

INTEGRATING ESG EXPERTISE INTO OPERATIONS

TAKING ACTION:
INSTITUTIONAL INVESTORS PROGRESS ON THE PATH TO SUSTAINABILITY



BNP PARIBAS

The bank
for a changing
world



FOREWORD

AS environmental, social and governance (ESG) concerns grow within the global conscience, institutional investors are further enhancing how they include these issues in their business practices and the way they invest.

From its humble beginnings, rooted in corporate social responsibility and responsible investing, the concept of ESG investing and integration has developed into an approach which is considered by many to be essential. This article will consider the findings from the survey to examine how institutional investors include ESG in the way they operate and how they work with external partners in doing so.

The integration of these criteria is no longer a single task exercise, ESG has permeated several areas of an investment organisation and here we outline the ways in which this is taking place. In the last iteration of the study, BNP Paribas identified that ESG had reached a tipping point. The data collected was evidence that ESG integration has become integral to the investment industry and players could not turn their back on it as a concept or approach; there is no going back and inclusion of these factors in investment processes has become almost standard.

In addition, the research provides evidence that the way ESG is being approached is evolving. The majority of investors use ESG integration specifically in relation to ESG or sustainable investing. However, just over half include ESG in their investment and portfolio management processes. This indicates that although the integration of ESG has become more prevalent, it remains, to some extent, siloed and has yet to be proliferated throughout all levels and processes across an organisation.

THE MAJORITY OF
INVESTORS USE ESG
INTEGRATION SPECIFICALLY
IN RELATION TO ESG OR
SUSTAINABLE INVESTING

INTEGRATION OF ESG EXPERTISE INTO OPERATIONS



BACKGROUND

AS it slowly moves away from being kept in a single part of an organisation, ESG expertise and data is being woven into the fabric of institutional investors' organisations and is now becoming a core part of integral processes. Research is showing that ESG has evolved from a niche concept to a fundamental practice for institutional investors.

There is growing consensus across the investment community that ESG integration is not only critical to build a sustainable, future-proof portfolio, but can also help enhance returns which meet the needs and requirements of various stakeholders along the whole investment value chain. The BNP Paribas ESG Global Survey demonstrates the continued dominance of ESG integration. Although compared to the previous iteration of this study, the number of respondents who say they use ESG integration as an approach to ESG has dropped, it remains the primary way in which institutional investors employ these criteria within their organisations. The lower reported usage of ESG integration could be taken to mean the approach is becoming integral to investors' business practice and part of their daily operations.

In 2021, 75% of investors said integration was their approach of choice. This year, 70% of investors say this is an approach they employ within their organisation. Further asserting the persistent influence of ESG integration is the significant gap between the number of investors using integration and those making use of negative screening, which is the second-most dominant approach across the sample.

70%
OF INVESTORS SAY
INTEGRATION IS AN
APPROACH THEY
EMPLOY WITHIN THEIR
ORGANISATION

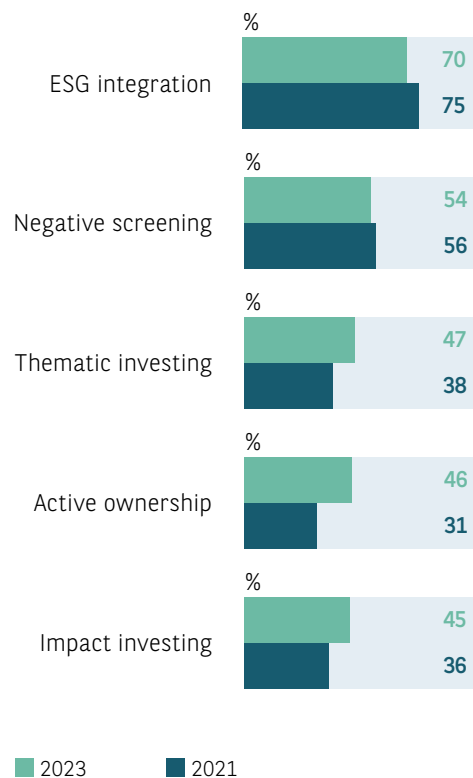


ESG integration has become a must for investors as several factors have encouraged greater inclusion of this approach. Interestingly, the prevalence of ESG integration as an area of focus is expected to dip in the coming two years. As this approach becomes integral to investors' organisations and grows as part of normal business practice, other, more niche approaches to ESG considerations, such as impact investing, will take precedence.

In fact, previous chapters on this year's surveys ([chapter 1](#), [chapter 2](#)) have shown that as investors focus on more specific ESG goals, such as net zero, investors are planning to prioritise particular ESG approaches such as impact investing and active ownership, which aim to make a positive change. This does not necessarily mean ESG integration is no longer important, but rather that the overall approach is evolving.

ESG INTEGRATION CONTINUES TO REIGN SUPREME

Which of the following ESG approaches/strategies do you employ within your organisation?



% Multiple answers allowed

The study delved deeper into the way organisations are integrating ESG within their operations, examining the different areas in which these principles are being applied and the extent to which ESG is being incorporated. Overall, half of investors apply ESG criteria to the way they make investment decisions and 42% do so within their risk management processes. Over a third (37%) integrate ESG criteria when monitoring compliance rules related to this approach.

