

Just in Time

SFDR

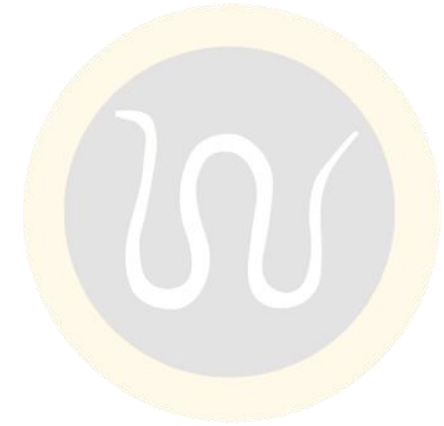
*The European SFDR Regulation on ESG Disclosure
in Finance*

Jun 2021

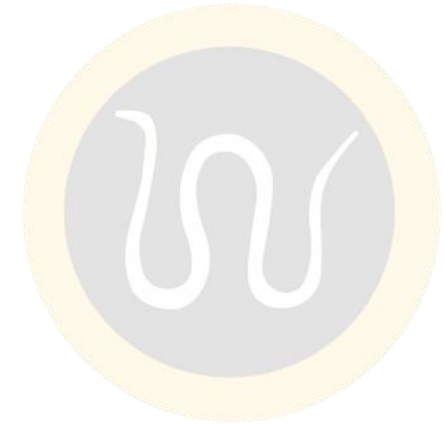
Executive Summary

The regulation on disclosure of ESG characteristics of financial investments, addressed to asset managers, product firms and financial advisors, is evidence of the European Authorities' efforts to formalize technical standards into a universe of relatively new products. As a matter of fact, in this framework standards and indicators are yet to be involved in the long run process of assimilating conventional financial data, therefore challenges in data management will have to be faced in the implementation of the regulation.

This work aims to summarize the objectives, salient features and open points of the legislation and to explain the related problems.



