_einseitig\\_Web.pdf](https://www.sustainablefinance.ch/upload/cms/user/SSF_Handbuch_Nachhaltige_Anlagen_2016_11_28_einseitig_Web.pdf).

<sup>25</sup> Bruns, Christoph/Meyer-Bullerdiek, Frieder (2020): Professionelles Portfoliomanagement, p. 330, <https://www.beck-eibrary.de/10.34157/9783791045290/professionelles-portfoliomanagement>.

### 5.3 Use and provision of sustainability data

In order to assess sustainability factors and risks in the context of investments, sustainability ratings can be used in addition to the analysis of internal company data provided by companies. However, it is important to keep in mind that externally sourced data always needs to be checked for plausibility. Using externally sourced data does not constitute an exclusion of liability as to the accuracy of the information disclosed by the company. A plausibility check is also important because there are currently no standardised requirements with regard to ESG ratings.

**The supervisory view: Financial intermediaries are to select methods for determining, assessing, managing and limiting sustainability risks that are suitable for them in accordance with their business models and sustainability strategies. The financial intermediaries are also to record such risks in a comprehensible manner in writing in order to supplement the existing risk management and investment process. In addition, it is expected that they provide sufficient financial and human resources for this purpose.**

## 6. Disclosure obligations relating to sustainability

The EU adopted Regulation (EU) 2019/2088 on sustainability-related disclosure obligations in the financial services sector (SFDR) and complemented it with several provisions in Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (Taxonomy, TR). Even though these EU regulations have not yet been incorporated into the EEA agreement, the FMA recommends that you take the transparency requirements into account in order to prevent competitive disadvantages in regard to EU competitors and that you comply with the recommendation of the joint committee of the European supervisory authorities EBA, EIOPA and ESMA.<sup>26</sup>

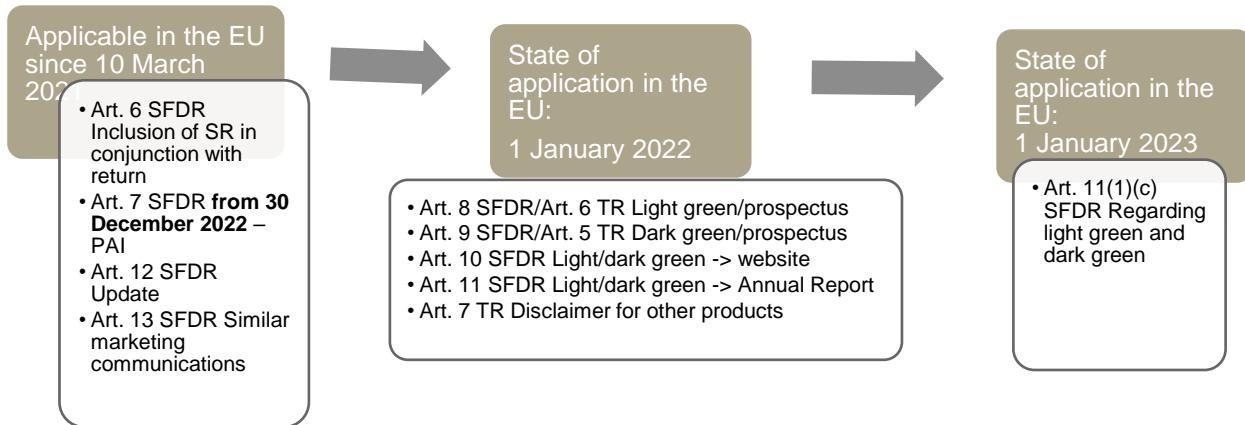
### 6.1 Product-related disclosure obligations

According to Article 6(1) of the SFDR, the manner in which sustainability risks are incorporated into investment decisions must be disclosed. In addition, it is necessary to assess the expected impact of sustainability risks on the return of the financial product. The result of this assessment must be disclosed. Article 6 of the SFDR has been in effect in the EU since 10 March 2021 and applies to every financial product within the meaning of Article 2(12) of the SFDR.<sup>27</sup>

According to Articles 8 and 9 of the SFDR, a distinction is made between two different types of sustainable financial products, known as “light-green” and “dark-green”. Financial products according to Article 8 of the SFDR are characterised by the fact that they are only advertised with environmental or social or environmental and social features, while products within the meaning of Article 9 of the SFDR are based on a fundamentally sustainable investment objective. Even though the Level 2 legal act will not go into effect in the EU until 1 July 2022, disclosure according to Articles 8 and 9 of the SFDR will be applicable in the EU area on a principles-based basis as early as 10 March 2021.