“Institutional investors are increasingly aware of the importance of choice when selecting external partners, with transparency of methodology being the most critical factor for 48% of investors. Brand reputation on ESG and providing leading ESG skills and expertise are also important elements for 41% and 37% of investors, respectively. The implementation of ESG into their strategies is not a transformation but an expansion of their businesses, and investors are looking for partners who can help them navigate this new landscape with transparency, expertise and shared values,” said Sophie Devillers, Head of Sustainable Finance, Securities Services BNP Paribas.



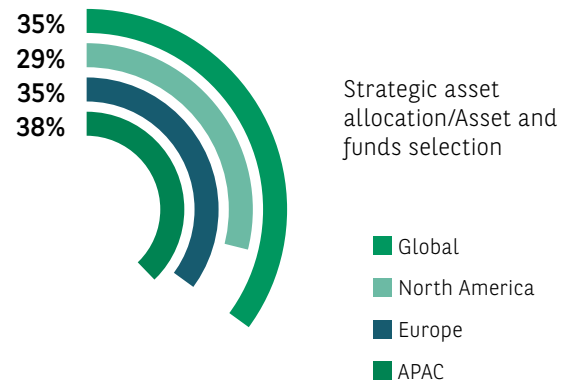
The implementation of ESG into strategies is not a transformation but an expansion of their businesses, and investors are looking for partners who can help them navigate this new landscape with transparency, expertise and shared values.

Sophie Devillers, Head of Sustainable Finance,
Securities Services BNP Paribas

HALF OF INVESTORS APPLY ESG CRITERIA TO THE WAY THEY MAKE INVESTMENT DECISIONS

ESG INTEGRATION INTO INVESTMENT-RELATED OPERATIONS

Has your organisation integrated ESG expertise and data into any of the following investment-related operations? Select all that apply



For investors, assessing an external organisation's ESG investing skills, beliefs and capabilities is very important when deciding which external partners they want to work with. "Before appointing a manager, the manager selection and monitoring team does a deep dive into the ESG activities of the asset manager. We want to be sure that ESG thinking and responsible investing is really integrated in all their processes," said an executive board member and chairman of the investment committee of a Dutch pension fund. This alignment is then closely monitored to ensure the manager's approach remains consistent and on target.

Regulatory developments are also supporting the integration of ESG, with European regulators spearheading these efforts, starting with its action plan on sustainable finance published in 2018. While regulators have progressed significantly in their approach to ESG, these developments, however, can be seen to have been slow to filter through to the investment community given European investors display the lowest levels of integration in their risk and compliance functions.

Regulators in other regions have followed suit and introduced a number of guidelines and rules related to ESG and sustainability.

**FOR INVESTORS,
ASSESSING AN EXTERNAL
ORGANISATION'S ESG
INVESTING SKILLS, BELIEFS
AND CAPABILITIES IS VERY
IMPORTANT WHEN DECIDING
WHICH EXTERNAL PARTNERS
THEY WANT TO WORK WITH**

DRIVING DECISIONS

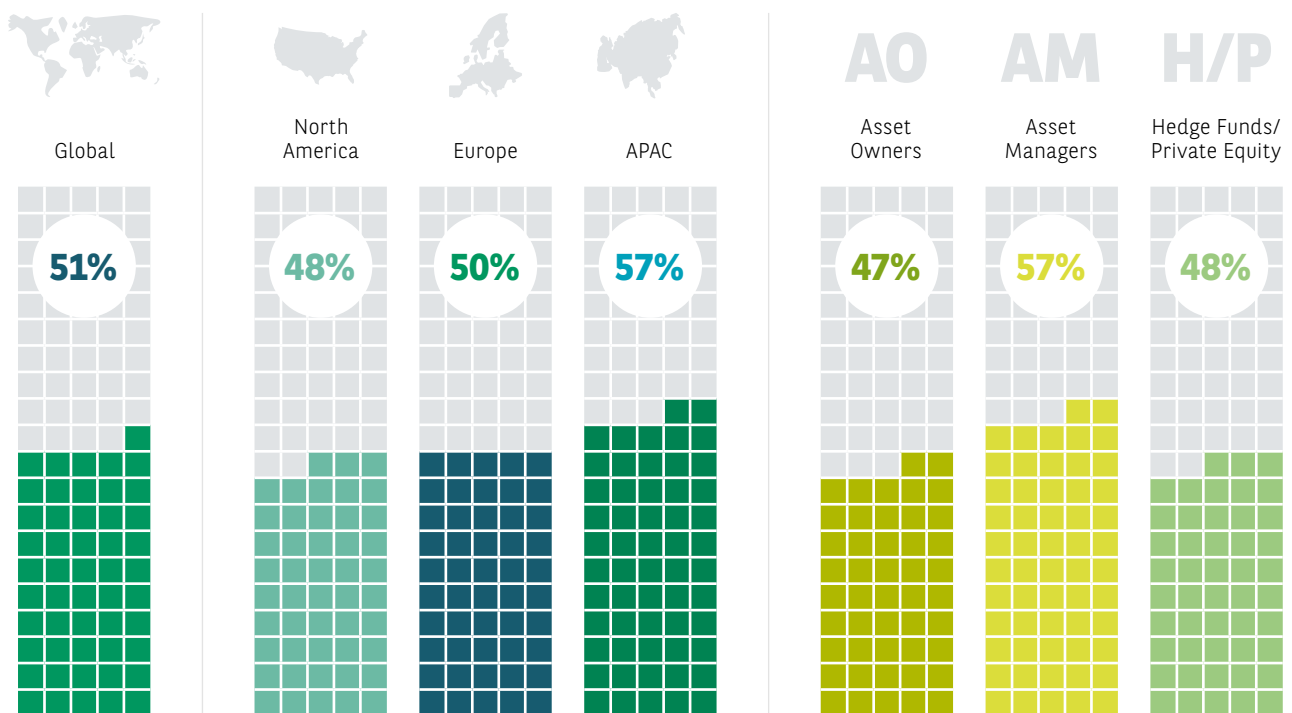


PORTFOLIO MANAGEMENT INTEGRATION

AS seen in the findings displayed above, portfolio management and investment decisions are the primary area in which investors integrate ESG. More than half (51%) of asset managers and asset owners say ESG expertise and data is now integrated into portfolio management and investment decisions. A greater number of asset managers integrate ESG expertise and data in this area (57%) while the practice is less prevalent among asset owners (47%).

