EU REGULATION ON SUSTAINABILITY-RELATED DISCLOSURES IN THE FINANCIAL SERVICES SECTOR

AT A GLANCE
The regulation (EU) 2019/2088 (Sustainability Disclosures Regulation) introduces new requirements and clarifies the sustainability-related disclosure obligations in the financial services sector. Disclosure requirements are set out at entity and product level. The new requirements distinguish between all products and financial products targeting or promoting environmental and/or social objectives. The regulation applies from 10 March 2021.

LINK TO TAXONOMY
The EU has also reached political agreement on a regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation). The final text is likely to be published in Q1/Q2 2020. The Taxonomy regulation and the Sustainability Disclosures Regulation apply to the same categories of funds and are designed to be complementary disclosure frameworks. In this briefing, key requirements of the Taxonomy regulation are also identified. For more details on the Taxonomy political agreement, please see the PRI's briefing note.

WHO IS AFFECTED?
The regulation applies to financial institutions, defined as:
- Insurance undertakings making available Insurance-Based Investment Products (IBIPs);
- Institutions for Occupational Retirement Provision (IORPs);
- Manufacturers of pension products;
- Pan-European Personal Pension Product (PEPP) providers;
- Alternative Investment Fund Managers (AIFMs);
- Undertakings for Collective Investment in Transferable Securities (UCITS) management companies; and
- Investment firms or credit institutions providing portfolio management and investment advice.
DISCLOSURE REQUIREMENTS

Transparency requirements for financial market participants and financial advisers

Financial market participants and financial advisers shall publish on their website:

■ Policies on the integration of sustainability risks in their decision-making or in their investment or insurance advice (Article 3, Disclosure Regulation);

■ A statement on how they consider principal adverse impacts of investment decisions on sustainability factors\(^1\). The statement shall include: policies on the identification, prioritisation and description of principle adverse sustainability impacts, summary on engagement policies and reference to conduct codes and standards and where relevant the degree of alignment with the Paris Agreement. This is on a comply or explain basis for firms below 500 staff and mandatory for those above (Art. 4, Disclosure Regulation);

■ Information on how their remuneration policies are consistent with the integration of sustainability risks (Article 5, Disclosure Regulation).

Transparency requirements at product level

For all products, financial institutions must disclose:

■ How sustainability risks are integrated in investment decisions, their likely impact on the return of the financial product (comply or explain) (Art. 6, Disclosure Regulation);

■ Whether and how a financial product considers principal adverse impacts on sustainability factors (comply or explain) (Art. 7, Disclosure Regulation);

■ How and to what extent the EU Taxonomy has been used in determining the sustainability of the underlying investments, the environmental objective(s) to which the fund contributes and the proportion of the underlying fund that is Taxonomy-aligned, expressed as a percentage. If this is not provided, the fund must carry a disclaimer stating *the investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments.* (Art. 4y, Taxonomy Regulation).

For all products, financial advisers must disclose:

■ How sustainability risks are integrated into their investment or insurance advice, their likely impact on the return of the financial product (comply or explain) (Art. 6, Disclosure Regulation).

Financial products promoting environmental and/or social objectives (“Article 8 products”):

■ A description of the environmental and/or social objectives of the product; details of how they are met; information on the reference index and the methodology used if a benchmark has been used (Art. 8, Disclosure Regulation);

\(^1\) Note: the European Supervisory Authorities are developing a regulatory technical standard which will contain sustainability indicators in relation to adverse sustainability impacts.
How and to what extent the EU Taxonomy has been used in determining the sustainability of the underlying investments, the environmental objective(s) to which the fund contributes and the proportion of the underlying fund that is Taxonomy-aligned, expressed as a percentage. (Art. 4β, Taxonomy regulation);

Disclosures shall be accompanied by the following statement: 'The “do no significant harm” principle is applied only for the investments underlying the product that take into account the EU criteria for environmentally sustainable investments. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable investments.' (Art. 4β, Taxonomy regulation).

Financial products with a sustainable investment² objective (“Article 9 products”):

- With index as reference benchmark: information on how the index is aligned with the objective and an explanation why and how this differs from a broad market index (Art. 9 (1), Disclosure Regulation); source of methodology (Art. 9 (4), Disclosure Regulation);
- Without index as reference benchmark: explanation, how the objective is to be attained (Art. 9 (2), Disclosure Regulation);
- Where the objective is a carbon emissions reduction, information on the alignment with the Paris Agreement targets shall be disclosed (Art. 9 (3), Disclosure Regulation); source of methodology (Art. 9 (4), Disclosure Regulation);
- Products invested in economic activities that contribute to environmental objective(s)³ set out in the Taxonomy shall disclose to which environmental objective the product is contributing and a description of how and to what extent the financial product is in invested in environmentally sustainable activities⁴ (Art. 4α, Taxonomy Regulation).

TECHNICAL STANDARDS

The European Supervisory Authorities (ESAs) shall develop Regulatory Technical Standards on the details of the content and the presentation requirements taking into account the various types of financial products, their characteristics and the differences between them. The standards will include sustainability indicators in relation to adverse impacts in the field of social and employee matters,

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² ‘sustainable investment’ means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance (Art. 2(17), Disclosure Regulation).

³ Cf. footnote 6

⁴ Criteria for environmentally sustainable economic activities is set out in Art. 3, Taxonomy Regulation
respect for human rights, anti-corruption and anti-bribery matters. The ESAs are asked to submit the draft regulatory technical standards by 30 December 2020.

DEVELOPMENT AND TIMELINE

The European Commission published a ‘proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341’ on 24 May 2018. It implements key actions announced in its action plan on sustainable finance relating to enhanced transparency of asset managers and institutional investors on sustainability risks.

A political agreement between the European Parliament and the European Council was reached on 25 February 2019. Following the adoption of the agreement by the European Ambassadors and the European Parliament, the text was published in the Official Journal in November 2019.

ESAs are tasked with drafting a report taking stock of the implementation of the Regulation 18 months after its entry into force.

POLICY CONTEXT

In 2018, the European Commission adopted an action plan on sustainable finance, building from the recommendations of the High-Level Expert Group on Sustainable Finance. The action plan included a package of legislative proposals. In addition to a proposal for enhanced disclosures requirements on sustainable investment and sustainability risks for financial institutions, the package included a proposal for a unified classification system of sustainable economic activities and a proposal for new categories of low carbon benchmarks.

PRI POSITION

Through its work with the Fiduciary Duty in the 21st Century Programme, the High-Level Expert Group on sustainable finance, and response to the consultation on the legislative proposals, the PRI demonstrated that ambiguity around investor duties has been a key barrier to the systematic ESG integration by investors. The PRI welcomes the creation of disclosure requirements for sustainability risks which will support integration of ESG issues across asset classes and geographies.

The regulation will also encourage investors to understand and mitigate the potential adverse impacts of their investment on society and the environment. This is consistent with the direction of the broader sustainable finance agenda, as investors increasingly work to understand non-financial investment outcomes.

5 Proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341
6 Action plan on financing sustainable growth
7 Final compromise text on the proposal for a regulation on sustainability-related disclosures in the financial services sector
8 Final regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector
The PRI strongly believes that the forthcoming Regulatory Technical Standards, which will set out the minimum requirements for the new disclosures, should build from existing good practice in the investment industry.

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