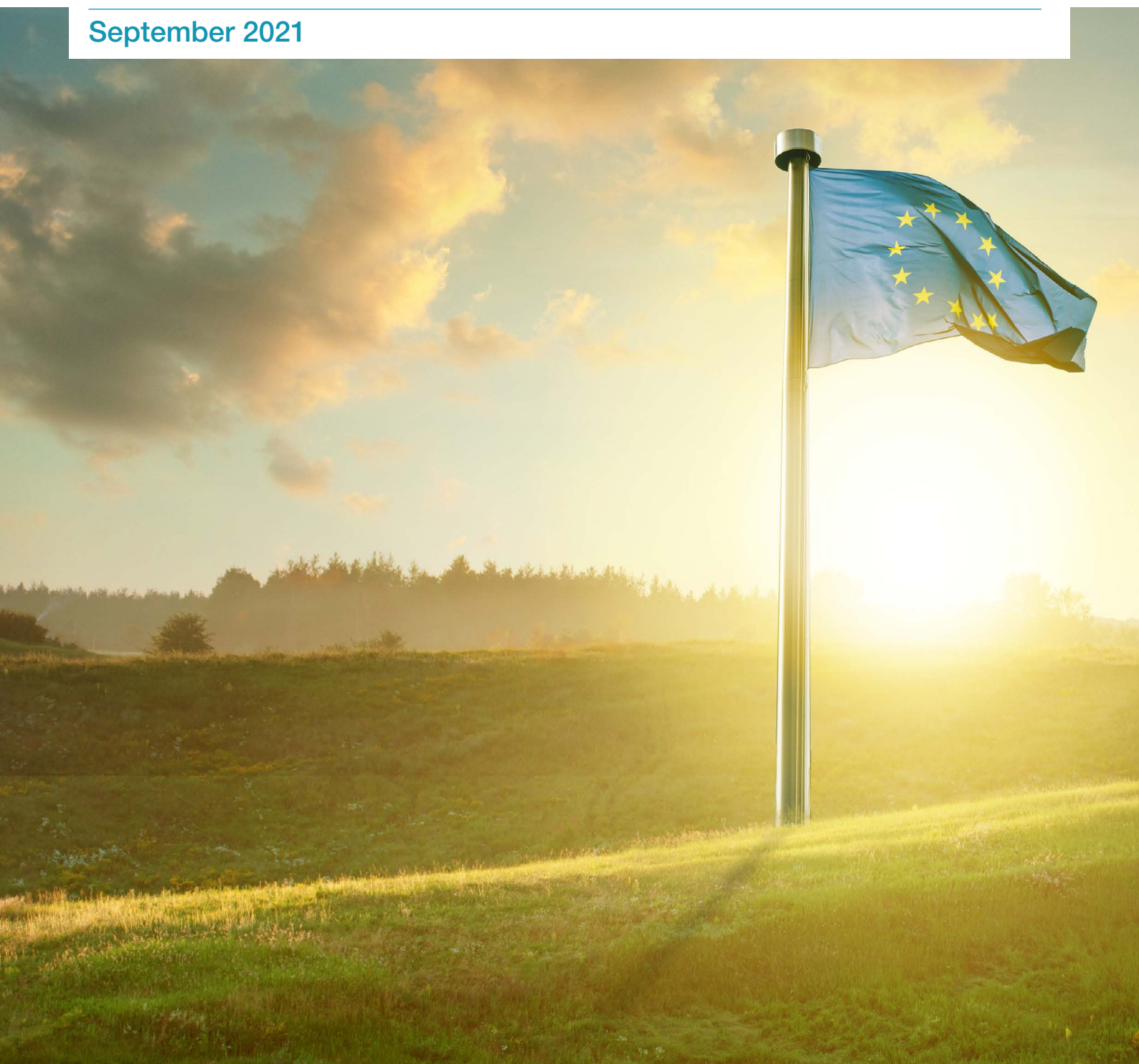


The Sustainability Disclosure Regime of the European Union

September 2021



Authors: Nicholas Pfaff, Simone Utermarck, Arthur Carabia, and Ozgur Altun, ICMA

This report is provided for information purposes only and should not be relied upon as legal, financial, or other professional advice. While the information contained herein is taken from sources believed to be reliable, ICMA does not represent or warrant that it is accurate or complete and neither ICMA nor its employees shall have any liability arising from or relating to the use of this publication or its contents. Likewise, data providers who provided information used in this report do not represent or warrant that such data is accurate or complete and no data provider shall have any liability arising from or relating to the use of this publication or its contents. © International Capital Market Association (ICMA), Zurich, 2021. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means without permission from ICMA.