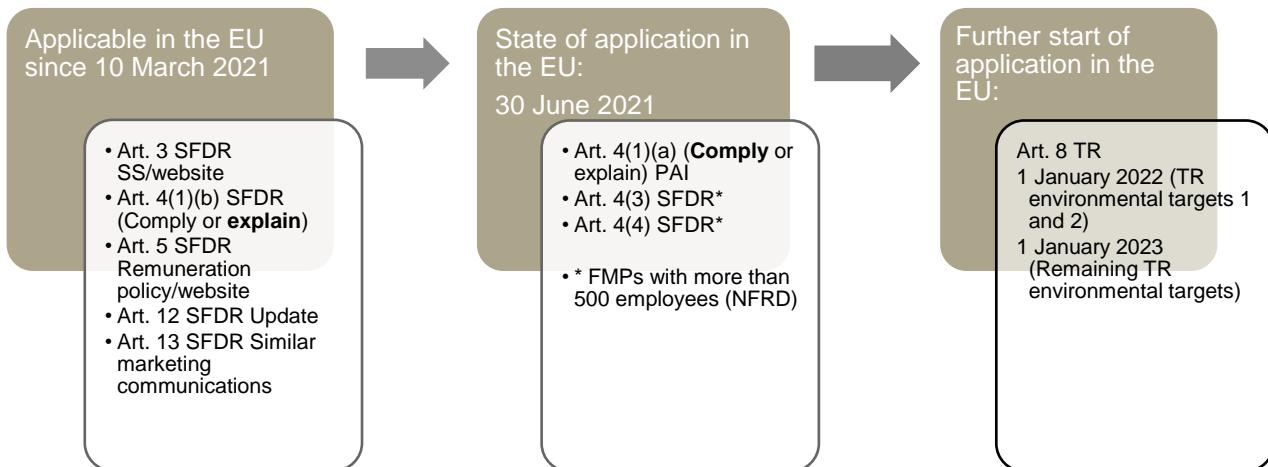
<sup>26</sup> See [www.esma.europa.eu/sites/default/files/library/jc\\_2021\\_06\\_joint\\_esas\\_supervisory\\_statement\\_-sfdr.pdf](http://www.esma.europa.eu/sites/default/files/library/jc_2021_06_joint_esas_supervisory_statement_-sfdr.pdf).

<sup>27</sup> From a purely formal point of view, there is no obligation to apply the SFDR in Liechtenstein until it is incorporated into the EEA agreement, although proactive application is essential for Liechtenstein to remain competitive in the international environment. The FMA provides support for a proactive application but does not prescribe it.



## 6.2 Company-related disclosure requirements

According to Article 3 of the SFDR, the company's internal sustainability strategy and the handling of sustainability risks must be published on the website. According to Article 4 of the SFDR, a statement of due diligence strategies is required in relation to impacts when considering substantial adverse sustainability impacts. It is theoretically possible here to decide against taking sustainability risks into account, but then it is necessary to give clear reasons for this in the declaration. It should also be noted that for companies with more than 500 employees in the EU, disclosure will be mandatory starting on 30 June 2021. Article 5 of the SFDR requires the adaptation of the remuneration policy and inclusion of sustainability criteria. Article 10 of the SFDR applies to financial products according to Articles 8 and 9 and requires additional disclosures on the website.<sup>27</sup>**Fehler! Textmarke nicht definiert.**



