

The SFDR's disclosure requirements

Júlia Knopp¹

INTRODUCTION

On March 10, 2021, a set of regulations known as the Sustainable Finance Disclosure Regulation (SFDR)² came into force. Its principal objective is to standardize sustainability disclosure across the European Union to improve the comparability of financial products about their environmental, social, and governance risks and sustainable investment goals. In this sense, to limit adverse sustainability effects and "greenwashing," the SFDR mandates financial institutions to give their clients clear and transparent information about the ESG risks and opportunities associated with their investment products.

The Regulation applies to financial market participants (FMP) and financial advisers (FA) based in the EU or offering their services within the EU. They must disclose specific metrics and information on their website and in pre-contractual and periodic disclosures. Besides, the SFDR distinguishes between entity-level disclosure (level 1), which refers to the sustainability practices of all investments made by a FMP, and product-level disclosure (level 2), which covers each financial product. The Regulation subjects must provide a Principal Adverse Impacts (PAI) statement with mandatory and voluntary sustainability indicators at both levels.

It is important to assert that even though the Regulation exempts financial institutions with less than 500 employees from producing a PAI statement, they must present a justification. According to Article 4(1) of the SFDR, if a metric is not disclosed, the financial institutions must explain why this happened and how it impacts their investment decisions. Thus, in any case, the publication must be made on a comply-or-explain basis.

Disclosure requirements down to specific metrics

At the entity level, from March 2021, Article 3 of the SFDR requires all entities to disclose on their website the firm policies integrating sustainability risks in their investment decision-making process and remuneration policies. At the product level, besides the adverse impacts and sustainability risks integrated into the product investment decision, Articles 8 and 9 describe the necessity to explain and disclose on the website and pre-contractual disclosures how the positive ESG characteristics promoted or ESG objectives are achieved. The level 2 disclosure started to be applicable in January 2022.

¹ Legal Head of EasySustainability. Legal and Sustainability Consultant. LLM in Law and Sustainable Development at the University of Milan.

² REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>. [accessed 26 February 2023]

Additionally, two other essential documents supplement the SFDR. In June 2020, the Regulation (EU) 2020/852, or EU Taxonomy³, amended the SFDR, establishing a framework to facilitate sustainable investment, determining whether an economic activity qualifies as environmentally sustainable. Furthermore, in April 2022, the EU released the Regulatory Technical Standards⁴ (RTS), supplementing the SFDR with a series of template disclosures to clarify the implementation of SFDR regulations. It specifies the metrics FMP and FA must use to present information on sustainability indicators and adverse impacts. These metrics are divided into environmental, social, and governance.

According to Annex I of the RTS, there is a “core” set of 16 or 18 universally required indicators – depending on the type of firm – which always have a negative impact on sustainability factors⁵; and additional “opt-in” indicators⁶ that can be discretionally used to identify, assess, and prioritize other major negative effects. Considering a focus on “core” indicators, the Annex infers that, for investments in investee companies, there are climate and other environment-related indicators and others for social and employee, respect for human rights, anti-corruption, and anti-bribery matters.

Regarding climate and other environment-related indicators, the RTS’s template starts with Greenhouse gas emissions⁷. It includes the following metrics: (1) GHG emissions⁸ subdivided

³ REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32020R0852>. [accessed 26 February 2023]

⁴ COMMISSION DELEGATED REGULATION (EU) .../... of 6.4.2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’, specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in precontractual documents, on websites and in periodic reports. Available at [https://ec.europa.eu/transparency/documents-register/detail?ref=C\(2022\)1931&lang=en](https://ec.europa.eu/transparency/documents-register/detail?ref=C(2022)1931&lang=en). [accessed 27 February 2023]

⁵ See Table 1 of the Template principal adverse sustainability impacts statement: Statement on principal adverse impacts of investment decisions on sustainability factors.

⁶ See Table 2 of the Template principal adverse sustainability impacts statement: Additional climate and other environment-related indicators; and Table 3: Additional indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters.

⁷ ‘greenhouse gas (GHG) emissions’ means greenhouse gas emissions as defined in Article 3, point (1), of Regulation (EU) 2018/842 of the European Parliament and of the Council of 30 May 2018 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement and amending Regulation (EU) No 525/2013 (OJ L 156, 19.6.2018, p. 26).

⁸ ‘GHG emissions’ shall be calculated in accordance with the following formula: $\sum (current\ value\ of\ investmenti\ investee\ company's\ enterprise\ valuei \times investee\ company's\ Scope(x)\ GHG\ emissionsi)$.

into scopes 1, 2, 3⁹ and total GHG emissions; (2) carbon footprint¹⁰; (3) GHG intensity of investee companies¹¹; (4) the share of investments in companies active in the fossil fuel sector; (5) the share of non-renewable energy¹² consumption and production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage of total energy sources; and (6) the energy consumption¹³ in GWh per million EUR of revenue of investee companies, per high impact climate sector.