APAC AND ASSET MANAGERS LEAD IN PORTFOLIO MANAGEMENT INTEGRATION

Has your organisation integrated ESG expertise and data into portfolio management/investment decisions?



The onus on asset managers to demonstrate their efforts in sustainability is considerable as their clients' demands in this regard continue to become ever more pressing. Therefore, it seems sensible that this group leads on integrating ESG in their investment decisions.

Considering the data on a regional basis, a lower percentage of investors in North America say they integrate ESG in their decision-making. Of greater note is the higher percentage of investors in the APAC region integrating ESG into their investment decisions (57%). Though Europe is often lauded to lead on ESG, this data suggests investors in APAC are keen to apply these principles to their investment process and are putting their sentiment into action.

With roots in socially responsible investing, several factors and industry developments have been driving greater integration of ESG principles in the way institutional investors make decisions. "Now we integrate ESG risk factors in that [investment decision-making] process, because it is very important to combine and monitor these factors for us as an insurance company," commented the CIO of an asset owner in the APAC region.



Our ESG group looks at all the holdings, public, private, real estate or equities and has access to all the usual ESG databases and characterises our assets according to various ESG metrics. That is used as a risk management type of function for the portfolio managers.

An investment director of a Canadian SWF

However, for some investors ESG is still not a decisive measure. The investment manager of a public pension fund in Australia, explained that his organisation has not yet made specific investment decisions because of ESG analysis. Rather, the ESG dimension is used to gain a broad picture of the investment and a better understanding of how it operates. "For us to make an investment decision, we want to know that there's a fair degree of reliability behind the data and the methodology. We have developed some internal models, we've used some external models. They're probably not perfect. It's hard to make investment decisions when you're dealing with imperfect information," the investment manager explained.

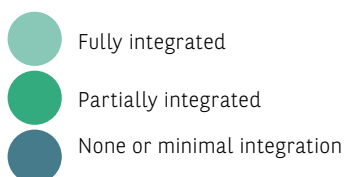
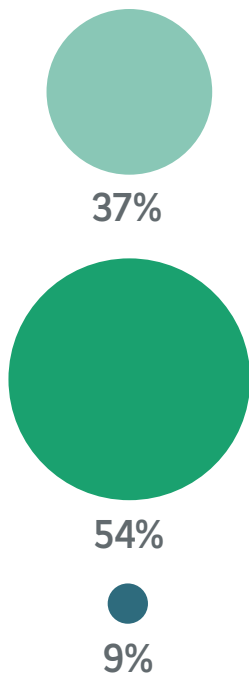
For some, including ESG in investment decisions acts as a form of risk management. The investment director of a USD 100 billion Canadian SWF explains: "Our ESG group looks at all the holdings, public, private, real estate or equities and has access to all the usual ESG databases and characterises our assets according to various ESG metrics. That is used as a risk management type of function for the portfolio managers". So, in this case, it's the risk profile of an investment which is steering the need for an ESG dimension, rather than the portfolio managers asking for an ESG-type investment.

In fact, the survey data shows that the practice of including ESG considerations when choosing investments is very closely linked to risk management among all investors, particularly in APAC and North America.

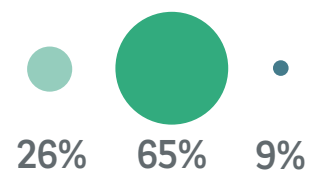
EUROPE AND APAC DRIVING FULL INTEGRATION

How would you rate ESG integration in portfolio management and investment decisions?