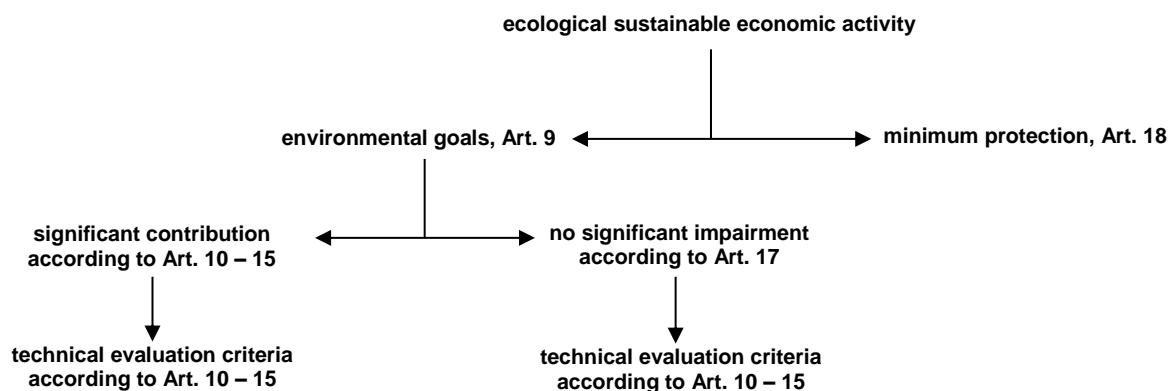
## 6.3 Disclosures under the Taxonomy Regulation

Financial market participants within the meaning of Article 2(1) of the SFDR must assess the environmental sustainability of their business activities within the meaning of the TR and take into consideration the possibility of determining the sustainability of investments. According to Article 3 of the TR, a business activity is environmentally sustainable if it makes a significant contribution to one of the environmental targets according to Article 9 of the TR, if it does not significantly impair any other environmental targets according to Article 17 of the TR, if it meets minimum social standards according to Article 18 of the TR ("minimum protection") and

if it complies with the technical assessment criteria defined by the European Commission. Details are specified in the corresponding Level 2 legal act.

There are additional disclosure obligations according to Articles 8 and 9 of the SFDR in accordance with Articles 6 and 5 of the TR, not only on the company level but also on the level of the financial products. If there is a financial product according to Articles 8 or 9 of the SFDR, the environmental target according to Article 9 of the TR that is being sought by the investment must be disclosed and a description of the extent to which the investments underlying the financial product are to be classified as environmentally sustainable within the meaning of Article 3 of the TR must be included.

Criteria for classifying the taxonomy conformity of a business activity:<sup>28</sup>



The articles mentioned refer to the Taxonomy Regulation.

Article 7 of the TR completes the classification of financial products made in the SFDR. Article 7 of the TR applies to all financial products that do not fall under Article 8 or 9 of the SFDR. So-called “other financial products” according to Article 7 of the TR must be accompanied by a disclaimer contained in the regulation text to the information to be disclosed according to Article 6 of the SFDR. Articles 5 to 7 of the TR will be applied in the EU starting from 1 January 2022.<sup>27</sup>

**The supervisory view:** Financial intermediaries assess on an ongoing basis whether the relevant information on the homepage, in the pre-contractual documents or in the periodic reports on the handling of sustainability risks is sufficient to fulfil the reporting and disclosure requirements. They also independently adapt these with advancing legal requirements, an improved ESG data situation and their own empirical values.

<sup>28</sup> Figure created based on Stumpf, Maximilian (2019): [www.degruyter.com/document/doi/10.15375/zbb-2019-0111/html](http://www.degruyter.com/document/doi/10.15375/zbb-2019-0111/html).

## **7. Amendment**

With the amendment on September 10<sup>th</sup> 2021 the applicability of Level II of SFDR was postponed from January 1<sup>st</sup> 2022 to July 1<sup>st</sup> 2022 (point 6.1.).

## **8. Data protection**

The FMA processes personal data exclusively in accordance with the general data processing principles of the General Data Protection Regulation (Regulation (EU) No. 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data on the free movement of such data and repealing Directive 95/46/EC) and in line with applicable data protection law.

Information regarding the processing of personal information, including details about the purpose of processing, the data controller and the rights of data subjects can be found in the FMA Privacy Policy:

<https://www.fma-li.li/de/fma/datenschutz/fma-information-zum-datenschutz.html>

Please contact the FMA for further information.