Table of contents

| | |
|---------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| Key points summary | 4 |
| Background | 5 |
| Issuers | 6 |
| KPI reporting under Article 8 of the Taxonomy Regulation | 6 |
| Disclosures under NFRD and new proposed CSRD | 7 |
| Asset managers, pension providers and financial advisers | 9 |
| Key concepts and reporting under SFDR | 9 |
| Reporting of entity alignment under Article 8 of the Taxonomy Regulation | 10 |
| Reporting of product alignment under Article 5, 6 and 7 of the Taxonomy | 11 |
| Benchmark providers | 11 |
| Credit rating agencies | 12 |
| Annex 1: EU sustainability disclosures grid | 13 |
| Annex 2: Integration of TCFD recommendations in NFRD guidelines on climate reporting (also in proposed Sustainability Reporting Standards) | 16 |

Key points summary

New and amended EU legislation is introducing significant sustainability and ESG related disclosure requirements that are impacting all participants in the European capital markets. In April 2020, ICMA published a [first update](#) summarising these various requirements and how they interact with each other. Since then, there have been further developments of which this document seeks to give as much as possible a comprehensive and practical overview. **Key points to retain are:**

The Taxonomy Regulation

- The Taxonomy Regulation under Article 8 creates obligations for (a) large firms already subject to the Non-Financial Reporting Directive (NFRD), and in the future the proposed Corporate Sustainability Reporting Directive (CSRD), to disclose their level of Taxonomy alignment; and (b) for asset managers and pension providers to disclose the Taxonomy alignment of investments that underlie their financial products.
- The Delegated Act adopted on 6 July 2021, further specifies the information to be disclosed by financial and non-financial companies about how sustainable their activities are, based on Article 8 of the Taxonomy Regulation.

The Sustainable Finance Disclosure Regulation (SFDR)

- SFDR which started to apply from 10 March 2021 aims to enhance the sustainability transparency of certain financial products (e.g. investment funds) and those who issue/sell them.
- The Regulatory Technical Standards (RTS) which further specify the content, methodologies and presentation of the sustainability-related disclosures required under SFDR at both entity and product level which have been drafted by the European Supervisory Authorities (ESAs) in February 2021 are yet to be finalised and endorsed by the EC. They will start applying from July 2022.

The Non-financial Reporting Directive (NFRD) and proposed Corporate Sustainability Reporting Directive (CSRD)

- The existing NFRD has been revised following a consultation, to better facilitate disclosures required from financial market participants (FMP) such as asset managers and pension providers¹ under SFDR.
- The proposed CSRD provides a key connection for other EU disclosure regulations by ensuring that relevant non-financial information is available from investee companies. It proposes to mandate the European Financial Reporting Advisory Group (EFRAG) to draft mandatory sustainability reporting standards, which should start applying from 2024 covering FY 2023.

The Low Carbon Benchmark Regulation

- Under the Low Carbon Benchmark Regulation, benchmark providers must disclose whether and how they take ESG factors into account in benchmarks as well as the newly introduced EU Climate Transition and EU Paris-Aligned Benchmarks.

Credit Rating Regulation

- ESMA guidelines introduced in 2019 mean that credit rating agencies must disclose when considering ESG factors.

For quick reference readers may wish to note the EU sustainability disclosures grid provided in Annex 1 (updated from the 2020 memo). ICMA will aim to review and update this document in line with future developments.

¹ SFDR refers to "financial market participants" that are in fact essentially defined as asset managers and pension providers.

Background

In March 2018, the European Commission (EC) published its [Action Plan](#): Financing Sustainable Growth which contained 10 actions stretching across the whole investment chain. Following this, it presented a [package](#) of measures related to sustainable finance: (i) the [Sustainable Finance Disclosure Regulation](#) (2019/2088), hereafter “SFDR” or “Disclosure Regulation” (ii) the [Low Carbon Benchmark Regulation](#) (2019/2089, amending Benchmark Regulation or [BMR](#) 2016/1011) and (iii) the [Taxonomy Regulation](#) (2020/852). On 11 December 2019, in its communication on the European Green Deal (EGD), the EC recognised the need to improve the disclosure of non-financial information by corporates and financial institutions and named the review of the Non-Financial Reporting Directive ([NFRD](#)) amongst its roadmap of [key actions](#) as part of its strategy to strengthen the foundations for sustainable investment.

As a result, on 21 April 2021, the EC adopted an ambitious and comprehensive package of measures to help improve the flow of money towards sustainable activities across the European Union (EU). Most notably for this paper on disclosure regulation is the proposal for a Corporate Sustainability Reporting Directive ([CSRD](#)) revising NFRD (Directive 2014/95/EU which had amended Directive 2013/34/EU) and addressing its shortcomings for both users and preparers relating to a lack of comparability, reliability and relevance of data among other², that had been identified through a public consultation in 2020. Additionally, CSRD would also amend provisions from the Accounting Directive, the Transparency Directive, the Audit Directive and the Audit Regulation.

On 6 July 2021, the EC published the [Renewed Sustainable Finance Strategy](#) (“Strategy for Financing the Transition to a Sustainable Economy”) which builds on the 2018 Action Plan as well as the transition finance [report](#) by the EU Platform on Sustainable Finance, and a consultation held in 2020. With the new strategy, the EU completes the three building blocks for a sustainable financial framework: (i) the EU Taxonomy as a classification system (ii) a mandatory disclosure regime in form of the CSRD, SFDR and the Taxonomy Regulation and (iii) benchmarks, standards and labels including the two new benchmarks created by the Benchmark Regulation. The three key regulations relating to what we refer to as the “EU Sustainability Disclosure Regime” are summarised below.

