

EU Disclosure Regulation Overview

What is it?

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (known as the Disclosure Regulation, ESG Regulation or SFDR), which is part of a broader legislative package under the European Commission's Sustainable Finance Action Plan.

Impact on the industry

It requires firms to make strategic business and policy decisions regarding their approach to ESG which must be disclosed on the firm's website and in pre-contractual and periodic disclosures. Although the focus of the Disclosure Regulation is the provision of information to investors, clients and other stakeholders, it is clear that the preparation of accurate and comprehensive information on ESG will necessitate significant system and control changes, and a material allocation of resource for many firms.

Application

Most of the obligations come into force on **10 March 2021**.

Scope

The Disclosure Regulation applies at the firm and the product level, and in respect of all financial products, not just those with an ESG focus. Some, but not all, firms identified in the table below are entitled to make some of the required disclosures on a "comply or explain" basis.

"Financial market participants (FMP)"	AIFMs, UCITS management companies, MiFID investment firms, managers of qualifying VC funds or qualifying social entrepreneurship funds, pan-European personal pension product providers, manufacturers of pension products and institutions for occupational retirement provision.
"Financial advisers (FA)"	AIFMs, UCITS management companies, investment firms, insurance intermediaries relating to IBIPs, insurance undertakings relating to IBIPs and credit institutions, where those firms provide investment advice.
"Financial products (FP)"	AIFs, UCITS, portfolios managed under MiFID, IBIPs, pension products and PEPPs.

Brexit implications

It is unlikely that the Disclosure Regulation will be on-shored into UK domestic law at the end of the transition period. However, given the UK Government's stated desire to "lead from the front" on ESG, we do expect the UK to introduce a similar regime in the not-too-distant future. UK firms with wholly UK operations will likely have a choice between taking a "wait and see" approach, pending clarity over any potential new UK regime, and voluntarily adopting the Disclosure Regulation obligations, perhaps in response to client or market expectations. On the other hand, UK firms who market to EU investors, as well as those with EU funds or mandates, will have to comply with the Disclosure Regulation from 10 March 2021.

New concepts

The Disclosure Regulation introduces a number of new concepts that firms will need to consider when disclosing their approach to ESG.

"Sustainable investment"	An investment in an economic activity: <ul style="list-style-type: none"> that contributes to an environmental or social objective, or an investment in human capital or economically or socially disadvantaged communities; that "does not significantly harm" those objectives; and where the investee company follows good governance practices.
"Sustainability risk"	An ESG event or condition that, if it occurs, could cause an actual or potential material negative impact on the value of an investment.
"Sustainability factors"	Environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Next steps

Consider the obligations required overleaf and begin to plan accordingly, whilst monitoring closely any publications from HMT and the Financial Conduct Authority on this topic, in order to understand any potential domestic divergence.

Requirement		Disclosure	RTS?	Deadline
Firm level obligations				
Sustainability risk policies	Publish information about the firm's policies on the integration of "sustainability risks" in its investment decision-making processes.	<ul style="list-style-type: none"> Website 	No	10 March 2021
Principal adverse impacts	<p>Consider principal adverse impacts of its investment decisions or advice on "sustainability factors" at manager or adviser level:</p> <ul style="list-style-type: none"> comply*: implement "sustainability due diligence policy" at firm level; or explain: statement on why they do not consider sustainability adverse impacts & whether intend to do so in the future. <p><i>*Mandatory for FMPs with >500 employees/parent undertaking of such, from 30 June 2021 but not for FAs with >500 employees.</i></p>	<ul style="list-style-type: none"> Website 	Yes	10 March 2021
Remuneration policy	Include information on how the firm's remuneration policy is consistent with integration of "sustainability risks".	<ul style="list-style-type: none"> Website 	No	10 March 2021
Product level obligations: all financial products, including those without an ESG objective				
Integration of sustainability risks	<p>Describe:</p> <ul style="list-style-type: none"> the manner in which "sustainability risks" are integrated in investment decision-making; and the results of the assessment of the likely impacts of "sustainability risks" on the returns of the FPs they make available. 	<ul style="list-style-type: none"> Pre-contractual 	No	10 March 2021
Principal adverse impacts	<p>For each FP where the FMP considers principal adverse impacts at the firm level, include in the disclosures on integration of sustainability risk:</p> <ul style="list-style-type: none"> whether and how the FP considers principal adverse impacts; and a statement that information on principal adverse impacts on sustainability factors is available as part of the FMP's periodic disclosures. <p>If not, a statement that the FMP does not consider principal adverse impacts and its reasons for doing so.</p>	<ul style="list-style-type: none"> Pre-contractual 	No	30 Dec 2022 10 March 2021 for negative statements
Marketing comms	Do not contradict information disclosed under the Disclosure Regulation.	<ul style="list-style-type: none"> All marketing communications 	Yes	10 March 2021
Product level obligations: financial products with an ESG characteristic or objective¹				
"Article 8" disclosures² <i>(FP promotes environmental or social characteristics)</i>	<p>Disclose certain prescribed information on:</p> <ul style="list-style-type: none"> how those characteristics are met; and whether and how any index designated as a reference benchmark is consistent with those characteristics. 	<ul style="list-style-type: none"> Website Pre-contractual Periodic 	Yes	10 March 2021 1 Jan 2022 for periodic disclosures
"Article 9" disclosures² <i>(FP with a sustainable objective)</i>	<p>Disclose certain prescribed information on:</p> <ul style="list-style-type: none"> how a designated index is aligned with the investment objective; why/how index differs from broad market index; and if no index, how objective is to be attained. 	<ul style="list-style-type: none"> Website Pre-contractual Periodic 	Yes	10 March 2021 1 Jan 2022 for periodic disclosures

¹ Additional disclosure obligations apply to financial products with an objective of reducing carbon emissions (also in the RTS).

² This requirement does not apply to financial advisers.



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