At a Glance



01 Focus on SFDR Regulation 4

02 Operational Aspects 10

01

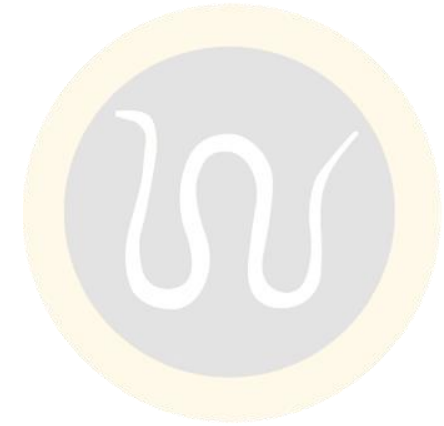
Focus on SFDR Regulation

Purposes of the Regulations and Recipients

SFDR Articles

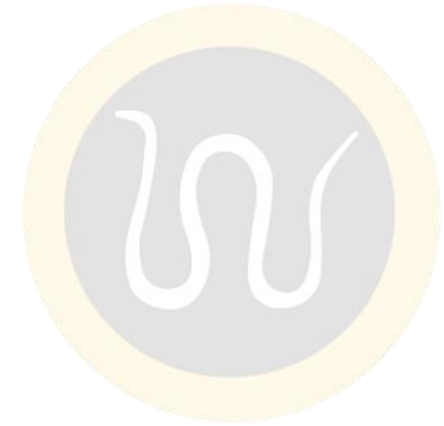
Focus on the Main Articles

The Timeline



Focus on SFDR Regulation

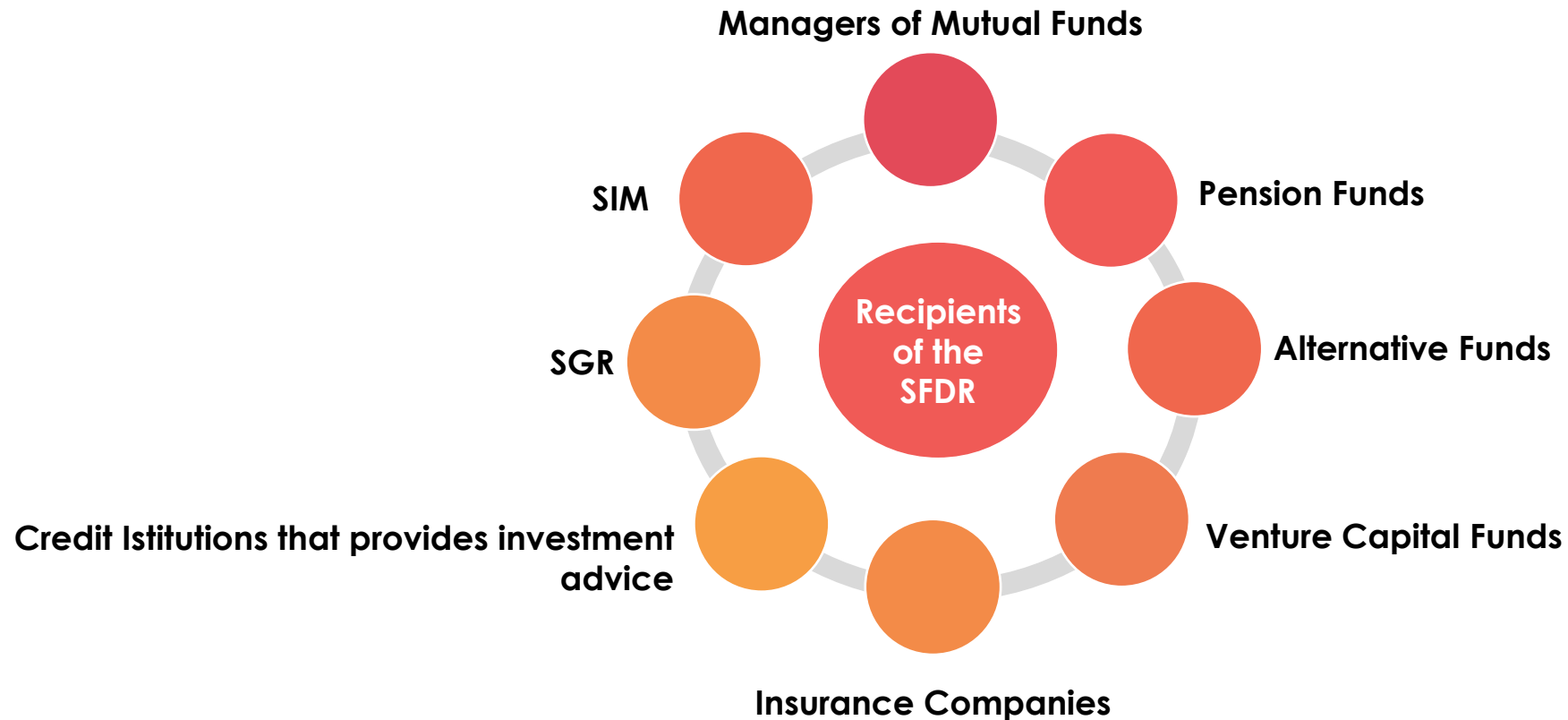
- The Sustainable Financial Investments Disclosure Regulation (SFDR) entered into force on **10th March 2021**.
- The attempt of the **European Regulation 2019/2088 (SFDR)** is to bring order within the sector of sustainable investments on ESG universe (Environment, Social, Governance), which had yet to become subject to a reference regulatory framework.
- This has led to the **risk of green washing**, *i.e.*, the proposal of facade operations, in terms of new products and in fundraising by financial operators, which had the only purpose of making products without any real sustainability feature attractive to the investor.
- The SFDR Regulation is **accompanied by** the Regulation 2020/852 (**Taxonomy Regulation**), which even more should bring some order in the context of data, classification and rating rules. This regulation is coming into effect in **January 2022** and aims to develop free public platforms for analyses and exchanges of data in the ESG universe.
- This section provides an overview on:
 - Purposes of the regulations and recipients;
 - Description of the body of the regulation.



Focus on SFDR Regulation 1/5

Purposes of the Regulations and Recipients 1/2

The SFDR is a set of EU rules which aim to make the sustainability profile of funds more comparable and better understood by end-investors. In particular, the regulation focuses on pre-defined metrics for assessing the **environmental, social and governance (ESG)** outcomes of the investment process. Therefore, the emphasis is placed on disclosure, including new rules that must identify any harmful impact made by the investee companies.



Focus on SFDR Regulation 2/5

Purposes of the Regulations and Recipients 2/2

The general purpose of the legislation is to **direct investments towards** products that guarantee **sustainable growth**, avoiding the risks of green washing, that is, false make-up in communications to customers. The greatest challenge was declining these elements into the following comparable add-ons:




Sustainability Risk

Consider sustainability risks in **investment decisions**



Principal Adverse Impact

Measure the adverse impacts (**PAI** = principal adverse impact) for the purpose of sustainability of investment decisions



Disclosure

Detailed disclosure obligations for **products** to be qualified with significant **ESG characteristics**



Market participants must disclose if they do not take these principles into consideration.