EU sustainability disclosure regime for financial and non-financial companies³

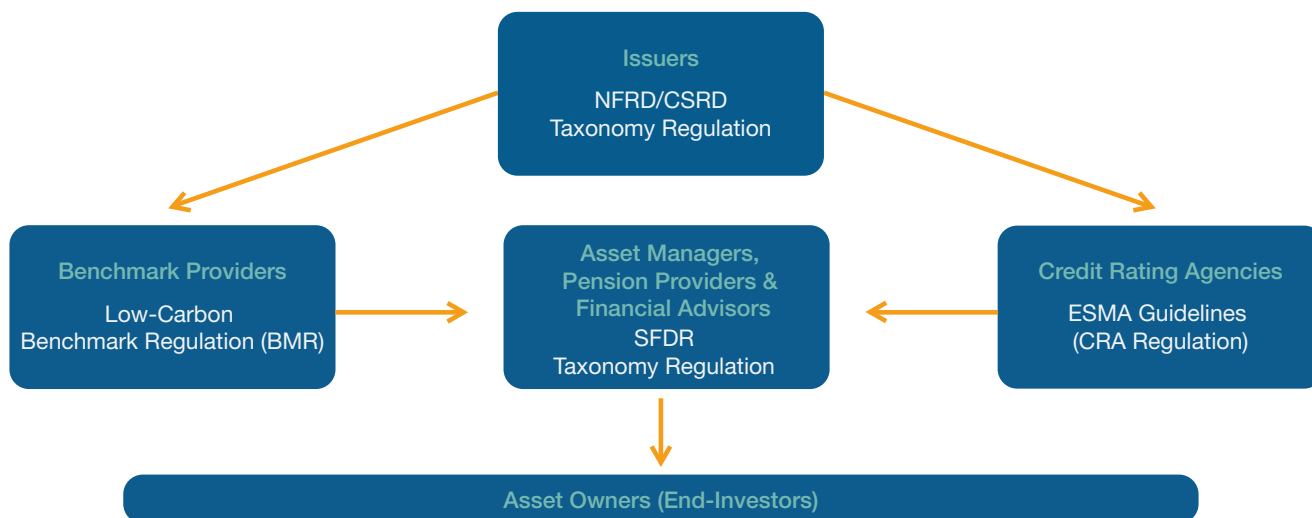
| Instrument | Corporate Sustainability Reporting Directive (CSRD) proposal | Sustainable Finance Disclosure Regulation (SFDR) | Taxonomy Regulation |
|------------|-----------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|
| Scope | All EU large companies and all listed companies (except listed micro enterprises) | Asset managers and pension providers offering investment products, and financial advisers | Asset managers and pension providers; all companies subject to CSRD |
| Disclosure | Report on the basis of formal reporting standards and subject to external audit | Entity and product level disclosure on sustainability risks and principal adverse impacts | Turnover, capital and operating expenditures in the reporting year from products or activities associated with Taxonomy |
| Status | Under negotiation, expected to apply from 2023 | Applies from 10 March 2021 | Applies from January 2022 |

² Inception Impact Assessment: a) Reported non-financial information is not sufficiently comparable or reliable; b) Companies do not report all non-financial information that users think is necessary, and many companies report information that users do not think is relevant; c) Some companies from which investors and other users want non-financial information do not report such information; d) It is hard for investors and other users to find non-financial information even when it is reported.

³ Table taken from p.4 of the Renewed Sustainable Finance Strategy.

This memorandum will explain what the Taxonomy Regulation means for issuers and investors. Furthermore, it considers the implications of both SFDR and the Low Carbon Benchmark Regulation for investors. It also explains how the proposed CSRD is a further step in connecting the dots with these regulations, all of which can only fully meet their disclosure objectives, if relevant non-financial information is available from investee companies. The graphic below illustrates the data flows to ICMA constituencies referred to in this memo.

Data flows to benefiting parties from regulatory disclosure requirements



Issuers

KPI reporting under Article 8 of the Taxonomy Regulation

The Taxonomy Regulation creates the world’s first-ever “green list” – a classification system for sustainable economic activities and brings new disclosure requirements for companies that are already required to provide a non-financial statement under NFRD (future proposed CSRD). According to Article 8⁴, for companies (“non-financial undertakings”) under the scope of NFRD⁵ it will be mandatory to report the proportion of turnover associated with Taxonomy-aligned activities as well as CapEx and where relevant OpEx that is aligned with the Taxonomy. “Taxonomy-aligned” means that when reporting on the percentage of turnover and CapEx compliant with the EU Taxonomy, companies bound by NFRD are also deemed to assess compliance with “do no significant harm” criteria and minimum safeguards.⁶ In addition, non-financial companies should provide for a breakdown of the KPIs based on the economic activity pursued, including transitional and enabling activities, and the environmental objective reached. The EC has launched an online tool on the EU Taxonomy (the ‘[taxonomy compass](#)’) designed to facilitate the use of the Taxonomy.

The European Banking Authority (EBA) in its March 2021 [response](#) to the EC’s [call for advice](#) from Sept 2020, made it clear that it considers KPIs based on turnover, CapEx or OpEx not suitable for credit institutions such as banks. It instead suggested using the **Green Asset Ratio (GAR)** which measures the share of a credit institution’s Taxonomy-aligned balance sheet exposures versus its total eligible exposures. Following a call for feedback on the Article 8 draft delegated act which was open for public comment until 2 June 2021, the EC adopted on 6 July 2021 a [Delegated Act](#) (DA) regulation, supplementing Article 8 of the Taxonomy Regulation for financial institutions (large banks, asset managers, investment firms and insurance/reinsurance companies).

