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What is the Sustainable Finance Disclosure Regulation (SFDR) ?

The new Sustainable Finance Disclosure Regulation (SFDR) (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) introduced various disclosure-related requirements for financial market participants and financial advisors at entity, service and product level.

It aims to provide more transparency on sustainability within the financial markets in a standardized way, thus preventing greenwashing and ensuring comparability.

SFDR will start to apply from March 10, 2021.

What is the Sustainable Finance Disclosure Regulation (SFDR) ?

History

On 25th September 2015, the UN General Assembly adopted a new global sustainable development framework: the 2030 Agenda for Sustainable Development (the "2030 Agenda"), which has at its core the Sustainable Development Goals (SDGs). The European Commission's communication on the next steps for a sustainable European future links the SDGs to the European Union policy framework to ensure that all European Union actions and policy initiatives, both within the European Union and globally, take the SDGs on board at the outset. On 20th June 2017, the European Council confirmed the commitment of the European Union and its Member States to the implementation of the 2030 Agenda in a full, coherent, comprehensive, integrated and effective manner.

The transition to a low-carbon, more sustainable, resource-efficient and circular economy in line with the SDGs is key to ensuring long-term competitiveness of the economy in the European Union. The Paris Agreement adopted under the United Nations Framework Convention on Climate Change (the "Paris Agreement"), which was approved by the European Union and which entered into force on 4th November 2016, seeks to strengthen the response to climate change by making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

As the European Union is increasingly faced with the catastrophic and unpredictable consequences of climate change, resource depletion and other sustainability-related issues, urgent action is needed to mobilize capital not only through public policies but also by the financial services sector. Therefore, financial market participants and financial advisers should be required to disclose specific information regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts.

What is the Sustainable Finance Disclosure Regulation (SFDR) ?

Goal and Content of the Regulation

The objectives of the EU SFDR is to strengthen protection for end investors and improve disclosure to them.

This regulation aims to reduce information asymmetries 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 disclosure to end investors.

To ensure the coherent and consistent application of this regulation, it is necessary to lay down a harmonized definition of “sustainable investment” which provides that the investee companies follow good governance practices and the precautionary principle of “do not significantly harm” is ensured, so that neither the environmental nor the social objective is significantly harmed.

The consideration of sustainability factors in the investment decision-making and advisory processes can realize benefits beyond financial markets. It can increase the resilience of the real economy and the stability of the financial system. In doing so, it can ultimately impact on the risk-return of financial products. It is therefore essential that financial market participants and financial advisers provide the information necessary to enable end investors to make informed investment decisions.

Financial market participants which consider the principal adverse impacts of investment decisions on sustainability factors should disclose in the pre-contractual information for each financial product, concisely in qualitative or quantitative terms, how such impacts are considered as well as a statement that information on the principal adverse impacts on sustainability factors is available in the ongoing reporting. Principal adverse impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors.

What is the Sustainable Finance Disclosure Regulation (SFDR) ?

(Continuation of Goal and Content of the Regulation)

Sustainable products with various degrees of ambition have been developed to date. Therefore, for the purposes of pre-contractual disclosures and disclosures in periodical reports, it is necessary to distinguish between the requirements for financial products which promote environmental or social characteristics and those for financial products which have as an objective a positive impact on the environment and society. As a consequence, as regards the financial products with environmental or social characteristics, financial market participants should disclose whether and how the designated index, sustainability index or mainstream index, is aligned with those characteristics and where no benchmark is used, information on how the sustainability characteristics of the financial products are met. As regards financial products which have as an objective a positive impact on the environment and society, financial market participants should disclose which sustainable benchmark they use to measure the sustainable performance and where no benchmark is used, explain how the sustainable objective is met. Those disclosures by means of periodic reports should be carried out annually.

What are the Regulatory Technical Standards (RTS)?

The three European Supervisory Authorities (EBA, EIPOA and ESMA (collectively, the "ESAs") have been mandated by the European Joint Committee to develop regulatory technical standards to further specify the content, methodologies and presentation of information in relation to sustainability indicators with regard to climate and other environment-related adverse impacts, to social and employee matters, to respect human rights, and to anti-corruption and anti-bribery matters as well as to specify the presentation and content of the information with regard to the promotion of environmental or social characteristics and sustainable investment objectives to be disclosed in pre-contractual documents, annual reports and on websites of financial market participants.