In this case, the products issued can **NO** longer be recommended to customers due to the provisions of **MIFID II**, effectively limiting the distribution channel of these products.

Focus on SFDR Regulation 3/5

SFDR Articles

The SFDR Regulation consists of **19 articles**, covering the **disclosure entity level** (at market participant or consultant level) and the **product level** (at market participant level). The articles can be classified into 5 key areas of intervention:



All the new measures are in response to the historic signing during 2015 of the **Paris Agreement** and the **United Nations 2030 Agenda for Sustainable Development**, which created the **Sustainable Development Goals**. The SFDR and other regulations are also **aligned with the European Green Deal**, which aims to make the EU carbon neutral by 2050.

Focus on SFDR Regulation 4/5

Focus on the Main Articles

Transparency of adverse sustainability impacts

Art. 4

It requires market operators and financial advisors to specify how **negative effects** on sustainability factors are considered in **investment decisions**. If the main negative impacts of investment decisions on sustainability factors are considered, a statement on liability policies must be published, in relation to their consequences, taking into account their size and nature. If, on the other hand, they are not considered in the investment decisions, it is necessary to clearly state the reasons why they are not.

Art. 6

Financial market participants shall include in pre-contractual disclosures the descriptions of the results obtained assessing the possible impacts of sustainability risks on the returns of the financial products. Article 6 covers **funds which do not integrate any kind of sustainability** into the investment process and could include **stocks currently excluded by ESG funds**, such as tobacco companies or thermal coal producers.

Art. 7

It provides further guidelines on the details that must be provided in the product information, for those who apply Article 4 in the positive way: a clear and reasoned explanation shall be provided on how a financial product considers **principal adverse impacts on sustainability factors**.

Art. 8-9

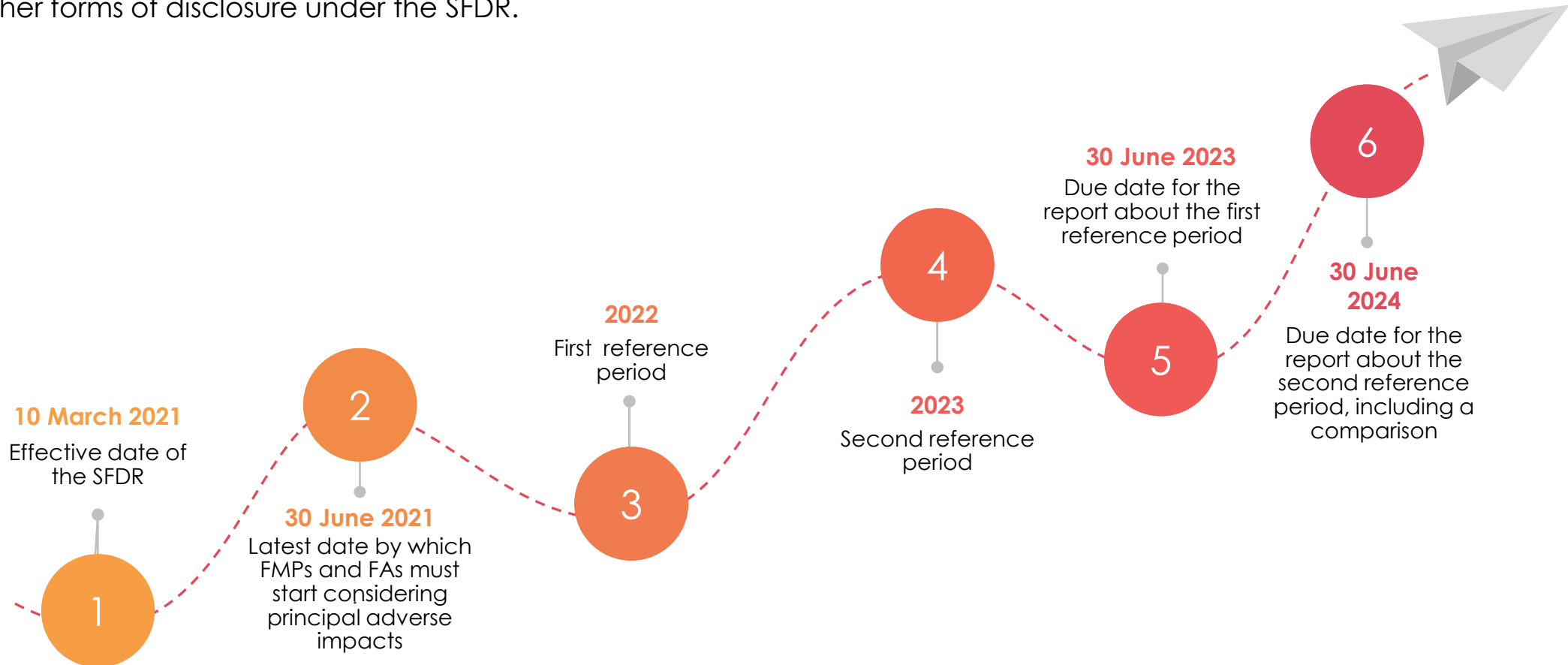
Article 8 refers to the **promotion of E or S characteristics** in the pre-contractual information, specifically, to how they are met. Article 9 concerns **transparency of sustainable investments** in pre-contractual disclosures. It covers a subset of the instruments eligible for art. 8, with more stringent constraints. The feature for art.8 products of "promoting" the ESG principles takes into consideration the materiality and quality of investments, while art.9 products are driven by specific sustainability objectives.

