Principles for Responsible Investment

INVESTOR BRIEFING

EU REGULATION ON SUSTAINABILITY-RELATED DISCLOSURES IN THE FINANCIAL SERVICES SECTOR

UPDATED FEBRUARY 2022

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,500 signatories – pension funds, insurers, investment managers and service providers – to the PRI's six Principles. with approximately US$121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their clients and beneficiaries, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investments play in financial markets and the impact those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ABOUT THIS BRIEFING

This briefing unpacks the EU regulation on sustainability-related disclosures in the financial services sector, known as the SFDR, which sets out transparency requirements for investors and financial advisers. The briefing is updated on a regular basis – please check the PRI investor briefings page for the most recent version. This version incorporates the draft SFDR Regulatory Technical Standards (RTS) on the content, methodologies and presentation of disclosures, published on 2 February 2021, and draft RTS on product disclosures related to the EU Taxonomy, published on 22 October 2021.

For more information, contact:

Elise Attal	Ben Leblique	Hazell Ransome
Head of EU Policy	Senior Policy Analyst	Policy Analyst
elise.attal@unpri.org	ben.leblique@unpri.org	hazell.ransome@unpri.org

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AT A GLANCE

WHY THE SFDR MATTERS

The SFDR creates disclosure requirements for sustainability risks in the financial services sector. This is crucial to combat ambiguity around investor duties, which the PRI has shown – through its work with the Fiduciary Duty in the 21st Century programme and the High-Level Expert Group on sustainable finance – to be a key barrier to systematic integration of ESG factors by investors.

The regulation also encourages investors to identify, assess and mitigate the potential adverse impacts of their investments on society and the environment. This is consistent with the direction of the broader sustainable finance agenda, as investors work towards understanding the social and environmental outcomes of their investment activities.

Sustainability disclosures are a key pillar of the EU's sustainable finance strategy, as defined in its 2018 action plan on financing sustainable growth (see Figure 1). The SFDR is therefore closely linked to the corporate sustainability reporting framework, the CSRD, currently under development, and the EU Taxonomy that provides a benchmark for defining what constitutes an environmentally sustainable economic activity. Ensuring consistency between these frameworks and standards is a key priority for the PRI's EU policy work.

Figure 1: EU sustainable finance action plan. Source: Adapted from European Commission

1. EU Taxonomy

A common classification of economic activities substantially contributing to environmental objectives, using science-based criteria

- Taxonomy Regulation: adopted on 18 June 2020, already applies to some funds

2. Disclosures

A comprehensive disclosures regime for both non-financial and financial institutions to provide investors with the information necessary to make sustainable investment choices

- SFDR: applies since March 2021
- Corporate Sustainability Reporting Directive: proposed by the European Commission in April 2021
- Sustainability preferences: will apply from August 2022

3. Tools

A broad toolbox for companies, market participants and financial intermediaries to develop sustainable investment solutions, while preventing greenwashing

- EU Climate Benchmarks Regulation: applies since April 2020
- European green bond standard: proposed by the Commission in 2021

HOW THE SFDR RELATES TO THE PRI'S PRINCIPLES

Reporting requirements under the SFDR are closely related to the PRI's Principles.

Table 1: PRI Principles and SFDR

PRI Principle	SFDR objectives and requirements
Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.	The SFDR requires financial market participants to disclose how they take account of sustainability risks, which encourages incorporation of ESG issues into investment decisions.
Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.	The SFDR should lead to further engagement with investees to source ESG metrics and data that need to be considered in investment practice.
Principle 6: We will each report on our activities and progress towards implementing the Principles.	The PRI reporting and assessment (R&A) framework is similar to the SFDR in some respects. For example, both the SFDR and the PRI R&A framework require investors to disclose how they integrate sustainability risks/ESG issues into investment decisions. Likewise, under the SFDR, large companies must disclose how they identify adverse sustainability impacts of their investments, while, under the PRI R&A framework, investors can voluntarily disclose how they are working towards achieving their sustainability targets. There are, however, also important differences: ▪ The PRI R&A framework only covers entity-level disclosures, whereas SFDR disclosures are required at both entity and product levels. ▪ PRI indicators vary depending on asset class, whereas SFDR requirements and indicators apply regardless of asset class (with some exceptions).

KEY FEATURES OF THE SFDR

The SFDR sets out requirements on sustainability-related disclosures in the financial services sector, both at entity and product levels. The requirements distinguish between financial products that have sustainable investment as their objective, those that promote environmental and/or social objectives and all other products. The regulation began to apply on 10 March 2021, although some more detailed obligations start only from this year or will from 2023.

WHO IS AFFECTED?

The regulation applies to financial institutions, defined as:

- insurance undertakings making available Insurance-Based Investment Products (IBIPs);
- Institutions for Occupational Retirement Provision (IORPs);
- manufacturers of pension products;
- providers of Pan-European Personal Pension Products (PEPPs);
- Alternative Investment Fund Managers (AIFMs);
- management companies of Undertakings for Collective Investment in Transferable Securities (UCITS);
- investment firms or credit institutions providing portfolio management and investment advice.

Non-EU financial market participants managing EU-domiciled funds or marketing non-EU domiciled funds into the EU may also be impacted by SFDR requirements.

REGULATORY TECHNICAL STANDARDS

To implement the SFDR, the European Supervisory Authorities (ESAs) have developed draft RTS. These detail the content and the presentation of required disclosures, which depend on the type of financial product and the product's claims about sustainability.