For Biodiversity, the second adverse sustainability indicator, the metric is: (7) the share of investments in investee companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas. For Water, the RTS defines as specific metric (8) Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average. Finally, for Waste, the metric consists in (9) Tonnes of hazardous waste¹⁴ and radioactive waste¹⁵ generated by investee companies per million EUR invested, expressed as a weighted average.

Regarding the second category, the adverse sustainability indicator is social and employee matters. Its first metric considers (10) the share of investments in investee companies involved in violations of UN Global Compact principles and OECD Guidelines for Multinational Enterprises. The second metric refers to (11) the share of investments in investee companies without policies to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises. The following metrics consider (12) the average unadjusted gender pay gap of investee companies; (13) the average ratio of female to male board members in investee companies; and (14) the share of

⁹ 'scope 1, 2 and 3 GHG emissions' means the scope of greenhouse gas emissions referred to in points (1)(e)(i) to (iii) of Annex III to Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

¹⁰ 'carbon footprint' shall be calculated in accordance with the following formula: $\sum (\text{current value of investmenti investee company 's enterprise valuei} \times \text{investee company's Scope 1, 2 and 3 GHG emissionsi}) / \text{current value of all investments (€M)}$.

¹¹ 'GHG intensity of investee companies' shall be calculated in accordance with the following formula: $\sum (\text{current value of investmenti current value of all investments (€M)} \times \text{investee company's Scope 1, 2 and 3 GHG emissionsi investee company 's €M revenuei})$.

¹² 'non-renewable energy sources' means energy sources other than those referred to in point (6) - 'renewable energy sources'; 'renewable energy sources' means renewable non-fossil sources, namely wind, solar (solar thermal and solar photovoltaic) and geothermal energy, ambient energy, tide, wave and other ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas, and biogas.

¹³ 'energy consumption intensity' means the ratio of energy consumption per unit of activity, output or any other metric of the investee company to the total energy consumption of that investee company.

¹⁴ 'hazardous waste' means hazardous waste as defined in Article 3(2) of Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives (OJ L 312, 22.11.2008, p. 3).

¹⁵ 'radioactive waste' means radioactive waste as defined in Article 3(7) of Council Directive 2011/70/Euratom of 19 July 2011 establishing a Community framework for the responsible and safe management of spent fuel and radioactive waste (OJ L 199, 2.8.2011, p. 48).

investments in investee companies involved in the manufacture or selling of controversial weapons.

Moreover, the RTS template provides indicators applicable to investments in sovereigns and supranationals and in real estate assets. The former considers environmental and social adverse sustainability indicators, measured respectively by (15) the GHG intensity of investee countries and (16) the number of¹⁶. In contrast, the latter consider fossil fuels and energy efficiency, measured by (17) the share of investments in real estate assets involved in the extraction, storage, transport, or manufacture of fossil fuels and (18) the share of investments in energy inefficient real estate assets.

CONCLUSIVE REMARKS

In light of the SFDR and the EU Taxonomy, the consideration of ESG elements, which was previously optional, is now a requirement for an increasing number of sectors. As stated by Riccardo Ceretti¹⁷, the SFDR has developed several regulations to reduce the danger of "greenwashing" by ensuring sufficient consistency between the declaration of value and the actual investment decisions made by the financial market actors. However, considering that the regulatory framework is still developing, it needs to be integrated and interpreted by both domestic and EU agencies to guarantee consistency in implementation.

In this line, the Regulatory Technical Standards supplementing the SFDR provides a detailed framework for financial market participants and financial advisors to disclose their ESG risks and opportunities and to ensure transparency in their investment decisions. By disclosing these specific metrics within the mandatory reporting template, the respective subjects can demonstrate their commitment to sustainable finance and contribute to the broader transition towards a more sustainable economy while also counting of more interest and, thus, capital.

REFERENCES

REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector. Available at

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>

REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32020R0852>

¹⁶ absolute number and relative number divided by all investee countries, as referred to in international treaties and conventions, United Nations principles and, where applicable, national law.

¹⁷ Head of the InnovactionLab department of Arca Fondi, Italy. Available at <https://fundspeople.com/it/insights/il-panorama-italiano-dei-fondi-articolo-8-e-9/>. [accessed 15 March 2023]

COMMISSION DELEGATED REGULATION (EU) .../... of 6.4.2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’, specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in precontractual documents, on websites and in periodic reports. Available at [https://ec.europa.eu/transparency/documents-register/detail?ref=C\(2022\)1931&lang=en](https://ec.europa.eu/transparency/documents-register/detail?ref=C(2022)1931&lang=en)

IL PANORAMA ITALIANO DEI FONDI ARTICOLO 8 E 9. FundsPeople. 24 November 2021. Available at <https://fundspeople.com/it/insights/il-panorama-italiano-dei-fondi-articolo-8-e-9/>