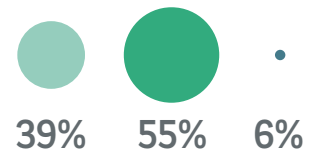
Global



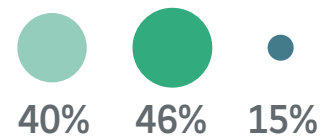
North America



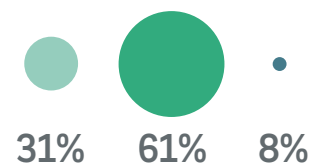
Europe



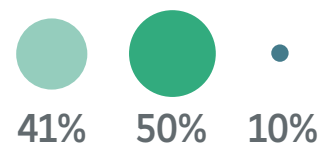
APAC



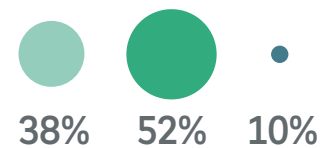
Asset Owner



Asset Manager



Hedge fund/Private equity



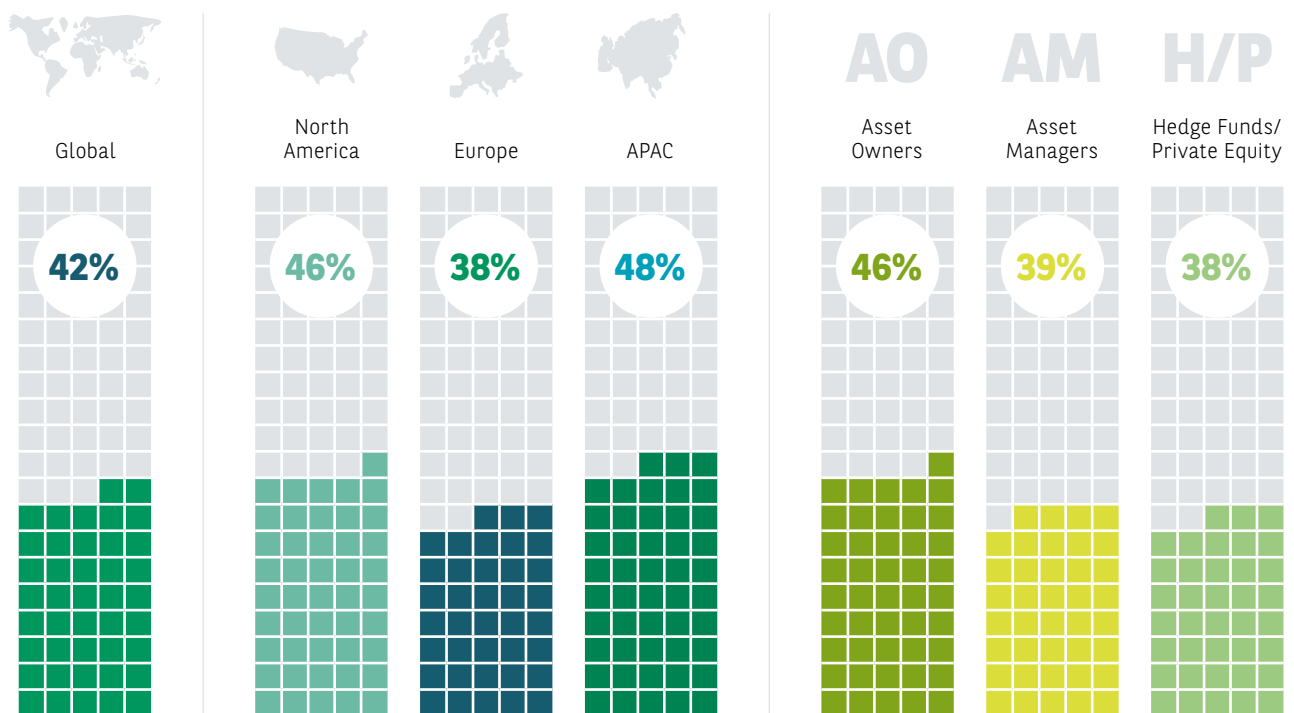
Multiple answers allowed

MULTI-FACETED RISK MANAGEMENT

SOUND investment decisions are based on information, and institutional investors are always thirsty for more sources of information that can better support their decisions. ESG criteria provide investors with an additional dimension to consider when selecting investments. By integrating ESG into their risk management, investors can take a multifaceted approach to assessing and mitigating risk.

ESG EXPERTISE AND DATA APPLICATION WITHIN RISK MANAGEMENT AND MONITORING

Has your organisation integrated ESG expertise and data into risk management and monitoring?



Across all investor types, 42% include ESG expertise and data in the way they manage risk, a practice which is more prevalent among asset owners. This group is more often called upon to defend their investment decisions and choices by various stakeholders and therefore, ensuring all risk is being accounted for is crucial to the way they carry out their duties.

The senior manager of sustainability at an impact investor gave a detailed account of the way these risks are handled within their organisation: “We make very strict choices, and we have a whole set of lists with inclusion criteria. The combination of that gives an indication what the risks are.” She explained that if a company is only operating in the Netherlands, this investor would not expect a high risk of human and labour rights violations. But if the company is operating in other emerging regions as well, the organisation would expect the company to have mitigating policies to make sure human and labour rights are not violated.

Sustainability challenges can also translate into financial risks, which makes the integration of ESG in risk management processes even more vital. The chief sustainability officer at a Dutch asset manager stressed that the financial analysis of a company or sector needs to sit alongside the sustainability and ESG risks as well.

In the case of risk management and monitoring, European investors lag their North American and APAC counterparts, as a smaller percentage (38%) say they apply ESG within this part of their process. Despite this, more of those in Europe who have included ESG in their risk management process have done so to the full extent. Within this group, 43% have fully integrated ESG into their risk management process, compared to 20% in North America and 21% in the APAC region.