The purpose of the RTS is to provide further detail and guidance to ensure that firms take a harmonized approach in their methods of collecting and disclosing information. This is needed to meet the objective of the EU SFDR.

On 23 April 2020) the ESAs launched a joint public consultation on draft regulatory technical standards for ESG disclosures. The consultation document provides concrete proposals for the content, methodologies and presentation of sustainability disclosures. It covers:

- A guidance on certain points of interpretation in the SFDR, and greenwashing risk;
- Adverse impact reporting at entity level: disclosures of principal adverse impacts of investment decisions on sustainability factors – including detailed indicators for environmental and social impacts; and
- Pre-contractual, website and periodic product disclosures: applicable to products with either environmental or social characteristics or with sustainable investment objectives, including provisions on "do not significantly harm".

RTS will begin to apply from Jan 1st 2022.

Who is impacted?

The SFDR applies to financial market participants (FMPs) and financial advisors.

FMPs are defined as professional players in the financial market, like: pension funds, asset managers, insurance companies banks, venture capital funds, credit institutions offering portfolio management or financial advisors.

Level 1 Entity Level (art 3 – 5 SFDR)

From 10.03.2021, he FMPs will have to disclose the following information on their website:

1. The FMPs will have to publish the policies in place on how Sustainability Risk* are integrated into investment advice or decisions.

2. FMPs will have to report on policies in place regarding the Principal Adverse Impacts** on investment advice or decisions.

3. Publish and explain how the remuneration policy is consistent with the integration of Sustainable Risk.

**Sustainability risk means an ESG event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.*
***Principal Adverse Impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors.*

Level 2 Product Level (art 6-11 SFDR)

From 10.03.2021, these following informations should be disclosed in the Pre-contractual info (Prospectus, Periodic Reports, websites):

1. Publish an explanation on how SR are integrated investment advice or decisions and the impact of these risks on the returns.

2. Report whether, and if so how, a product considers the Principal Adverse Impact on sustainability.

3. Include a description of the characteristics and objectives, and assessment methodologies for measurement & monitoring.

Level 2 Product Level (art 6-11 SFDR)

TYPE 1 (mainstream product): the product does not integrate any kind of sustainability into the investment process:

If financial market participants deem sustainability risks not to be relevant, the descriptions referred to the above shall include a clear and concise explanation of the reasons therefor (Art 6 SFDR).

Level 2 Product Level (art 6-11 SFDR)

TYPE 2 (light green product): the main investment objective of the product is not "Sustainable investment", but it promotes some sustainable characteristics (article 8 SFDR):

If a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, the following information have to be disclosed:

(a) information on how those characteristics are met;
(b) if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics.

Practically the following questions have to be answered:

1. What environmental and social characteristics are promoted by this financial product?
2. What Investment strategy does this financial product follow?
3. What is the asset allocation planned for this financial product?
4. Does this financial product take into account principal adverse impacts on sustainability factors?
5. Can I find more product specific information online?
6. Is a specific index designated as a reference benchmark and its in alignment with each of the E&S characteristics?

Level 2 Product Level (art 6-11 SFDR)

TYPE 3 (dark green product): the main investment objective of the product is "Sustainable investment" (article 9 SFDR):
If financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, the following information have to be disclosed:

(a) information on how the designated index is aligned with that objective;
(b) an explanation as to why and how the designated index aligned with that objective differs from a broad market index.

Practically the following questions have to be answered:

1. What is the sustainable investment objective of this financial product?
2. What Investment strategy does this financial product follow?
3. What is the asset allocation planned for this financial product?
4. Does this financial product take into account principal adverse impacts on sustainability factors?
5. Can I find more product specific information online?
6. Is a specific index designated as a reference benchmark and its in alignment with each of the E&S characteristics?
7. Does the financial product have the objective of a reduction in carbon emissions?

Level 2 Product Level (art 6-11 SFDR)

To disclose on the pre-contractual documents (ex: prospectus):

<table>
<tr><th></th><th>Mainstream products</th><th>Products promoting environmental or social characteristics</th><th>Products with sustainable investment objective</th><th></th></tr>
<tr><td>Integration of sustainability risks</td><td colspan="3">The manner in which sustainability risks are integrated in the investment decision/investment or insurance advice
Assessment of the likely impacts of sustainability risks on the financial return
Where sustainability risk is deemed not to be relevant, explanation of the reasons for this</td><td>Financial Market Participant
Financial Advisor</td></tr>
<tr><td>Principal adverse impact</td><td colspan="3">Where the FMP considers it: consideration of the product's principal adverse impacts on sustainability factors
Where the FMP does not consider it: statement on non-consideration + reasons for this</td><td>Financial Market Participant</td></tr>
<tr><td>Additional sustainability disclosures</td><td>n/a</td><td>How the characteristics are met
Consistency of the index with the characteristics</td><td>How the objective is to be attained
Alignment of the index with the objective</td><td>Financial Market Participant</td></tr>
</table>