Telephone: +423 236 73 73

E-mail: [info@fma-li.li](mailto:info@fma-li.li)

## 9. Annex



Finanzmarktaufsicht  
Liechtenstein

2019/2088

### 9.1 Disclosure requirements under Regulation (EU)

Disclosure topic	Financial Market Participants (FMP) Financial Advisers (FA)	"Normal" financial products	"Light-green" financial products (Art. 8 SFDR)	"Dark-green" financial products (Art. 9 SFDR)	Validity in the EU
<b>Strategy for dealing with sustainability risks</b>	Website: FMP: Art. 3(1) SFDR FA: Art. 3(2) SFDR	–	–	–	10.03.2021
<b>Principal adverse impact of investment decisions on ESG factors (PAI)</b>	Website: Art. 4 SFDR FMP: par. 1–4: Comply/explain Mandatory for companies >500 employees FA: par. 5: Comply/explain; publication on website	Pre-contractual documents: Art. 7 SFDR Annual Report: Art. 7(1) and 11(2) SFDR; Art. 4–9 RTS	Pre-contractual documents: Art. 7 SFDR Annual Report: Art. 7(1) and 11(2) SFDR; Art. 4–9 RTS	Pre-contractual documents: Art. 7 SFDR Annual Report: Art. 7(1) and 11(2) SFDR; Art. 4–9 RTS	<b>FMP:</b> 10.03.2021 Comply/explain <b>Compliant FMP:</b> 30.06.2021 >500 employees 30.06.2022 First PAI specification 30.06.2023 First reference period for PAI report <b>Fund (compliant FMP)</b> 30.12.2022 Pre-contractual documents. 01.01.2023 Annual Report: <b>FA:</b> 10.03.2021
<b>Inclusion of sustainability risks in remuneration policy</b>	Website: FMP and FA: Art. 5 SFDR	–	–	–	10.03.2021
<b>How sustainability risks are considered in investment decisions</b>	–	Pre-contractual documents: FMP: Art. 6(1)(a) SFDR FA: Art. 6(2)(a) SFDR	Pre-contractual documents: Art. 6(1)(a) SFDR	Pre-contractual documents: Art. 6(1)(a) SFDR	10.03.2021

<b>Impact of sustainability risks on returns</b>	–	Pre-contractual documents: Art. 6(1)(b) SFDR	Pre-contractual documents: Art. 6(1)(b) SFDR	Pre-contractual documents: Art. 6(1)(b) SFDR	10.03.2021
<b>Disclosure topic</b>	<b>Financial Market Participants (FMP) Financial Advisers (FA)</b>	<b>“Normal” financial products</b>	<b>“Light-green” financial products (Art. 8 SFDR)</b>	<b>“Dark-green” financial products (Art. 9 SFDR)</b>	<b>Validity in the EU</b>
<b>Fulfilment of the advertised sustainability characteristics</b>	–	–	Pre-contractual documents: Art. 8 SFDR; Art. 13–19 RTS Website: Art. 10 SFDR; Art. 31–44 RTS Annual Report: Art. 11 SFDR; Art. 58–63, 71, 72 RTS	–	10.03.2021: Pre-contractual documents and website 01.01.2022: Annual Report
<b>Achievement of the sustainability investment objective</b>	–	–	–	Pre-contractual documents: Art. 9 SFDR; Art. 20–27 RTS Website: Art. 10 SFDR Art. 31, 45–57 RTS Annual Report: Art. 11 SFDR; Art. 64–71, 73 RTS	10.03.2021 Pre-contractual documents and website 01.01.2022 Annual Report
<b>TR harmonisation</b>	–	Pre-contractual documents: Art. 7 TR Annual Report: Art. 7 TR	Pre-contractual documents: Art. 6 TR and 8(2a) SFDR Website: Art. 10 SFDR Annual Report: Art. 6 TR and 11(1)(d) SFDR	Pre-contractual documents: Art. 5 TR and 9(4a) SFDR Website: Art. 10 SFDR Annual Report: Art. 5 TR and 11(1)(c) SFDR	01.01.2022 (Climate protection and adapting to climate change) 01.01.2023 (Other environmental targets according to Art. 9 TR)

