Sustainable Finance Disclosures Regulation (SFDR)

The Regulation on sustainability-related disclosures in the financial services sector (Sustainable Finance Disclosures Regulation or SFDR) became applicable on 10 March 2021. It introduces new disclosure obligations for insurance intermediaries providing advice with regard to insurance-based investment products (IBIPs) and for investment firms in order to integrate sustainability factors in their investment decisions and advice processes, as part of their duty to act in the best interest of clients. SFDR provides for an exemption from its scope for self-employed and entities with less than three employees. Member States may decide to opt-out from this exemption.

These sustainability-related obligations apply to all financial products as defined in SFDR, including IBIPs, portfolio management, pension products and PEPPs, regardless of whether or not they are designed as "green" products with an ESG profile (Environmental, Social and Governance).

There are disclosure obligations at entity- and at product level.

Insurance and financial intermediaries must:

1) publish information on their websites about their policies on the integration of sustainability risks in their investment advice or insurance advice,
2) publish on their websites and include information on how their remuneration policies are consistent with the integration of sustainability risks,
3) publish on their websites information as to whether they consider in their investment advice or insurance advice the principal adverse impacts on sustainability factors or information as to why they do not do so.
4) disclose, as pre-contractual disclosures in relation to each financial product, (i) the manner in which sustainability risks are integrated in their investment/insurance advice, and (ii) the result of the assessment of the likely impacts of sustainability risks on the returns of the financial products they advise on,
5) ensure that any information published is up to date.
6) ensure that their marketing communications do not contradict the information disclosed pursuant to SFDR.

When acting as product manufacturers, insurance and financial intermediaries will be required to make additional disclosures at entity level, at pre-contractual level and at periodic level about the green financial products they make available. Under the SFDR, green products can either:

1) have only sustainable investment as their objective ("dark green", Article 9 of SFDR), or
2) promote environmental or social characteristics ("light green", Article 8 of SFDR).

In April 2022, the European Commission adopted the Regulatory Technical Standards (RTS), which are Level 2 rules aiming to specify the content, methodologies and presentation of disclosures under SFDR and Taxonomy (establishing a framework to facilitate sustainable investment). The RTS – that are built on the ESAs' proposals- require financial market participants (i.e. product manufacturers) to use mandatory templates to make sustainability-related disclosures, relating particularly to the principal adverse impacts of investment decisions and to the sustainability features of a wide range of financial products ("light green" and "dark green" products). The RTS requirements, which are currently subject to a three-month scrutiny by the European Parliament and the Council, will need to be formally adopted and will start to apply from 1 January 2023.

In parallel, at the end of March 2022, the three ESAs published an update of their joint supervisory statement on the application of the SFDR and Taxonomy Regulation. The statement includes a new timeline, expectations about the explicit quantification of disclosures on taxonomy-aligned products, and the use of estimates. The updated statement replaced the initial joint supervisory statement on SFDR, which was released in February 2021.

Sustainability preferences incorporated in the IDD & MiFID II

On 2 August 2021, the final rules amending the IDD and MIFID II (and other sectoral legislation, i.e. AIFMD, UCITS, Solvency II) to integrate sustainability factors, risks and preferences into decision-making, were published in the Official Journal of the European Union. The IDD/MiFID amended rules will start to apply from 2 August 2022.

According to the new rules, insurance intermediaries distributing IBIPs and investment firms providing investment advice and portfolio management should ask questions to identify a customer's individual sustainability preferences. In accordance with their obligation to act in the best interest of their customers, recommendations to clients and potential clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is clarified that, in order to avoid mis-selling practices and misinterpretations, insurance intermediaries distributing IBIPs and investment firms providing investment advice should first assess a customer's/ client's other investment objectives, time horizon and individual circumstances, before asking for his or her potential sustainability preferences.

In April 2022, EIOPA published for consultation its draft Guidelines on integrating the customer's sustainability preferences in the suitability assessment for IBIPs under the IDD. Similarly, ESMA published for consultation a review of its MiFID Guidelines on suitability integrating the client's sustainability preferences. The Guidelines aim at promoting coherent application of these rules and prevent greenwashing practices. BIPAR submitted its response to both consultations.

On 4 May 2022, BIPAR organised a webinar on sustainable finance for its members, where Senior Expert at EIOPA, Ms Ursula Bordas, gave a presentation about the new sustainability-related obligations of insurance and financial intermediaries.

Taxonomy for sustainable economic activities

Taxonomy is a "green list" – a classification system for sustainable economic activities – that aims to create a common language which investors can use everywhere when investing in projects and economic activities that have a substantial positive impact on the climate and the environment. The Regulation on "the establishment of a framework to facilitate sustainable investment", the so-called Taxonomy Regulation or TR, started to apply on 1 January 2022 as regards the (1) and (2) environmental objectives (climate change mitigation and climate change adaptation) and will be applicable on 1 January 2023 as regards the (3), (4), (5) and (6) environmental objectives (i.e. water, biodiversity, pollution prevention and circular economy).

The first Delegated Act to the Taxonomy Regulation specifying technical screening criteria for economic activities that can make a substantial contribution to climate change mitigation and climate change adaptation, while at the same time cause no significant harm to any of the other environmental objectives, started to apply on 1 January 2022. Following this, the Commission also presented a Taxonomy Complementary Climate Delegated Act covering certain gas and nuclear activities. The Complementary Delegated Act sets out the conditions subject to which certain nuclear and gas activities can be added as transitional activities (as defined in the TR) for climate change mitigation to those activities already covered by the first Act. Once the scrutiny period by the EP and Council is over, the Complementary Act will be formally adopted and it will apply as of 1 January 2023.