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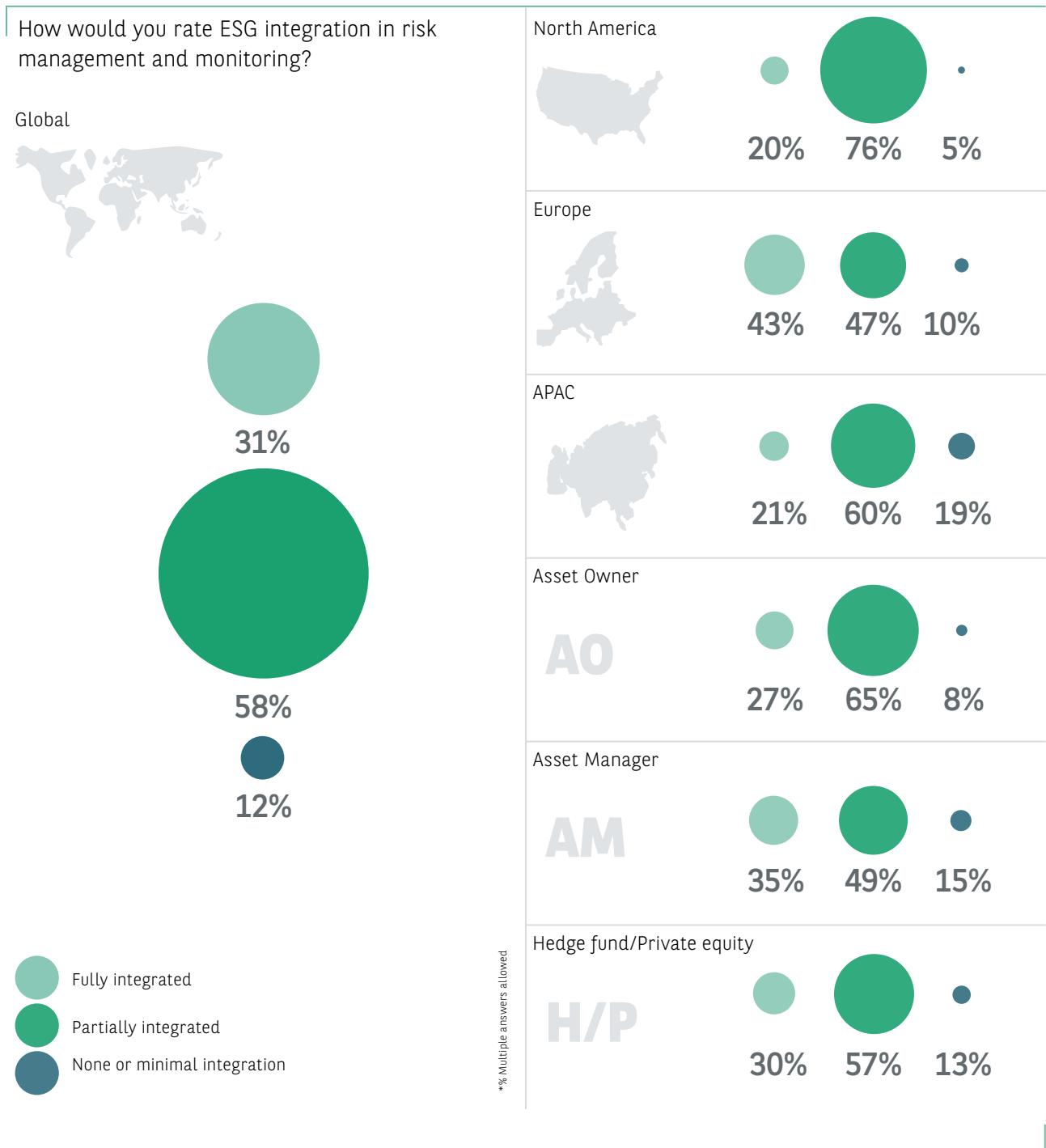
A senior manager of sustainability at an
impact investor

Investors consider issues such as the physical risk of a particular industry, both in terms of its existing sustainability profile and the transition risk involved. The data and analysis in this regard then informs the investors' risk management process. Compared to integration of ESG expertise and data in portfolio management, a slightly lower percentage of investors (31%) say ESG expertise and data is fully integrated into their risk management and monitoring processes.

This practice is more prevalent among asset managers where 35% fully integrate ESG expertise and data into the way they manage risk. Although issues around the ESG data challenges have been well documented, managers are refining the way they collect, evaluate and assimilate this data, in order to provide a more holistic understanding of the ESG risk investments represent.

**INVESTORS CONSIDER ISSUES
SUCH AS THE PHYSICAL RISK
OF A PARTICULAR INDUSTRY,
BOTH IN TERMS OF ITS
EXISTING SUSTAINABILITY
PROFILE AND THE TRANSITION
RISK INVOLVED**

DEPTH OF INTEGRATION



CLOSE SCRUTINY



MONITORING ESG COMPLIANCE RULES

THE FOCUS on risk is also motivated by regulatory changes which have ramped up investor accountability and responsibility for the sustainability profile of their investments. As a result, investors now need to monitor compliance with ESG rules and regulations themselves, or with the help of an external partner, including banking partners.

As an example of this, the European Banking Authority (EBA) has published a report on how to incorporate ESG risks in the supervision of investment firms¹ which stated: “Acknowledging the current limitations related to data and methodologies in the assessment of ESG risks, the EBA recommends that the integration of ESG aspects in the supervisory process could follow a gradual approach, prioritising the recognition of ESG risks in investment firms’ strategies, governance arrangements and internal processes, and later incorporating them in the assessments of risks to capital and liquidity”.

