



IT'S ALL ABOUT THE DISCLOSURE

Parallels might be drawn between COVID-19 and climate change, each being global in nature and requiring a globally coordinated response. Each requires capital investment by the public and private sector totalling significant sums of money to achieve a positive outcome.

In order to adapt to the climate change challenges, sustainability risks and adverse impacts must be considered, one of which must now include the social aspects of how firms are reacting to the current pandemic.

It is therefore timely that the three European Supervisory Authorities (EBA, EIOPA and ESMA – the ESAs) issued a paper entitled 'joint consultation paper – ESG disclosures' ([the consultation paper](#)) on 23 April 2020, seeking input on proposed environmental, social and governance (ESG) disclosure standards for financial market participants, advisers and products.

These standards have been developed under the EU Regulation on sustainability-related disclosures in the financial services sector ([SFDR](#)), aiming to:



Recital 10 of the SFDR aims to reduce information asymmetries in principal agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make pre-contractual and ongoing disclosures to end investors (principals). This will be recognised by the creation of regulatory technical standards (RTS).

The consultation paper also contains proposals under the recently agreed Regulation on the establishment of a framework to facilitate sustainable investment (the [Taxonomy Regulation](#)), on the do not significantly harm (DNSH) principle.

Scope

The scope of the SFDR is extremely broad, covering a very wide range of financial products and financial market participants. The SFDR is in essence trying to harmonise ESG disclosure standards for disclosures of different types of information complexity, granularity and consumer-friendliness, ranging from detailed fund prospectuses to

the concise “key information documents” for pan-European pension products (PEPPs).

Areas covered by the draft RTS

The draft RTS relate to several disclosure obligations under the SFDR regarding the publication of:

	Topic	Details	Article Reference in SFDR
	Presentation and content	Information in relation to the principle of ' <i>do not significantly harm</i> ' consistent with the content, methodologies, and presentation of indicators in relation to adverse impacts.	2(17), 4(6) and (7)
	Due diligence policy and website statement	A statement on an entity's website of the due diligence policy in respect of the adverse impact of investment decisions on sustainability factors in relation to climate and other environment-related impacts and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.	4(6) and (7)
	Pre-contractual information	How a product with environmental or social characteristics meet those characteristics and if an index has been designated as a reference benchmark, whether and how that index is consistent with those characteristics.	8
	Pre-contractual information	To show, where a product has sustainable investment objectives and a) has a designated index as a reference benchmark, how that index is aligned with the sustainable investment objective and an explanation as to why and how that designated index aligned with the objective differs from a broad market index; or b) if no index has been designated as a reference benchmark, an explanation on how that objective is to be attained.	9(1) and 9(2)
	Website information	Describe the environmental or social characteristics of financial products or the sustainable investment; the methodologies used; the pre-contractual information and the periodic reports.	8, 9 and 11
	Periodic reports	Information in periodic reports according to sectoral legislation specifying (a) the extent to which products with environmental and/or social characteristics meet those characteristics, and (b) for products with sustainable investment objectives and products whose objective is a reduction in carbon emissions: (i) the overall sustainability-related impact of the product by means of relevant sustainability indicators and (ii) where an index has been designated as a reference benchmark, a comparison between the overall impact of the financial product with the designated index and a broad market index through sustainability indicators.	11



Entity-level principal adverse impact disclosures

The principal adverse impacts that investment decisions have on sustainability factors should be disclosed on the website of the entity, and the proposals set out rules for how this public disclosure should be done. The disclosure should take the form of a statement on due diligence policies with respect to the adverse impacts of investment decisions on sustainability factors, showing how investments adversely impact indicators in relation to:

- Climate and the environment; and
- Social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

The ESAs have included draft indicators for adverse impacts, based on consultations with the Joint Research Centre of the European Commission and the European Environment Agency.

