



ADVISORY
Industry Information

New regulations focus on sustainability in the financial services sector (Part 1 – Disclosures Regulation)

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Work has been continuing at a steady pace in Europe to implement the package of measures set out in the European Commission’s action plan on sustainable finance. Sustainable finance involves taking sustainability considerations into account as part of the financial decision making process.

Two of the proposals set out in the action plan on sustainable finance have been published¹ as regulations, (i) a regulation on disclosures relating to sustainable investments² and sustainability risks (the “Disclosures Regulation”)³; and (ii) a regulation amending the Benchmarks Regulation⁴ to create two new categories of benchmarks (the “BMR Amendment”)⁵. An overview of the key provisions of the Disclosures Regulation are set out below while the key provisions of the BMR Amendment are set out in Part 2 of this advisory series.

Disclosures Regulation - Key dates

Website and pre-contractual disclosures	10 March 2021
Periodic reports	1 January 2022
Certain financial product specific pre-contractual disclosures	30 December 2022

The Disclosures Regulation applies to “financial market participants” including alternative investment fund managers (“AIFMs”), UCITS management companies and certain types of MiFID investment firms and credit institutions which provide portfolio management and certain types of insurance undertakings and “financial advisers” including certain AIFMs, UCITS management companies, investment firms and credit institutions which provide investment advice and certain insurance undertakings and intermediaries. Certain sections of the Disclosures Regulation apply in respect of “financial products” including UCITS, alternative investment funds (“AIFs”) and certain investment portfolios, pension products and insurance based investment products. Focusing on the requirements for financial market participants, the following disclosures will need to be made available on websites, included in pre-contractual disclosure documents (such as prospectuses for UCITS and AIFs and MiFID disclosures for investment firms or credit institutions) and in periodic reports (such as the annual reports for UCITS and AIFs and MiFID periodic reports for investment firms or credit institutions):

¹ Published in the official journal of the European Union on 9 December 2019.

² Sustainable investment is defined as an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

³ Regulation (EU) 2019/2088

⁴ Regulation (EU) 2016/1011

⁵ Regulation (EU) 2019/2089



Information to be published on a website

1. Policies on the integration of sustainability risks in their decision making process.
2. Where financial market participants consider the principal adverse impacts of investment decisions on sustainability factors, a statement on due diligence policies with respect to those impacts which provides at least:
 - » information about their policies on identification and prioritisation of principal adverse sustainability impacts and indicators;
 - » a description of the principal adverse sustainability impacts and any actions in relation thereto taken, or where relevant, planned;
 - » a brief summary of the shareholder engagement policy in accordance with article 3(g) of the Shareholder Rights Directive, where applicable;
 - » reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and where relevant the degree of their alignment with the objectives of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (the "Paris Agreement").
3. Where financial market participants do not consider the adverse impacts of investment decisions on sustainability factors, clear reasons why such consideration have not taken place, including where relevant, information as to whether and when such adverse impacts will be considered.
4. Updated remuneration policy including information on how this policy is consistent with the integration of sustainability risks.
5. Financial market participants shall publish and maintain on their websites the following information for each financial product which (i) promotes environmental or social characteristics (or a combination of these); (ii) has sustainable investment as its objective and/or (iii) has a reduction of carbon emissions as its objective:
 - » a description of the environmental or social characteristics or the sustainable investment objective;
 - » information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product;
 - » the information referred to in the sections entitled "*Promotion of environmental or social characteristics*", "*Sustainable investment*" and "*Reduction in carbon emissions*" as relevant; and
 - » the information referred to in the section entitled "*Periodic reports*" as relevant.

A derogation applies to certain financial market participants in respect of the requirements set out in paragraphs 2 and 3 above. From 30 June 2021, such financial market participants shall publish and maintain on their websites a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors which contains at least the information set out in paragraph 2 above.

Financial market participants⁶ need to ensure that any information published is understandable to investors and available on a prominent easily accessible area of the website. Such information should be kept up to date and where a financial market participant amends such information, a clear explanation of such amendment needs to be published on the same website.