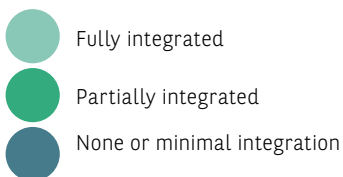
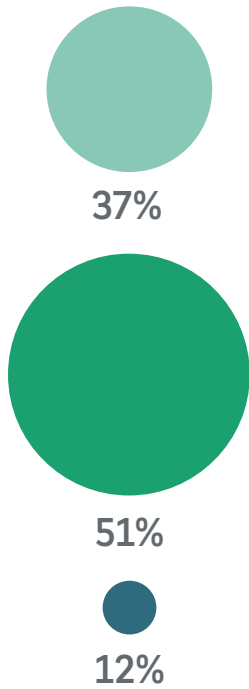
INVESTORS NOW NEED TO
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THEMSELVES, OR WITH
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PARTNER, INCLUDING
BANKING PARTNERS

¹ <https://www.eba.europa.eu/eba-publishes-report-integration-esg-risks-supervision-investment-firms>

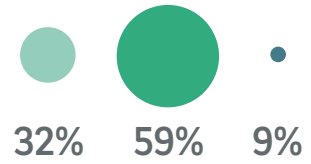
MONITORING ESG COMPLIANCE RULES, INCLUDING INTERNAL GUIDELINES

How would you rate ESG integration in monitoring ESG compliance rules, including internal guidelines?

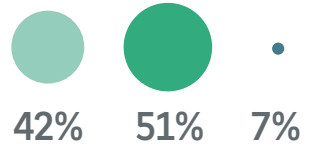
Global



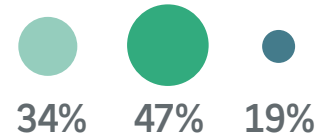
North America



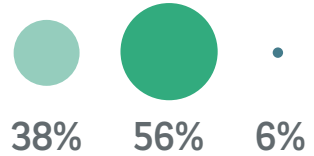
Europe



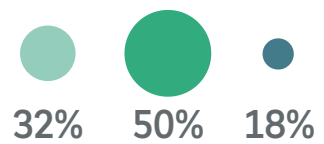
APAC



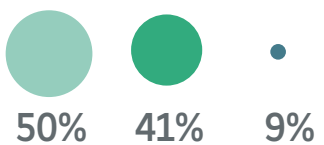
Asset Owner



Asset Manager



Hedge fund/Private equity



*% Multiple answers allowed

As shown in the chart, most investors have either fully or partially integrated ESG expertise and data into monitoring ESG compliance rules, including internal guidelines. Regionally, European investors, as with risk management integration, demonstrated the most in-depth inclusion of ESG criteria in this regard, as 42% say they have implemented full integration here. This is due to the regulatory landscape in Europe, where the European Union has introduced a wide range of regulations around ESG and sustainable finance in recent times, including the Sustainable Finance Disclosure Regulation (SFDR) for example, with more in the process of being implemented. In a similar vein, several countries in APAC have launched or proposed new legislation or guidance related to ESG and the data shows this matter is therefore front of mind for these investors.

By organisation type, hedge funds and private equity investors are those who have adopted the deepest level of integration of ESG expertise and data into the compliance function, as according to this year's survey data 50% have done so. These organisations have been under regulators' scrutiny of late, as new legislation has been either introduced or recommended to ensure this part of the investment industry keeps pace with the broader asset management world on ESG and sustainability matters. In the EU for example, the Action Plan on Sustainable Finance has been credited with bringing hedge funds and private equity to the ESG table. Prior to this shift, private equity and venture capital funds could choose whether to adopt responsible investment policies. The US Securities and Exchange Commission has also proposed rules to drive enhanced ESG disclosure among private funds.²

This year's research also shows that investors are either using, or considering, an external banking partner or provider to assist in various tasks related to ESG compliance and reporting. For example, 24% of investors globally are using, or would consider using, a banking partner for independent monitoring of their ESG investment guidelines (see chart next page). And 22% are using, or would considering using, a banking partner to fill and shape regulatory ESG reporting (regionally, this varies from 12% for North America to 26% for APAC). In addition, to fill and shape voluntary ESG reporting for either internal or external purposes, 15% of investors are using, or would consider using, a banking partner. It seems likely that these numbers will increase, as investors are faced with an increasing workload in ensuring that they comply with, and report on, regulatory requirements on sustainability and other ESG criteria. In support of this view, ESG expertise and data is only partially integrated into regulatory reporting at 42% of investors (fully integrated at 47% of investors), and it is only partially integrated into voluntary external reporting of ESG ambitions and performance at 49% (fully integrated at 40% of investors). And even if investors have fully integrated ESG expertise into different tasks around compliance and reporting, they may still benefit from using an external banking partner, given that the partner will have extensive experience in these areas gained from working with many other investment organisations.

² <https://www.sec.gov/files/ia-6034-fact-sheet.pdf>



EXTERNAL EXPERTS FOR EXECUTION

GIVEN their substantial influence on global markets, institutional investors are at the forefront of the ESG movement. Their fiduciary duties towards their stakeholders, together with their internal policies related to ESG principles, drive their need for specialist expertise in this regard. As they continue to recognise the multi-faceted nature of ESG, these investors understand that collaborating with external partners is not only beneficial but often essential to successfully embedding ESG principles across their organisation.

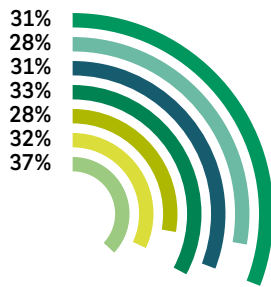
External partners can offer diverse expertise, data, analytics and research capabilities which can enhance the way institutional investors navigate the ESG landscape, allowing them to make more informed decisions and align their strategies with their broader goals. “The policy behind our approach to ESG, in terms of what we’re trying to achieve, is entirely developed internally. The execution of that policy relies on external partners,” said the investment manager of an Australian public pension fund. This particular fund mostly works with asset managers, but also collaborates with research houses and other external partners.