(Source: Sustainable Finance Disclosure Regulation, PwC)

Level 2 Product Level (art 6-11 SFDR)

To disclose on the Website:

Mainstream products	Products promoting environmental or social characteristics	Products with sustainable investment objective
• n/a	• Summary • Description of the characteristics • Information on the methodologies for assessing, measuring and monitoring of the characteristics • Due diligence on the underlying assets • Data sources, screening criteria for the underlying assets and relevant sustainability indicators • Limitation to methodologies and data	• Summary • Description of the objective • Information on the methodologies for assessing, measuring and monitoring of the impact • Due diligence on the underlying assets • Data sources, screening criteria for the underlying assets and relevant sustainability indicators • Limitation to methodologies and data

(Source: Sustainable Finance Disclosure Regulation, PwC)

Level 2 Product Level (art 6-11 SFDR)

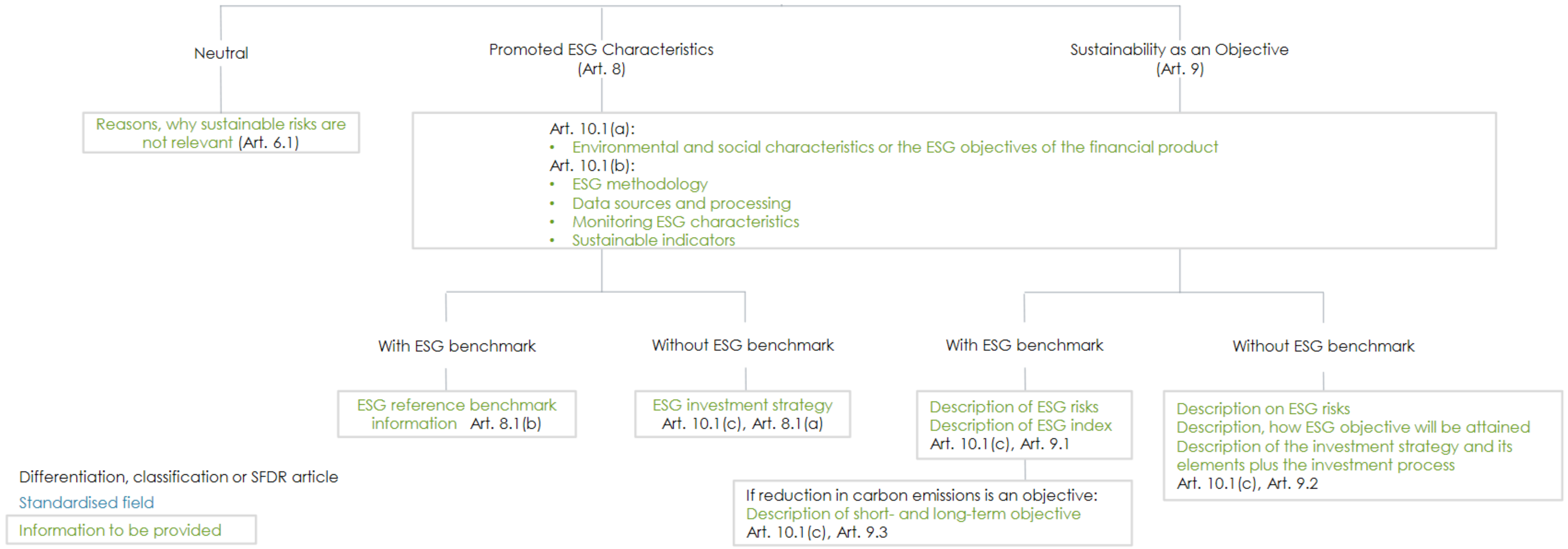
To disclose on the periodic reports:

	Mainstream products	Products promoting environmental or social characteristics	Products with sustainable investment objective
Principal adverse impacts	• Where the financial market participant considers it: information on principal adverse impacts on sustainability factors		
Additional sustainability disclosures	n/a	• The extent to which the **environmental or social characteristics** are met	• The overall **sustainability-related impact** • A **comparison** between the product impact and the impacts of the designated index and of a broad market index
Additional green taxonomy-related information	**Statement** The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities	• Requirements as for products with sustainable investment objective **as applicable** • **Additional statement** that the DNSH principle is applied only to investments in Taxonomy	• **Taxonomy objective(s)** to which the product contributes • **% investments** in Taxonomy activities • **% of enabling and transitional** activities

(Source: Sustainable Finance Disclosure Regulation, PwC)

Level 2 Product Level (art 6-11 SFDR)

Summary:



(source: Adaptions of openfunds on SFDR, Taxonomy, Brexit and more Webinar, 01 March 2021, OpenFunds)

Does a non EU-Manager marketing a non-EU fund in Europe has to comply with SFDR?

Yes, it applies. In additional words, SFDR will apply:

(i) directly to non-EU managers which market AIFs into the EU under AIFMD national private placement rules and
(ii) Indirectly to non-EU managers providing portfolio management and/or investment advice services to EU firms that are themselves subject to the new regulations.

What is the EU Taxonomy?

The EU Taxonomy Regulation determines whether an **economic activity** is environmentally sustainable or not.

The Taxonomy sets performance thresholds (referred to as 'technical screening criteria') for economic activities which:

- ✓ make a substantive contribution to one of **six environmental objectives** (see the list next page);
- ✓ do no significant harm (DNSH) to the other five objectives;
- ✓ meet minimum safeguards (e.g., OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights).

The Goal?

The performance thresholds will help companies, project promoters and issuers access green financing to improve their environmental performance, as well as helping to identify which activities are already environmentally friendly. In doing so, it will help to grow low-carbon sectors and decarbonize high-carbon ones.

The EU Taxonomy is one of the most significant developments in sustainable finance and will have wide ranging implications for investors and issuers working in the EU, and beyond

Six environnemental objectives (Article 9 EU Taxonomy) :

(a) climate change mitigation*;

(b) climate change adaptation*;

(c) the sustainable use and protection of water and marine resources;

(d) the transition to a circular economy (waste prevention and recycling);

(e) pollution prevention and control;

(f) the protection and restoration of biodiversity and ecosystems.

** The difference between climate change mitigation strategies and climate change adaptation is that mitigation is aimed at tackling the causes and minimizing the possible impacts of climate change, whereas adaptation looks at how to reduce the negative effects it has and how to take advantage of any opportunities that arise.*

EU Taxonomy: who has to do what, and by when?

3 groups concerned:

1. Financial market participants offering financial products in the EU, including occupational pension providers;
2. Large companies who are already required to provide a non-financial statement under the Non-Financial Reporting Directive; and
3. The EU and Member States, when setting in public measures, standards or labels for green financial products or green (corporate) bonds.

Financial market participants will be required to complete their first set of disclosures against the Taxonomy, covering activities that substantially contribute to climate change mitigation and/or adaptation, by the 31st of December, 2021.

An expanded set of disclosures covering activities that substantially contribute to all six environmental objectives will be required by the end of 2022. Technical screening criteria for activities that make a substantial contribution to water, a circular economy, pollution prevention and control, and protection of ecosystems will be issued by the end of 2021.

EU Taxonomy: who has to do what, and by when?

For each relevant product, the financial market participant will be required to state:

1. how and to what extent they have used the Taxonomy in determining the sustainability of the underlying investments;
2. to what environmental objective(s) the investments contribute; and
3. the proportion of underlying investments that are Taxonomy-aligned, expressed as a percentage of the investment, fund or portfolio. This disclosure should include details on the respective proportions of enabling and transition activities, as defined under the Regulation.

Where should disclosures be made?

The Taxonomy Regulation requires financial market participants to provide their disclosures as part of existing pre-contractual and periodic disclosure obligations, and subsequently on their websites.

Market segment	Examples	Pre-contractual	Periodic reporting
Pensions and Asset Management	Occupational pension providers (IORPs)	Information to prospective members (Article 41, IORP II Directive)	Annual report (Article 29, IORP II)
	UCITS management companies	Prospectus (Article 69, UCITS Directive)	Annual report (Article 69, UCITS Directive)
	Alternative Investment Fund Managers (AIFMs)	Disclosure to investors (Article 23(1), AIFMD)	Annual report (Article 22, AIFMD)
	Investment firms providing portfolio management or investment advice (MiFID II)	Information to clients (Article 24(4) of MiFID II)	Periodic report (Article 25(6) of MiFID II)

Pre-contractual (ex: prospectus) disclosures should focus on ex-ante information, including, but not limited to:

- the environmental objectives of the fund, including any Taxonomy-related targets (e.g., 20% of the fund invested in companies with >50% Taxonomy-aligned turnover, or with substantial Taxonomy-related capex);
- how the Taxonomy will be used to achieve these objectives (e.g., portfolio construction or as the basis of engagement with companies).