Investment product manufacturers can use these criteria in order to define whether or not and to what extent the investment of a financial product has environmentally sustainable objectives. Since intermediaries will be required to take into account the customer's sustainability preferences in their suitability assessment, they should be able to look for the necessary sustainability-related information in the product information document provided by the product manufacturers.

The European Commission's Platform on Sustainable Finance published at the end of March 2022 its Report on technical screening criteria for the four remaining environmental objectives under the EU Taxonomy. The

Report is not binding, and its recommendations are now subject to the Commission's scrutiny. The Platform on Sustainable Finance has also published two more Reports relating to the EU Taxonomy: 1) Report on Environmental Transition Taxonomy (classification for activities eligible for green transition) and 2) Report on Social Taxonomy.

EU Green Bond Standard

Under the umbrella of the Taxonomy, the European Commission published in July 2021 a proposal for a Regulation on a voluntary European Green Bond Standard (EU GBS). The proposal sets out requirements for EU and non-EU issuers of bonds who wish to use the designation "EU GB" for their environmentally sustainable bonds made available to investors in the Union. For insurance, the funds raised by the bond should be fully allocated (100%) to projects related to economic activities that meet the EU Taxonomy requirements by the time the bond matures. The proposal also establishes a registration system and ESMA supervisory framework for external reviewers of European green bonds. The Commission's proposal is now under examination by the EP and the Council in order to reach an agreement on the final text of the Regulation.

EU Ecolabel for retail financial products

The Joint Research Centre (JRC), the Commission's in-house science service, has published its 4th draft Technical Report proposing EU Ecolabel criteria for retail financial products, mainly PRIIPs (i.e. UCITS and retail AIFs) and IBIPs referred to as Profit Participation and Multi-Option Product (MOP) life insurance. The EU Ecolabel criteria will determine which products are sufficiently "green" to be awarded with the EU Ecolabel by competent bodies following a verification process. The EU Ecolabel for retail financial products is a voluntary award scheme intended to promote products with a reduced environmental effect and to provide consumers with information on the environmental impact of products. This voluntary scheme applies to manufacturers of the green financial products.

According to the JRC, the EU Ecolabel for financial products is based on two principles. Firstly, a significant share of the portfolio value should be invested in environmentally sustainable economic activities as defined by the EU Taxonomy. In the draft Report, 50% to 70% of the portfolio value should be invested in green activities. Secondly, investments cannot be incompatible with the EU environmental objectives. The EU Ecolabel excludes investment in some companies that derive their revenue from excluded environmental, social and governance aspects listed therein. Following the final JRC Technical Report, the European Commission will decide whether to adopt a legislative proposal on EU Ecolabel for retail financial products.

Corporate Sustainability Reporting Directive

On 21 April 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD). The objective is to provide investors with information about the sustainability impact of the companies in which they invest, in order to promote the market for green investments. The CSRD aims ultimately to ensure that companies report the information needed by financial market participants and intermediaries subject to the SFDR to comply with their own disclosure requirements and to design products.

According to the Commission's proposal, the CSRD aims to amend the existing reporting requirements of the Non-Financial Reporting Directive (NFRD). NFRD currently applies to large, listed companies, banks, and insurance companies that are large with more than 500 employees. The Commission's proposal for a CSRD extends the scope to all large companies (non-listed) companies and all (SME) companies listed on regulated markets (except listed micro-enterprises). This means that large insurance intermediaries would fall within the scope of CSRD. Non-listed SMEs are not covered by the scope of the Commission proposal for a CSRD, but they could choose to use the simple standards on a voluntary basis. The Commission's proposal is now under examination by the EP and the Council in order to reach an agreement on the final text of the Directive.

Taxonomy Regulation (Article 8) requires companies falling within the scope of the existing NFRD – and the additional companies brought under the scope of the proposed CSRD, if approved by the co-legislators – to report on the extent to which their activities are taxonomy-aligned. The indicators for this are specified in a separate Commission's Delegated Act on key performance indicators which was formally published in the Official Journal of the EU in December 2021. Companies will have to report these indicators on taxonomy-aligned activities alongside other sustainability information mandated by the proposed CSRD. The Delegated Act will start to apply from 1 January 2023 for non-financial undertakings and from 1 January 2024 for financial undertakings. From 1 January 2022 until 31 December 2023, financial undertakings will have to disclose less detailed information.

Future EU Sustainable Finance Initiatives

In July 2021 the European Commission adopted the new Sustainable Finance Strategy which sets out several initiatives to tackle climate change, and other environmental challenges, while increasing investment in the EU's transition towards a sustainable economy. The Strategy includes, among others, the following:

- the Commission will propose minimum sustainability criteria for financial products that fall under Art. 8 of the SFDR (financial products that promote environmental or social characteristics);
- the Commission will consider merits of further changes to enable financial market participants and advisers to systematically consider positive and negative sustainability impacts of the products they advise on and of their investment decisions;
- the Commission will launch a Climate Resilience Dialogue by 2022, with the support of the insurance industry, national, local-level authorities, to exchange best practices and identify ways to address the climate protection gap and increase climate resilience either through recommendations or through voluntary commitments;
- subject to further assessment, the Commission will consider taking steps to strengthen the sustainability expertise and qualification of financial advisors, in line with the Capital Market Union action plan;
- the ESAs will be asked to review the RTS under the SFDR, to clarify indicators for both climate and environment-related principal adverse impacts and principal adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.