Financial advisers are subject to obligations to publish on their websites information about their policies on the integration of sustainability risks in their advice, whether they consider in their advice the principal adverse impacts on sustainability factors (and if not, why) and their updated remuneration policies.

⁶ Financial market participants (i) exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year or (ii) which are parent undertakings of a large group as referred to in the EU Accounting Directive (2013/34/EU) exceeding on the balance sheet date of the group, on a consolidated basis, the criterion of the average number of 500 employees during the financial year.



Pre-contractual disclosures

For AIFs and UCITS, the following disclosures should be included in the prospectus:

- a. the manner in which sustainability risks are integrated into their investment decisions or where the financial market participant has deemed sustainability risks not to be relevant a clear and concise explanation of the reasons why this decision has been made should instead be included;
- b. the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available;
- c. a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors;
- d. a statement that information on principal adverse impacts on sustainability factors is available in the periodic reports; and
- e. where paragraph 3 of the section entitled "*Information to be published on a website*" applies a statement that the financial market participant does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefor should be included for each financial product.

There is a three year transitional period (30 December 2022) in respect of the information set out in paragraphs (c), (d) and (e) of this section, with paragraphs (c) and (d) applying only to the financial market participants described in paragraph 2 of the section entitled "*Information to be published on a website*" or those relying on the derogation described in that section.

MiFID investment firms and credit institutions providing portfolio management should disclose the information set out above in accordance with their MiFID disclosure requirements.

For financial advisers, similar obligations to those in points (a) and (b), above, apply in the context of their advice.

Additional disclosure requirements for "sustainable" financial products

Promotion of environmental or social characteristics

Where a financial product promotes environmental or social characteristics (or a combination of these), provided that the companies in which investments are made follow good governance practices in addition to the information set out in the section entitled "Pre-contractual disclosures", the following information needs to be disclosed:

- a. information on how those characteristics are met; and
- b. if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics. In addition, an indication of where the methodology used for the calculation of the index is to be found.

Sustainable investment

Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, in addition to the information set out in the section entitled "*Pre-contractual disclosures*", the following information needs 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; and
- c. an indication of where the methodology used for the calculation of the index is to be found.

Where a financial product has sustainable investment as its objective and no index has been designated as a reference benchmark, in addition to the information set out in the section entitled "*Pre-contractual disclosures*", the following information needs to be disclosed:

- a. an explanation on how that objective is to be attained; and
- b. where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark as defined in the BMR Amendment is available, a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.



Reduction in carbon emissions

Where a financial product has a reduction in carbon emissions as its objective, in addition to the information set out in the section entitled "Pre-contractual disclosures", the following information needs to be disclosed:

- a. the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement; and
- b. an indication of where the methodology used for the calculation of the benchmark is to be found.

Periodic reports

Where financial market participants make available a financial product which (i) promotes environmental or social characteristics (or a combination of these); (ii) has sustainable investment as its objective and/or (iii) has a reduction of carbon emissions as its objective, the financial market participant shall include a description of the following in periodic reports from 1 January 2022:

- a. for a financial product which promotes environmental or social characteristics (or a combination of these), the extent to which environmental or social characteristics are met;
- b. for a financial product which has sustainable investment and/or a reduction of carbon emissions as its objective: (i) the overall sustainability related impact of the financial product by means of relevant sustainability indicators; or (ii) where an index has been designated as a reference benchmark, a comparison between the overall sustainability related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators.

The European Supervisory Authorities have been tasked with developing a number of draft technical standards on the content, methodology and presentation of information relating to the above disclosure requirements. The majority of the draft technical standards are required to be developed by 30 December 2020 with an additional 12 month period being given to the development of draft technical standards on the content, methodology and presentation of the information in respect of sustainable indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Next steps

Financial market participants and financial advisors should consider the additional disclosures they may be required to include on their websites and in pre-contractual disclosures to investors from 10 March 2021 and/or in periodic reports from 1 January 2022 to comply with the requirements of the Disclosures Regulation.

Part 2 of our advisory series contains information on regulation amending the Benchmarks Regulation. If you have any queries on the content of this advisory please speak to your usual contact in Walkers or connect with:

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