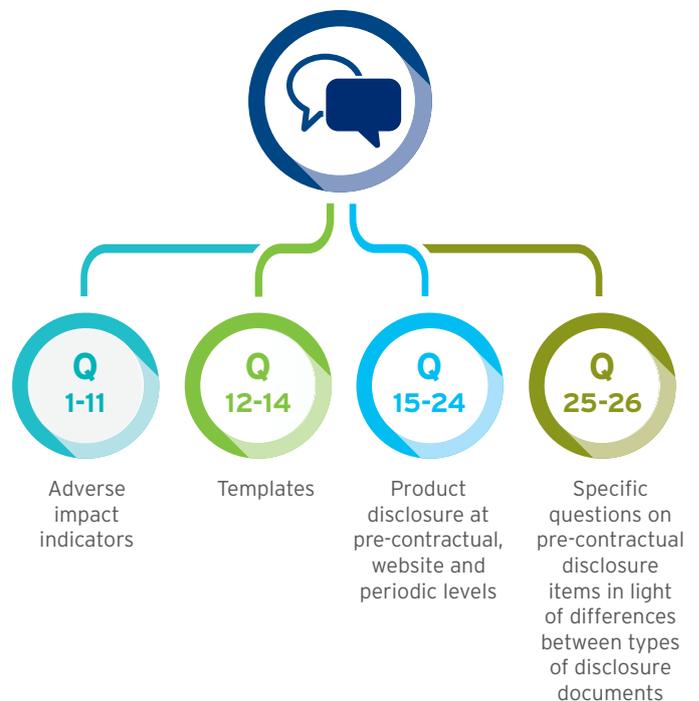
Product level ESG disclosures

The sustainability characteristics or objectives of financial products should be disclosed in their pre-contractual and periodic documentation and on the entity’s website. The proposals included in the draft RTS indicate the rules for how this disclosure should be carried out, ensuring transparency to investors regarding how products meet their sustainability characteristics or objectives. They also set out the additional disclosures that should be provided by products that have designated an index as a reference benchmark.

Finally, the product level proposals set out suggested provisions for disclosing how a product based on sustainable investments complies with the DNSH principle.

What are the ESA's interested in?

The questions asked in the consultation can be broken down into the following high-level areas:



Next steps

The ESAs have requested feedback to this consultation by 1 September 2020. Following the close of the consultation the draft RTS will be finalised and submitted to the European Commission before being published in the Official Journal of the European Union.

Summary of RTS

Principal adverse impact disclosure – Article 4(6) and 4(7) SFDR

The draft RTS provides a specification for the content, methodology and presentation of the information required in respect of the sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts.

This text is complemented by proposals for the empowerment under the SFDR which requires the RTS to specify the content, methodology and presentation of the information required in respect of the sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

The draft RTS combine these two empowerments into a single framework for adverse impact disclosure by financial market participants. The draft RTS includes:

- A mandatory reporting template to use for the statement on considering principal adverse impacts of investment decisions on sustainability factors, which contains required reporting items on summary, scope, the principal adverse impacts, policies on the identification of principal adverse impacts, actions taken and planned to mitigate the principal adverse impacts, adherence to international standards and a historical comparison;
- A set of indicators for both climate and environment-related adverse impacts and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters, including:
 - » A core set of mandatory indicators that will always lead to principal adverse impacts of investment decisions on sustainability factors, irrespective of the result of the assessment by the financial market participant; and
 - » Additional indicators for environmental and social factors, to be used to identify, assess and prioritise additional principal adverse impacts;
- A statement to be published where adverse impacts of investment decisions are not considered by financial market participants and financial advisers under the SFDR; and
- Requirements for financial advisers in line with their obligations under the SFDR.



Product pre-contractual disclosure – Articles 8 and 9 SFDR, including “Do not significantly harm” – Article 2a SFDR

The draft RTS set out the details of the content and presentation of the information to be disclosed at the pre-contractual level in the sectoral documentation prescribed by the SFDR. The draft RTS include:

- A requirement to use a mandatory reporting template for the presentation of pre-contractual disclosure;
- A list of items to be included in the reporting indicating clearly the type of product and how the environmental or social characteristic (or combination thereof) or the sustainable investment objective of the product are achieved;
- Additional items of disclosure where the product designates an index as a reference benchmark; and
- Requirements for products making sustainable investments regarding how the product complies with the “do not significantly harm” principle from the SFDR in relation to the principal adverse impact indicators in Annex I of the draft RTS.

Product website disclosure – Article 10 SFDR, including “Do not significantly harm” – Article 2a SFDR

The draft RTS for product website disclosure set out the details of the content and presentation of information to be publicly disclosed on the website by the financial market participant for products that promote environmental or social characteristics and products that have sustainable investment as their objective. The draft RTS:

- Set out where and how the financial market participant must publish the information on the website, including the need to publish a two-page summary;
- Includes a list of items to be included in the disclosure, focusing on the methodology employed, the data sources used, and any screening criteria employed; and
- Includes requirements for products making sustainable investments regarding how the product complies with the “do not significantly harm” principle from the SFDR in relation to the principal adverse impact indicators in Annex I of the draft RTS.

Product periodic disclosure – Article 11 SFDR, including “Do not significantly harm” – Article 2a SFDR

The draft RTS for periodic product disclosure set out the details of the content and presentation of information to be disclosed for products that promote environmental or social characteristics and products that have sustainable investment as their objective in the sectoral documentation prescribed in the SFDR. The draft RTS include:

- A requirement to use a mandatory reporting template for the presentation of the periodic disclosure;
- A granular list of items to be included in the reporting, focusing on the success of the product in attaining its environmental or social characteristic (or combination thereof) or sustainable investment objective; and
- Requirements for products making sustainable investments regarding how the product has successfully complied with the “do not significantly harm” principle from the SFDR in relation to the principal adverse impact indicators in Annex I of the draft RTS.

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