⁴ https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-article-8-faq_en.pdf

⁵ The scope of undertakings subject to Article 8 of the Taxonomy Regulation will adjust automatically to the changes brought to the NFRD by the CSRD as and where relevant.

⁶ Art.3 Taxonomy Regulation: taxonomy aligned means an economic activity a) contributes substantially to one or more of the 6 environmental objectives; b) does not significantly harm any of the environmental objectives set out in Article 9; c) is carried out in compliance with the minimum safeguards laid down in Article 18; and d) complies with technical screening criteria that have been established by the EC.

The DA follows the EBA's advice in defining three KPIs for credit institutions (banks): a main KPI for on-balance-sheet assets related to financing activities, KPIs for off-balance-sheet assets and a KPI for commissions and fees related to other activities than financing. Where relevant, credit institutions should also disclose information related to their trading portfolios. However, only the main KPI and the KPI for off-balance sheet exposures apply initially while the KPIs for commissions and fees, and for trading activities, apply at a later date⁷. Specifically, the DA states that “the main key performance indicator for credit institutions should be the Green Asset Ratio (GAR)”.

All undertakings will have to start disclosing how their business activities align with the climate objectives (adaptation and mitigation)⁸ under the EU Taxonomy Regulation in the course of 2022 (covering financial year 2021) and all six environmental objectives⁹ in the course of 2023 (covering financial year 2022)¹⁰. This requirement aims to address the data gap for investors who in turn will be required to disclose the degree of alignment of their financial products with the Taxonomy objectives (see section below).

Disclosures under NFRD and new proposed CSRD

Since the entry into application of NFRD in 2018, large, listed companies with more than 500 employees are required by EU law to report on non-financial aspects related to environmental, social, employee, human rights, anti-corruption and bribery matters. Non-financial statements on these aspects should include a brief description of companies' business models, policies (including on due diligence), outcomes of these policies, risks and risk management and non-financial KPIs.

In June 2017, the EC provided [Guidelines on non-financial reporting](#) to help companies disclose relevant non-financial information in a more consistent and more comparable manner. And in June 2019, as a supplement to these 2017 guidelines the EC published [Guidelines on reporting climate-related information](#) which integrate the recommendations by the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (for [TCFD](#) also see table in Annex 2). Both guidelines are voluntary (non-binding) and did not create any new legal obligations. In order to be more effective, they should also be taken into account by the mandatory sustainability reporting standards to be created under the proposed CSRD. The table below provides a comparison between NFRD and CSRD.

NFRD vs proposed CSRD

| Instrument | NFRD | CSRD |
|-------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Scope | <ul style="list-style-type: none"> Large public-interest companies with more than 500 employees | <ul style="list-style-type: none"> Extended to additional companies, including all large companies and listed companies/SMEs (except listed micro-companies) |
| Information related to these topics | <ul style="list-style-type: none"> Environmental matters Social matters and treatment of employees Respect for human rights Anti-corruption and bribery Diversity on company boards (in terms of age, gender, educational and professional background) | <p>Additional disclosure requirements:</p> <ul style="list-style-type: none"> Company's strategy and targets Role of the board and management Principle adverse impacts (PAI) connected to the company, its value chain, and intangibles, etc. How reported info has been identified |
| Reporting standard | <ul style="list-style-type: none"> None -> non-binding guidelines¹¹ on: <ul style="list-style-type: none"> non-financial reporting (2017) and climate related reporting (2019) | <ul style="list-style-type: none"> EU sustainability reporting standards¹² defining how to report impact to and risks from environmental, social and governance areas |
| Filings | <ul style="list-style-type: none"> May be included in Management Report or separate report | <ul style="list-style-type: none"> Management Report |

⁷ See p. 10 https://ec.europa.eu/finance/docs/level-2-measures/210704-staff-working-document-delegated-act_en.pdf

⁸ On 21 April 2021 the EU Taxonomy climate delegated act was adopted by the EC. It provides the first technical screening criteria on which economic activities can be considered to make a substantial contribution to climate mitigation and adaptation objectives. In H2 2021 the EC is expected to adopt a complementary Delegated Act covering agriculture, certain energy sectors (nuclear and gas) and certain manufacturing activities.

⁹ Six environmental objectives are: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.