ESG Products

Focus on SFDR Regulation 5/5

The Timeline

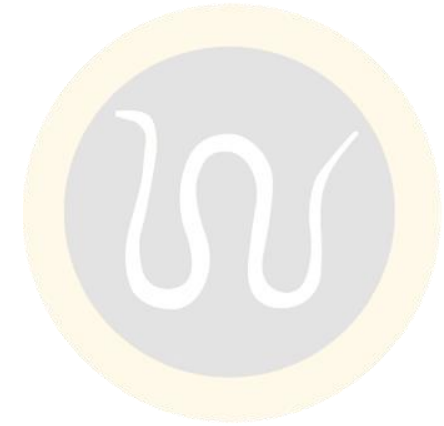
The SFDR entered into force on 10th March 2021, but its effects are going to be noticeable depending on other relevant dates, such as 30th June 2024; within such date FMP and FA must report their entity-level performance on various ESG indicators and make a comparison between the first and second reporting periods, through the Declaration on adverse sustainability impacts and other forms of disclosure under the SFDR.



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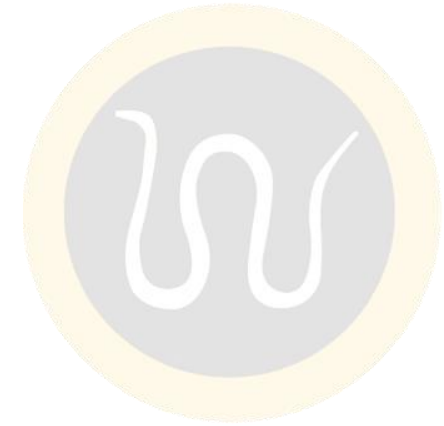
Operational Aspects