It is important to remember that investors could work with external partners on a wide range of areas related to ESG investing, from obtaining and using ESG data, fulfilling their stewardship responsibilities, reporting on compliance with ESG regulations or guidelines, portfolio management, or areas such as structured products or banking services when they have a link to ESG matters. Given this breadth of areas where ESG expertise may be needed, an external banking partner or provider could be a valuable ally for investors as they will cover most, if not all, of these areas through providing banking and other services to investment organisations.

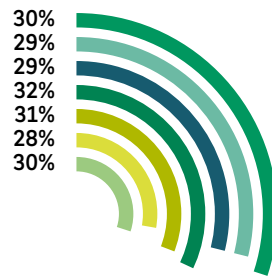
EXTERNAL PARTNERS CAN
OFFER DIVERSE EXPERTISE,
DATA, ANALYTICS AND
RESEARCH CAPABILITIES
WHICH CAN ENHANCE
THE WAY INSTITUTIONAL
INVESTORS NAVIGATE
THE ESG LANDSCAPE

WORKING WITH A BANKING PARTNER/PROVIDER

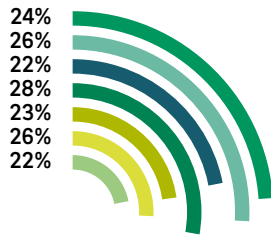
For which of the following areas is your organisation using, or would consider using, a banking/partner provider?



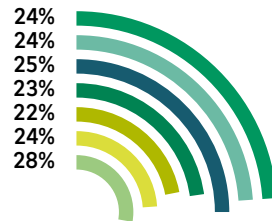
Structured ESG products



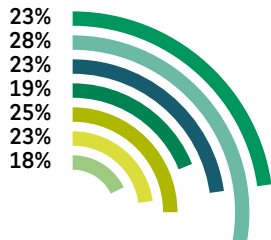
Facilitate your access to raw ESG data



Independent monitoring of your ESG investment guidelines



Data Management services to integrate, process, clean, aggregate ESG data



Risk-manage portfolios with market benchmarks

- Global
- North America
- Europe
- APAC
- Asset Owner
- Asset Manager
- Hedge Fund/Private Equity

% Multiple answers allowed

One of the areas where investors seek support from banking partners is in relation to structured ESG products (31%). Although many of these investors now integrate ESG into the way they invest, their forte does not necessarily lie in building products or funds which fully incorporate these criteria, or they may need the specialist skills or resources possessed by a banking partner. Investors in APAC are keenest to reach out to banking partners for support to build structured ESG products (33%). They are also more apt to do so across the other top three areas identified as requiring external banking expertise.

It is also noticeable that hedge funds and private equity firms stand out as using, or to consider using, a banking partner for structured ESG products (37%), and for data management services to integrate, process, clean and aggregate ESG data (28%). On the former, hedge funds and private equity firms may require a banking partner which can help by acting as a counterparty or by providing other specific services related to structured products. On the latter, for hedge funds and private equity firms, ESG data management services may have been a non-core activity until recently, but one where a banking partner can help them with support and solutions.

ESG data remains a bone of contention among investors as many continue to lament inconsistency and a lack of transparency. Therefore, it follows that they are eager to hunt for banking partners who can help in gaining clarity here. Three in 10 (30%) say they would like external parties to facilitate access to raw ESG data and 24% give data management services for ESG data as an area to make use of a banking partner. The global sustainability & ESG investment specialist at a corporate pension fund in the US details their experience of working with their custodian: "The data is clean. They have a specialist ESG branch which is really good. They also have a lot of educational material, aside from just being a good custodian. If you see data is mismatching, it's an easy fix, as long as you have someone with the service that can understand and identify it."

Other areas where investors are, or would consider, using a banking partner include independent monitoring of ESG investment guidelines (24%), risk managing portfolios with market benchmarks (23%) and filling and shaping regulatory reports (22%). This shows the range of services where investors might work with a banking partner.

A CAREFUL CHOICE

WHEN choosing partners to work with, institutional investors value transparency of data methodology (48%), brand reputation on ESG (41%) and providing leading ESG skills and expertise (37%). In addition, shared ESG values (28%) and allowing cost synergies (26%) are also part of the criteria used. In North America, data transparency is emphasised a lot more, as here 60% say this is critical to their selection of external partners.

Given the slightly unstable perspective on ESG as a whole across North America, this suggests investors, who believe in these principles, are looking to make sure their efforts are beyond reproach and the partners supporting them can provide strong evidence which can validate their processes.

In APAC, on the other hand, brand has more sway (46%). This could be driven by the notion that investors here are at an early point of their ESG journey and therefore are more likely to seek out well-established, trusted brands to help them navigate through these foundational milestones. Asset managers also value brand more highly as 47% say this is critical to their selection of partners.

An Australian portfolio manager outlines the criteria considered when choosing external partners to work with: "Number one is philosophical alignment. Number two would be breadth of coverage. Three would be the internal resources available to that organisation". The manager added that cost plays a role as well, however it has not emerged as the lynchpin of these decisions.

Investors also identified that they need their partners to provide leading ESG skills and expertise (37%). The global sustainability & ESG investment specialist at the US corporate pension

fund quoted earlier discussed the challenges in making these selections: "Everyone is really going for more subject matter expertise, or resourcing. Because many companies are now selling some type of ESG service." As a result, investors are looking for those experts who can differentiate themselves and not offer the same service their competitors are providing.