¹⁰ Taxonomy Compass: https://ec.europa.eu/sustainable-finance-taxonomy/tool/index_en.htm

¹¹ See Annex 1

¹² <https://www.efrag.org/Lab2?AspxAutoDetectCookieSupport=1#subtitle2> p. 25

| Instrument | NFRD | CSRD |
|---------------------------|----------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Format | <ul style="list-style-type: none"> Flexible | <ul style="list-style-type: none"> Digital, machine readable Digital taxonomy |
| Assurance | <ul style="list-style-type: none"> Not required | <ul style="list-style-type: none"> Limited assurance¹³ required with option to move to reasonable assurance requirement at later stage |
| Sanctions and Enforcement | <ul style="list-style-type: none"> None | <ul style="list-style-type: none"> Enforcement of sustainability reporting by national competent authorities (NCAs) based on ESMA guidelines to promote convergent supervision Member States for non-listed undertakings |

The proposed CSRD also contributes to the completion of the Capital Markets Union (CMU) and is a further step in connecting the dots with other EU Regulation that resulted from the EU Action Plan such as SFDR, the EU Taxonomy Regulation and the amended Benchmark Regulation, all of which can only fully meet their disclosure objectives, if relevant non-financial information is available from investee companies. Specifically, the CSRD proposal aims to ensure that:

- investee companies report the information that is needed by asset managers and pensions providers in order to fulfil their own **SFDR** reporting requirements;
- the reporting requirements for companies are consistent with the **Taxonomy Regulation**. This will be achieved above all through the proposed EU sustainability reporting standards, drafts of which will be developed by the European Financial Reporting Advisory Group (EFRAG). These will take into account the indicators companies have to disclose about the extent to which their activities are environmentally sustainable according to the Taxonomy and build on the ‘substantial contribution’ and ‘do-no-significant-harm’ screening criteria and thresholds of the Taxonomy; and
- sustainability reporting standards take account of disclosure requirements under the **BMR** and minimum requirements for the construction of the EU climate transition benchmarks (CTB) and EU Paris-aligned benchmarks (PAB).

CSRD also further clarifies the obligation to report according to the **double materiality** perspective i.e. companies should report (i) information necessary to understand how sustainability matters affect them, otherwise referred to as **risks to the undertaking** (outside in perspective) and (ii) information necessary to understand the impact they have on people and the environment, otherwise referred to as **impacts of the undertaking** (inside out perspective).

In a wider context, it aims to build on and contribute to international sustainability reporting initiatives such as the [proposal](#) of the IFRS Foundation to establish a “new Sustainability Standards Board (SSB) under the governance structure of the IFRS Foundation to develop global sustainability standards”.

Some of the standard and framework setters already used by companies in their non-financial reporting, had already converged¹⁴ on climate-related information on the basis of the Taskforce on Climate-related Financial Disclosure (TCFD) in 2020 and are starting to collaborate more closely. In November 2020 the Global Reporting Initiative (GRI), which is also cooperating with EFRAG¹⁵, the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), the Climate Disclosure Standards Board (CDSB) and CDP (formerly the Carbon Disclosure Project), announced they would join forces to work together towards Comprehensive Corporate Reporting, and in December 2020 published a [joint paper](#). Furthermore, SASB and IIRC, which both focus on financial materiality, in June 2021, merged into the new Value Reporting Foundation ([VRF](#)).

The proposed CSRD will now work its way through the European Parliament and Council, then through trilogues. Negotiations could easily take 18 months, experts predict. According to the indicative timeline, companies can expect to have to publish first reports according to the new standards in 2024, covering FY 2023.

¹³ Including on the compliance of the sustainability reporting with the reporting standards, on the process carried out by the company to identify the information reported pursuant to the standards, on the mark-up of sustainability reporting, and on the indicators reported pursuant to Art. 8 of the Taxonomy Regulation.

¹⁴ As the Better Alignment Project found in 2019; <https://corporatereportingdialogue.com/better-alignment-project/>

¹⁵ <https://www.efrag.org/Assets/Download?assetUrl=%2fsites%2fwebpublishing%2fSiteAssets%2fEFRAG%2520GRI%2520COOPERATION%2520PR.pdf>

Asset managers, pension providers and financial advisers

Key concepts and reporting under SFDR

Requirements under **SFDR** relate to three key concepts: sustainable investment, sustainability risk and sustainability factors which are defined as follows:

- **Sustainable investment** is an investment in an economic activity which (i) contributes either to an environmental or a social objective; (ii) does not significantly harm any environmental or social objectives and (iii) where the investee company follows good governance practices (N.B. this reflects Art. 3 of the **EU Taxonomy Regulation**).
- **Sustainability risk** is an environmental, social or governance event or condition which, if it occurs, could cause a material negative impact on the value of an investment.
- **Sustainability factors** are environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters (N.B. this reflects **NFRD/CSRD**).

With regards to these three concepts, SFDR revolves around two key sustainability themes on entity level and a third on product level. SFDR aims to increase transparency mainly through website and pre-contractual disclosures (e.g. in prospectuses) as well as periodic reports (see table below). The focus is also on **double materiality**, i.e. both the integration of sustainability within the firm, and external impact of a firm's investing on sustainability factors.