Periodic reporting should focus on ex-post information, including, but not limited to:

- how the strategies have been implemented in practice; and
- a point-in-time calculation of the Taxonomy percentage.

(Source: Taxonomy: Final report of the Technical Expert Group on Sustainable Finance, March 2020)

What is the relationship between SFDR and the EU Taxonomy? Does the SFDR already incorporates all the EU Taxonomy rules?

The Taxonomy Regulation supplements certain SFDR rules related to transparency in disclosures for pre-contractual documents and periodic reports.

Most of the relevant SFDR provisions impacted by the Taxonomy Regulation will begin to apply as from 1 January 2022.

Whats new with Openfunds regarding ESG?

The following ESG field already exists in the current version of Openfunds:

OF-ID	**OFEM051050**	Field Name	**EMT Compatible With ESG Preferences**
Field Tags	EMT		
Field Level	Fund	Link Reference	
Data Type	string	Introduced / Revoked	1.26 / --
Description	Is the fund compatible with investor preference for investments with an environmental, social and governance (ESG) focus? // The correspondent MiFID II field introduced by the European Working Group with their MiFID Data Dictionary Template (EMT) is: EMT: 05105_Intended_Compatible_With_Clients_Having_ESG_Preferences. This is an Optional EMT field.//		
Values	"yes" / "neutral"		
Example	yes		

Whats new with Openfunds regarding ESG?

Regarding the new Fund Classification in the EMT 3.1 (No ESG, Light Green, Dark green), the Openfunds fields will be adapted. And the following fields will be added in the Next version v.1.27:

OF-ID	**OFEM051051**	Field Name	**EMT Compatible With Sustainability Preferences**

Description
Is the fund intended to be compatible with investor preference for investments with an environmental, social and governance (ESG) focus?
Neutral
C = preferences for products having ESG Charecteristics (similar to Article 8 of the EU SFDR)
O = preferences for products having Sustainable Objectives (similar to Article 9 of the EU SFDR)

Whats new with Openfunds regarding ESG?

The 3 following fields are necessary if the fund is marketed in Germany:

OF-ID **OFEM090000** Field Name **EMT ESG Category For German Market for Funds**

Description The ESG category of the fund, for the German market.

Neutral products: are products that are neither B, E or I
Basic (B):
- ESG opportunities/risks according to the criteria of the "ESG integration enhanced" taken into account
- Integration approach disclosed
- Product manager follows recognised industry standard (UN PRI)
ESG €:
- Dedicated ESG strategy (pursuant to Art. 8 Disclosure Regulation)
- Minimum exclusion criteria
- Relevant for both individual products and those in a portfolio/basket (shares/bonds)
- Product manager follows recognised industry standard (UN PRI)
Impact (I):
- Impact-related investments (pursuant to Art.9 Disclosure Regulation)
- No serious breach of UNGC
- Relevant for both individual products and those in a portfolio/basket (shares/bonds)
- Product manager follows recognised industry standard (UN PRI)

OF-ID **OFEM090100** Field Name **EMT ESG Focus**

Description Whether the primary focus of the fund is Environmental, Social, or Governance, for the German Market.

OF-ID **OFEM090200** Field Name **EMT ESG Label or Standard**

Description The ESG label or standard of the fund, for the German market. Multiple selections are possible, which should be given separated by a pipe "|" (ASCII 124) symbol.

A= ICMA Green Bond Principles; B= EU Green Bond Standard; C= EU Ecolabel for Financial Products; D= FNG Siegel (Fonds); E = CBI Climate Bonds Standards; F= ISCMA Social Bonds Principiles; G= LuxFLAG ESG; H= LuxFLAG Climate Finance; I= LuxFLAG Environment; J= "Kein Verstoß gegen Atomwaffensperrvertrag"; K= ISR; L= Febelfin; M= UZ49 - das österreichische Umweltzeichen; N= Nordic Swan; O= GreenFin Label

Sources

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