**Review of the information to be disclosed**

FMP:  
Art. 12(1) SFDR  
FA:  
Art. 12(2) SFDR

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## 9.2 Overview of the disclosure medium depending on the requirement and financial product

Financial product	SFDR requirement	Medium	SFDR require- ment	Medium	SFDR require- ment	Medium
<b>AIF</b>	Art. 6–9 SFDR	Fund documents: Art. 105 AIFM Act Art. 13(1) Regulation (EU) No. 345/2013 Art. 14(1) Regulation (EU) No. 346/2013 Art. 23 Regulation (EU) 2015/760	Art. 10 SFDR	Website: FMP	Art. 11 SFDR	Annual Report: Art. 104 AIFM Act
<b>UCITS</b>	Art. 6–9 SFDR	Fund documents/prospectus: Art. 71(1) UCITS Act	Art. 10 SFDR	Website: FMP	Art. 11 SFDR	Annual Report: Art. 71(2) UCITS Act
<b>IBIP</b>	Art. 6–9 SFDR	Information documents: Art. 106, 148 ISA  Client information: Art. 51 LIDA  PRIIPS Basic Information Sheet	Art. 10 SFDR	Website: FMP	Art. 11 SFDR	Information documents: Art. 106, 148 ISA  Client information: Art. 51 LIDA



# FMA

Financial product	SFDR requirement	Medium	SFDR require- ment	Medium	SFDR require- ment	Medium
<b>Old-age provision product (OAPP)</b>	Art. 6–9 SFDR	Requirement to provide information: Art. 57 PFA or in written form	Art. 10 SFDR	Website: FMP	Art. 11 SFDR	Written form
<b>PEPP</b>	Art. 6–9 SFDR	Art. 26 PEPP Regulation Basic Information Sheet	Art. 10 SFDR	FMP website	Art. 11 SFDR	PEPP performance information Art. 36 PEPP Regulation
<b>FI according to Annex I(C) MiFID</b>	Art. 6–9 SFDR	Requirement to educate/inform: Art. 16 AMA Art. 8c Banking Act	Art. 10 SFDR	FMP website	Art. 11 SFDR	Periodic reports: Art. 28 AMA Annual Report Art. 10 Banking Act

### 9.3 List of abbreviations

AIF	Alternative Investment Fund
AIFMD	Alternative Investment Fund Directive/Directive 2011/61/EU on Alternative Investment Fund Managers
CSRD	Corporate Sustainability Reporting Directive/Proposal of the European Commission for a Directive on Corporate Sustainability Reporting C (2021)189 final
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ESG	Environment, Social, Governance
ESMA	European Securities and Markets Authority
EEA	European Economic Area
FA	Financial advisor within the meaning of (EU) Regulation 2019/2088
FMA	Financial Market Authority Liechtenstein
FMP	Financial market participant within the meaning of Regulation (EU) 2019/2088
IBIP	Insurance-Based Investment Product
IDD	Insurance Distribution Directive/Directive (EU) 2016/97 on Insurance Distribution
IPCC	Intergovernmental Panel on Climate Change
MiFID	Markets in Financial Instruments Directive/Directive 2014/65/EU on Markets in Financial Instruments
NGFS	Network for Greening the Financial System
SR	Sustainability risk within the meaning of Regulation (EU) 2019/2088
PAI	Principal Adverse Impact/substantial adverse sustainability impact
PEPP	Pan-European Personal Pension Product within the meaning of Regulation (EU) 2019/1238 on a Pan-European Personal Pension Product
RTS	Regulatory Technical Standards
SFDR	Sustainable Finance Disclosure Regulation/Regulation (EU) 2019/2088 on Sustainability-Related Disclosure Requirements in the Financial Services Sector
TR	Taxonomy Regulation/Regulation (EU) 2020/852 on the Establishment of a Framework to Facilitate Sustainable Investments
UCITS	Undertaking for the Collective Investment in Transferable Securities