Table summarising main provisions under SFDR

| Types of disclosure | Legal obligation | Scope | Where to disclose |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|---------------------------------------------------------|
| Policies on the integration of sustainability risks in investment decisions or advice (Art.3) | Mandatory | Asset managers and pension providers + financial advisors | Website |
| Consideration of adverse sustainability impacts at entity level (Art.4): <ul style="list-style-type: none"> • Principal adverse impacts/indicators/actions • Engagement policies • Adherence to standards on due diligence, alignment with Paris Agreement (where relevant) | Comply or explain Firms, group subsidiaries with > 500 employees cannot "explain" after 30 June 2021 | Asset managers and pension providers + financial advisors | Website |
| Consistency between remuneration policies and sustainability risks (Art.5) | Mandatory | Asset managers and pension providers + financial advisors | Website |
| Integration of sustainability risks in investment decisions or advice and impacts of sustainability risks on the returns of the financial products (Art.6) | Comply or explain | Asset managers and pension providers + financial advisors | Pre-contractual documents |
| Consideration of adverse sustainability impacts at product level (Art.7): <ul style="list-style-type: none"> • Methodology integrating sustainability adverse impacts into their investment decisions | Comply or explain By 2023 each financial product issued by firms needs to comply or explain unless firms < 3 persons | Asset managers and pension providers | Pre-contractual documents |
| Characteristics/objectives/benchmarks of ESG and "sustainable" financial products (Art.8, 9, 10 & 11). | Mandatory | Asset managers and pension providers | Pre-contractual documents, website and periodic reports |

The content, methodologies and presentation of the sustainability-related disclosures required under SFDR at both entity and product level will be further specified by the final regulatory technical standards (RTS). So far, the **draft RTS** proposed by the ESAs¹⁶ on 2 February 2021, relate to two levels of disclosure, summarised in the table below:

| Entity level principle adverse disclosures | Pre-contractual, website and periodic product ¹⁷ level disclosures |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Disclose the principal adverse impacts (PAI) that investment decisions have on sustainability factors, i.e. indicators in relation to climate and environment; social and employee matters, respect for human rights, anti-corruption and anti-bribery aspects</p> | <p>Disclose information to show how a product with ESG/sustainable characteristics (often referred to in the market as “light green”) or with sustainable investment objectives meets those characteristics or objectives (so called “dark green”)</p> <p>Disclose why sustainable investments do not harm environmental or social objectives (DNSH)</p> |

According to the ESAs’ proposal, asset managers will have to report at entity level their ESG footprint by assessing all their investments against 18 mandatory environmental and social KPIs¹⁸ and two other ones to be chosen among a list of 46 optional indicators. These KPIs listed in the draft RTS relate to climate and social aspects such as greenhouse gas emissions, biodiversity, water, waste and social and employee matters. Separate indicators applicable to investments in sovereigns and supranationals as well as real estate assets, are proposed. This reporting will come with several challenges as highlighted [here](#) in ICMA’s *Asset Management and Investors Council (AMIC) note on these SFDR draft RTS and the 18 mandatory KPIs*.

Beyond the entity disclosure against these mandatory KPIs, which is the most striking novelty introduced by the draft RTS, the text proposed by the ESAs introduces mandatory templates to disclose the sustainability characteristics or objectives of financial products at pre-contractual level and via periodic documentation. Fund managers will have to disclose (among other things) whether, and if so how, they consider the overall KPIs at product level and in particular when conducting the DNSH assessment of sustainable investments. They will also have to disclose if the product promotes ESG characteristics and/or has a sustainable investment objective, and the share of investments aligned with the EU Taxonomy (calculation methodology yet to be defined). Please note that these RTS are yet to be endorsed and could still be changed by the EC before being adopted/implemented in 2022. ICMA’s AMIC has [invited](#) the ESAs and the EC to refine the list of eligible assets to be factored in the Taxonomy KPI and to simplify information to be disclosed to end-investors.

While asset managers, pension providers and financial advisers were required to apply most of the provisions on sustainability-related disclosures laid down in the SFDR from 10 March 2021 (Level 1 disclosure obligations), the application of the RTS was delayed to a later date following an October 2020 [EC letter to the ESAs](#). In February 2021, the ESAs proposed in these draft RTS that the application date of the RTS (Level 2 disclosures) should be 1 January 2022. In a [letter](#) on 8 July 2021, the EC however informed the European Parliament and Council that it planned to bundle all of the draft RTS into a single Delegated Act and defer the dates of application by six months to 1 July 2022.¹⁹

Reporting of entity alignment under Article 8 of the Taxonomy Regulation

As already mentioned in the issuer section, on 6 July 2021 a Delegated Act ([DA](#)) regulation was adopted as a supplement to Article 8 of the Taxonomy Regulation, further specifying the disclosure obligations for financial institutions, mainly large banks, asset managers, investment firms and insurance/reinsurance companies which will have to disclose the share of environmentally sustainable economic activities in the total assets they finance or invest in. For asset managers this means, they should report the proportion of their Taxonomy-aligned managed investments in the value of all covered assets under management²⁰ from both their collective and individual portfolio management activities (Green Investment Ratio).

¹⁶ <https://www.esma.europa.eu/press-news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rts>

¹⁷ SFDR refers to “financial products” meaning quite specifically: (a) a portfolio managed in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments; (b) an alternative investment fund (AIF); (c) an IBIP; (d) a pension product; (e) a pension scheme; (f) a UCITS; or (g) a PEPP.

¹⁸ See from page 60 https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

¹⁹ <https://nfrregulationstomorrow.lexblogplatformthree.com/wp-content/uploads/sites/416/2021/07/SFDR-letter.pdf>

²⁰ All AuM except for sovereign exposures.