"We want [an external partner who is] a little bit higher up on the curve and provides better reporting, better risk management and a better view of ESG", said the investment director of a Canadian SWF. "It helps the investment decision process", he added. However, the director notes that it's acceptable for an external manager to have a slightly lower score on the ESG rankings, if its risk-adjusted return profile is very solid.

Selecting external partners is a delicate process which needs to be executed carefully. A senior investment manager at an APAC asset owner went through the way their organisation handles this: "Firstly, we will evaluate and analyse a report provided by the counterparty. We will use them for a trial period, if they provide a model, and check it with our investments. Over a period of time, we will get to know the counterparty better. We will choose to work with them if the tools, data and reports they provide are suited to the way we invest. But if they cannot provide useful tools and information, then we will not want to work with them."

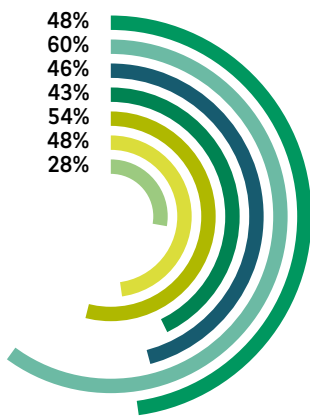


Everyone is really going for more subject matter expertise, or resourcing. Because many companies are now selling some type of ESG service.

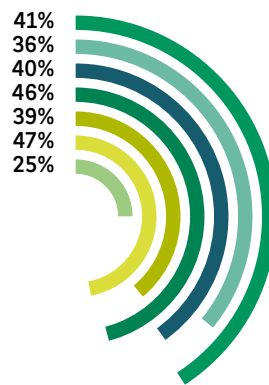
A global sustainability & ESG investment specialist at the US corporate pension fund

INVESTORS' CRITERIA WHEN SELECTING A PARTNER FOR ESG-RELATED OPERATIONS

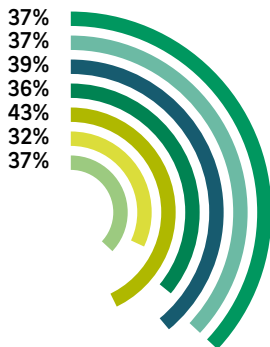
Which of the following criteria is most important to you when selecting an external partner for ESG-related operations?



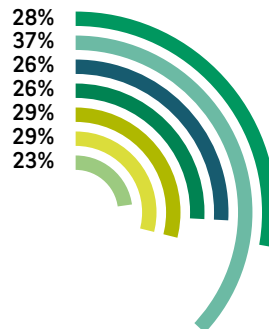
Transparency of data methodology



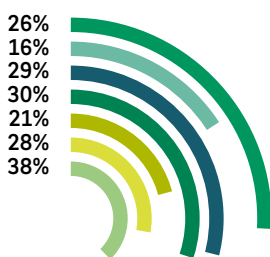
Brand reputation on ESG



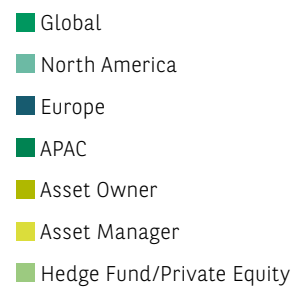
Providing leading ESG skills/expertise



Shared ESG values



Allowing costs synergies



% Multiple answers allowed

CONCLUSION



THE adoption of ESG and sustainability principles within institutional investor organisations has evolved into a fundamental pillar of their modus operandi for many. The data collected in this study shows this approach is now permeating various parts of investors' processes and is being embedded in the way these organisations function at their core.

We can also see progression and evolution happening through the research findings. For instance, ESG integration is widely used as an approach or strategy when practicing ESG or sustainable investing by 70% of investors.

"Cultivating a more sustainable financial landscape requires a shift in mindset", said Sophie Devillers of BNP Paribas. "Currently 70% of investors embrace ESG integration, seeking to harmonise their investments with their values. However, the real transformation lies in our commitment, as an industry, to embedding ESG expertise in every facet of our investment strategies. By fostering a culture of sustainability that transcends traditional boundaries, we can make lasting change, where ESG expertise becomes an inherent part of our investment DNA, catalysing a brighter, more responsible future for all."

For investors, another important aspect of improving the use of ESG and sustainability expertise is through relationships with external organisations, such as asset managers or other partners and providers. Here, investors say that they wish to work with partners with strong ESG capabilities alongside other attributes which they value and prioritise. In this area, it is important to note that when investors assess potential partners and providers on their ESG and sustainability capabilities, they also look at whether the external organisations operate in line with their professed beliefs and attitudes towards ESG and sustainability. Investors want to feel that they are aligned with their external partners. This is likely to bring a closer relationship based on shared values and a mutual understanding of how they approach sustainable investing. Ultimately, this collaboration enriches their ESG journey and ensures they are set on the right path to foster an ecosystem which supports them in meeting their investment and sustainability goals.



The real transformation lies in our commitment, as an industry, to embedding ESG expertise in every facet of our investment strategies. By fostering a culture of sustainability that transcends traditional boundaries, we can make lasting change, where ESG expertise becomes an inherent part of our investment DNA, catalysing a brighter, more responsible future for all.

Sophie Devillers, BNP Paribas



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