Sustainability Adverse Impact Indicators (PAI) Entity Level



Operational Aspects

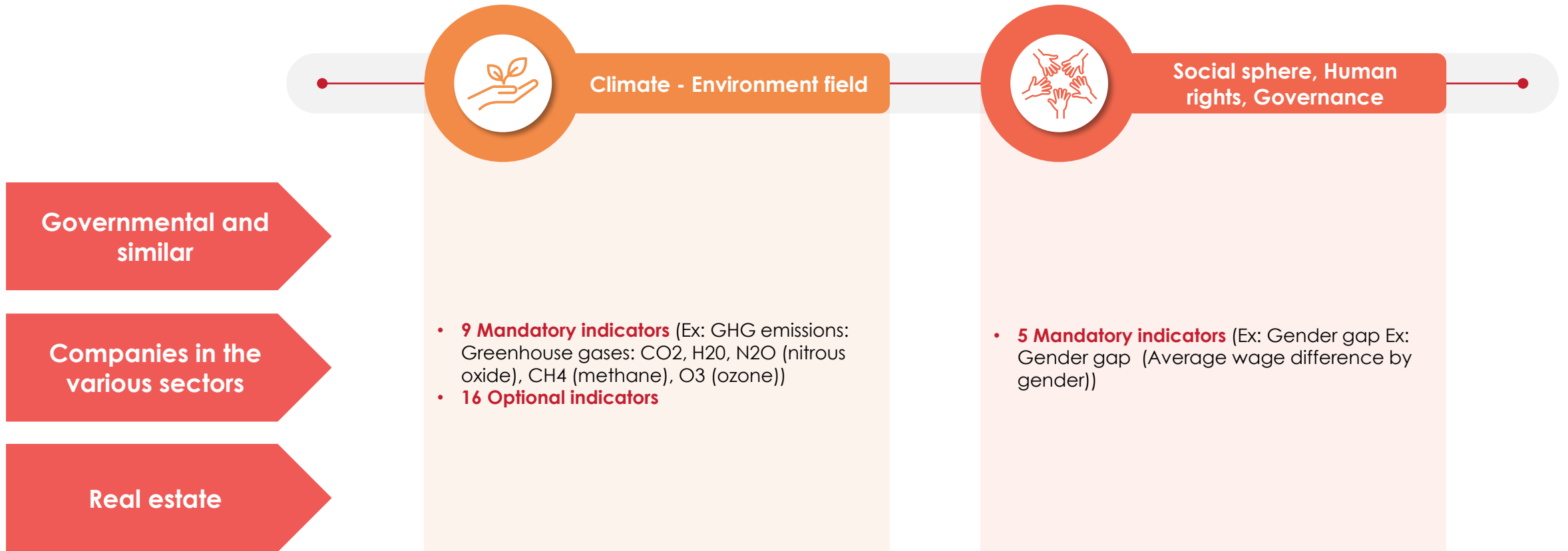
- The new regulation constitutes a first step in the discipline of ESG investments, as it represents the regulatory framework that must be completed with the approval of the so-called **Regulatory Technical Standards (RTS)**.
- On February 4th, the European Supervisory Authorities - EBA, EIOPA and ESMA - presented a **final draft report on RTS** which, it is expected, will come into force **from January 2022**. However, with a subsequent intervention, the same authorities have emphasized that the deadline could be **postponed if the RTS are not finalized by 30th June of 2021**.
- Considering these timelines and a possible postponed of final RTS, the European Commission has stressed that the **application of the Regulation is not subject** to the formal adoption and **to the entry in force of the RTS**. In the meanwhile, the **final draft may constitute a useful guide to interpret the legislation**, since the general principles of the information related to sustainability have already been established at the first level - therefore in the SFDR.
- **The normative body is now completed**. Further information is provided in this section (ref. Sustainability Adverse Impact Indicators (PAI) Entity Level)



Operational Aspect

Sustainability Adverse Impact Indicators (PAI) Entity Level

The final text of the RTS provides a short list of **mandatory indicators** and a broader list of **optional indicators**. The indicators are classified into two areas, **Climatic & Environmental** and **Social, Governance & Human Rights**, and they are divided considering the macro investment sector: **A) governmental and similar, B) companies in the various sectors, C) real estate.**



Sources and Literature

[01] **BIQH** [website](#).

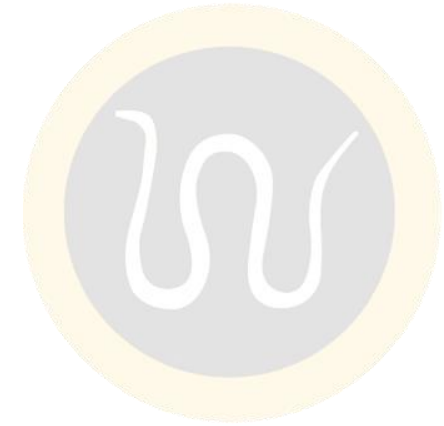
[02] **Bloomberg**. [Demystifying the Sustainable Finance Disclosure Regulation](#). February 2021.

[03] **EBA, EIOPA, ESMA**. [Final Report on draft Regulatory Technical Standards](#). February 2021.

[04] **EFAMA**. [Response to the ESA's consultation on the draft RTS under the sustainable finance disclosures regulation](#). May 2021.

[05] **European Parliament**. [Regulation EU 2020/852 on sustainability-related disclosures in the financial services sector](#). Official Journal of the European Union, June 2020.

[06] **European Parliament**. [Regulation EU 2019/2088 on sustainability-related disclosures in the financial services sector](#). Official Journal of the European Union, November 2019.



Company Profile

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Michele Bonollo

Chief of Risk Methodologies Officer



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