It is important to note that sovereign exposures or investment in sovereign debt are excluded from both the numerator and the denominator of the **Green Investment Ratio (GIR)**²¹. The Commission services will review this at a later stage (by 30 June 2024) to decide whether and how to develop a methodology for assessing the environmental performance of sovereign exposures. Financial undertakings may, on a voluntary basis, provide information in relation to exposures to Taxonomy-aligned bonds and Taxonomy-aligned debt securities that are issued by central governments, central banks or supranational issuers²².

Asset managers and pension providers 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 **31 December 2021**. Disclosures in relation to all six environmental objectives are due by the **31 December 2022**. All these disclosures will have to be made in pre-contractual documents, the website and periodic reports.

Reporting of product alignment under Article 5, 6 and 7 of the Taxonomy

On a product level, asset managers and pension providers under the scope of SFDR, are also facing disclosure requirements under Articles 5, 6 and 7 of the **Taxonomy Regulation**. This means, they need to disclose the Taxonomy alignment of their financial products (e.g. managed portfolios/funds). More specifically:

- **Products that have sustainable investment as their objective** (“dark green” SFDR Article 9 Products) must disclose the percentage of the fund that is Taxonomy-aligned (Art. 5 Taxonomy Regulation).
- **Products with environmental or social characteristics** (“light green” SFDR Article 8 Products) must disclose the percentage of the fund that is Taxonomy-aligned; the “do no significant harm principle” only applies for the investments underlying the products²³ that consider the EU Taxonomy. Mandatory statement: “The ‘do no significant harm’ principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.” (Art. 6 Taxonomy Regulation).
- **Products that do not consider the EU Taxonomy** must include the mandatory statement: “The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.” (Art.7 Taxonomy Regulation).

Benchmark providers

Under the **Low Carbon Benchmark Regulation**, which amended the existing **Benchmark Regulation**, all benchmark providers²⁴ (except interest rate and foreign exchange benchmarks) administering benchmarks have to disclose whether and how they take ESG factors into account²⁵. These disclosure requirements also apply to the two new categories of benchmarks introduced by the amended regulation in 2020, namely EU climate transition benchmarks (CTB) and EU Paris-aligned benchmarks (PAB).

On 17 July 2020, the EC [adopted](#) new rules setting out minimum technical requirements for the methodology of EU climate benchmarks. The Delegated Acts (DAs) were published in the Official Journal of the European Union on 3 December 2020 and applied from 23 December 2020. Exceptions to this timetable are:

- the requirement to include certain Scope 3 GHG emissions data in CTB and PAB methodologies, which will apply from 23 December 2022 or 23 December 2024, depending on the sector; and
- the requirement to exclude certain types of companies from the composition of CTBs, which will apply from 31 December 2022.

21 The same applies to the Green Asset Ratio (GAR) for financial institutions.

22 P. 11 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-article-8-faq_en.pdf

23 Portfolio, AIF, IBIP, pension product, pension scheme, UCITS or PEPP.

24 Referred to as benchmark administrators in the regulation.

25 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1816&from=EN>

DA [\(EU\) 2020/1816](#) requires disclosures on **how ESG factors are reflected in each benchmark** with a list of ESG factors to be considered based on the underlying assets of the benchmark: equity, fixed income, sovereign debt, commodity and other assets. It also provides templates for the:

- Explanation of how ESG factors are reflected in the benchmark statement
- Additional disclosure requirements for EU CTB and EU PAB
- Disclosure of the alignment with the objectives of the Paris Agreement

DA [\(EU\) 2020/1817](#) requires disclosures on **how ESG factors are reflected in the benchmark methodology**. With the exception of commodity benchmarks, administrators should explain which factors referred to in Regulation (EU) 2020/1816 have been taken into account in their methodology and how they are reflected in its key elements including the selection of underlying assets, weighting factors, metrics and proxies.

Beyond disclosures, it is important to note that DA [\(EU\) 2020/1818](#) provides guidance on **minimum standards for CTB and PAB** aligned benchmarks.

Credit rating agencies

Under ESMA's guidelines on Disclosure Requirements applicable to Credit Ratings [published](#) on 18 July 2019, when a credit rating agency (CRA) considers ESG factors it needs to disclose in its press releases or reports:

- Whether the key drivers behind the change of rating/outlook correspond to ESG factors identified by the CRA;
- The key driving factors that were considered by that CRA to be ESG factors;
- An explanation of the impact of these ESG factors to the credit rating or rating outlook; and
- A link to the relevant source on the CRA's ESG methodology.

In 2019, ESMA had also published [technical advice](#) on sustainability considerations in the credit rating market and [advised](#) against an update to existing CRA Regulation to explicitly mandate the consideration of sustainability characteristics in all rating assessments.

As announced in the Renewed Sustainable Finance Strategy [published](#) on 6 July 2021, "subject to further assessment of the effectiveness of the existing measures by ESMA, the EC will take action to improve transparency and ensure the inclusion of relevant ESG factors in credit ratings and credit outlooks, while ensuring methodological transparency". This is expected to be introduced by potential regulatory measures in 2023.

Annex 1: EU sustainability disclosures grid

| Who? | Which law? | What to disclose? | Where, how to report it? | Next steps |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issuers NFRD: Large Public Interest Entities with more than 500 employees CSRD: all large companies and listed companies | NFRD | Mandatory NFRD: information on environmental, social, employee, human rights, anti-corruption and bribery matters including description of business model, policies on sustainability matters, outcomes, principal risks, and KPIs | Where? Quarterly/annual reports or dedicated CSR report How? Guidelines on non-financial reporting Guidelines on Climate-reporting | None |
| | Proposed CSRD | Mandatory NFRD plus additional disclosure requirements on a company's strategy and targets; role of the board and management; principle adverse impacts (PAI) connected to the company/value chain; intangibles (e.g. intellectual capital, human capital incl. skills development, brand, social capital, relationship capital incl. reputation capital, intellectual property and intangibles related to R&D) and how the reported info has been identified | Where? Management Report How? Proposed Sustainability Reporting Standards | Co-legislators to reach agreement on Level 1 of proposed CSRD |
| | Taxonomy Regulation | Mandatory <ul style="list-style-type: none"> • Turnover derived from products/services associated with the Taxonomy • CapEx and/or OpEx related to asset/ processes associated with the Taxonomy • Green Asset Ratio (GAR) for credit institutions | Where? Quarterly/annual reports or dedicated CSR report How? Delegated act adopted by EC on 6 July 2021 | The Climate DA transmitted for scrutiny by the European Parliament and the Council for a period of 4 months EU Platform working on the remaining 4 objectives. |

| Who? | Which law? | What to disclose? | Where, how to report it? | Next steps |
|--------------------------------------------------------------------------|-------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Asset managers and pension providers | Disclosure Regulation (SFDR) | Mandatory <ul style="list-style-type: none"> Integration of sustainability risks in investment decisions or advice, and remuneration | Where? Website How? Technical standards pending | Level 1 applies since: 10.03.2021 Level 2: Proposed application date of the final RTS is 1 July 2022 |
| | | Comply or explain <ul style="list-style-type: none"> Consideration of adverse sustainability impacts at product and entity levels: firms and group subsidiaries with > 500 employees cannot “explain” after 30 June 2021 | Where? Website, Pre-contractual documents How? Technical standards pending | |
| | | Comply or explain <ul style="list-style-type: none"> Impacts of sustainability risks on the returns of the financial products | Where? Pre-contractual documents How? No technical standard | |
| | | Mandatory <ul style="list-style-type: none"> Characteristics/objectives/benchmarks of ESG and “sustainable” financial products | Where? Pre-contractual documents, website and periodic reports How? Technical standards pending | |
| | Taxonomy Regulation | Mandatory <ul style="list-style-type: none"> Alignment of “Sustainable” and ESG products (as defined in SFDR) aligns with the EU Taxonomy objectives, including the “do no significant harm (DNSH)” principle Statement for products with no ESG characteristics: “does not consider Taxonomy” | Where? Pre-contractual documents and periodic reports How? No recommended format | Applies from: -“Sustainable” products: 31.12.2021 -others: 31.12.2022 |
| Benchmarks administrators: All except interest rate and foreign exchange | Low Carbon Benchmark Regulation | Mandatory <ul style="list-style-type: none"> Consideration of ESG factors for each benchmark Mandatory <ul style="list-style-type: none"> EU PAB carbon emissions are aligned with the objectives of the Paris Agreement EU CTB: underlying assets are on a decarbonisation trajectory | Where? Websites and statements How? Delegated acts specifying the relevant disclosures (DA on the benchmark statement, DA on the benchmark methodology, and DA on EU CTB and EU PAB) | The amended BMR applies since April 2020 while the EC adopted the supplemented delegated acts in July 2020. Other requirements apply from: -Scope 3: 22.12.2022-2024 (depending on the sector) -Exclusion of certain companies: 31.12.2022 |

| Who? | Which law? | What to disclose? | Where, how to report it? | Next steps |
|------------------------|------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|
| Credit rating agencies | CR disclosure guidelines | Mandatory When a CRA considers ESG factors it needs to disclose: <ul style="list-style-type: none"> • Whether the key drivers behind the change of rating/outlook correspond to ESG factors identified by the CRA • Key driving factors that were considered by that CRA to be ESG factors • Explanation of the impact of these ESG factors to the credit rating or rating outlook • A link to the relevant source on the CRA's ESG methodology. | Where? Press releases or reports How? Guidelines on Disclosure Requirements Applicable to Credit Ratings | Applies since: 30.03.2020 |

Annex 2: Integration of TCFD recommendations in NFRD guidelines on climate reporting (also in proposed Sustainability Reporting Standards)

| Who? | | Business Model | Policies and due diligence | Outcomes | Principal risks & Mgmt | KPIs |
|-------------------|-----------------------------------------|----------------|----------------------------|----------|------------------------|------|
| Governance | Board oversight | | √ | | | |
| | Management role | | √ | | | |
| Strategy | Climate risks and opportunities | | | | √ | |
| | Impact of climate risks & opportunities | √ | | | | |
| | Resilience of the operation strategy | √ | | | | |
| Risk Management | Processes for identifying & assessing | | | | √ | |
| | Processes for managing | | | | √ | |
| | Integration risk management | | | | √ | |
| Metrics & targets | Metrics used to assess | | | | | √ |
| | GHG emissions | | | √ | | |
| | Targets | | | √ | | |

Source: ICMA based on regulation