Two sets of RTS have been published by the ESAs:

- The first set, published in February 2021, contains detailed SFDR reporting requirements, including templates for pre-contractual and periodic disclosures and statements on principal adverse impacts (PAIs).
- In October 2021, the ESAs published RTS on taxonomy-related product disclosures. The standards spell out how taxonomy-alignment ratios should be calculated at product level and how they should be presented. The document also contains consolidated draft RTS (page 123), excluding the templates for PAIs. The consolidated draft RTS are the standards we refer to in this briefing unless otherwise indicated.

The European Commission has stated that it will adopt the entire set of SFDR RTS in a single delegated act and will defer their application to 1 January 2023.

LINK TO THE TAXONOMY REGULATION

The Taxonomy Regulation, published in 2020, sets out the overarching conditions an economic activity has to meet in order to qualify as environmentally sustainable. The Taxonomy Regulation and the SFDR both apply to the same categories of funds and are designed to be complementary disclosure frameworks.

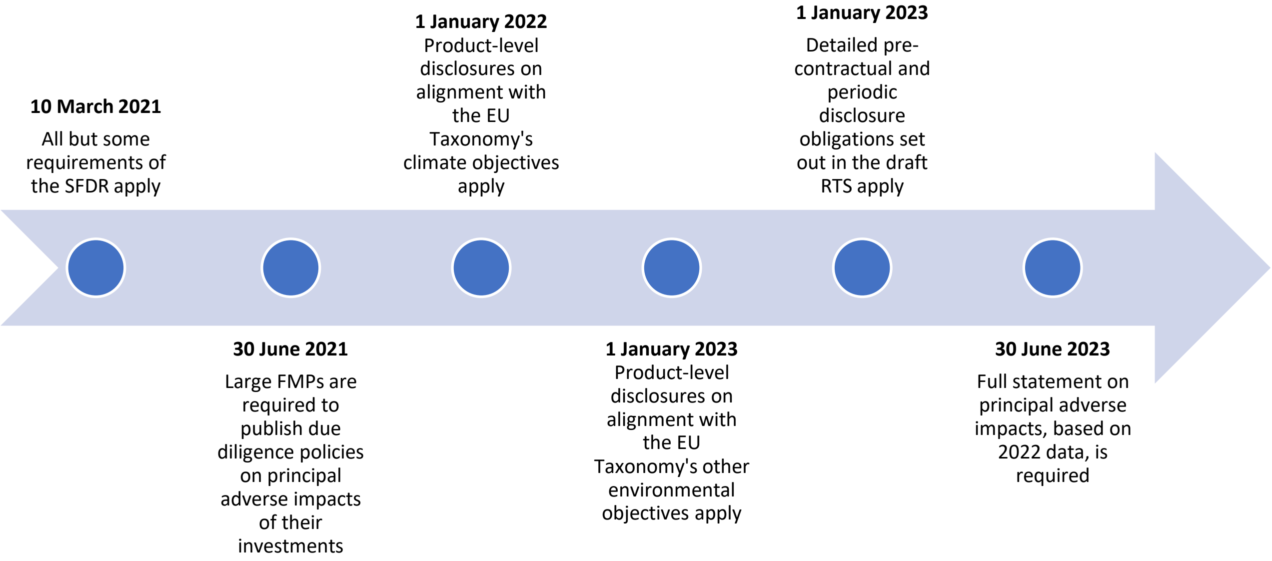
As of 1 January 2022, investors claiming to make environmentally sustainable investments (under Articles 5 and 6 of the Taxonomy Regulation) are required to justify this in their product disclosures by reporting the alignment of those investments with the EU Taxonomy. From 1 January 2023, they will be required to use the detailed methodology set out in the draft RTS[1].

As of January 2022, companies and investors are also required to report against the EU Taxonomy at entity level under Article 8 of the Taxonomy Regulation. A delegated act published in July 2021 sets out the detailed methodology and timing for these disclosures[2].

For more details on the EU Taxonomy, please see the PRI's briefing note.

APPLICATION TIMELINE

Figure 2: Application timeline for EU sustainable disclosures obligations



[1] See Box 4 further on in this briefing for more details.

[2] See also the Commission's recent FAQ guidance on entity-level disclosures under Article 8 of the Taxonomy Regulation.

OVERVIEW OF DISCLOSURE REQUIREMENTS

The table below provides an overview of disclosure requirements for Financial Market Participants (FMPs) falling under the scope of the SFDR, at both entity and product levels.

Table 2: Overview of disclosure requirements under the SFDR

	FMPs must disclose:
Entity level	Their policies on the integration of sustainability risks in investment decisions
	Information on how their remuneration policies are consistent with the integration of sustainability risks
	A statement relating to principal adverse sustainability impacts
Product level	How sustainability risks are integrated (Article 6, which applies to all products on a comply-or-explain basis)
	How they consider the product's principal adverse sustainability impacts, if over 500 employees, or, if fewer employees, whether they do so
	For products that promote environmental and/or social characteristics (so-called Article 8 products), how those characteristics "are met", as well as information on taxonomy alignment
	For products that have sustainable investment as their objective (so-called Article 9 products), how that objective is to be attained, as well as information on taxonomy alignment

PRODUCT CLASSIFICATION

The SFDR contains detailed disclosure requirements for FMPs that market their products as sustainable, distinguishing between two types of products:

- Products that promote social and/or environmental characteristics (SFDR Article 8)
- Products that have sustainable investment as their objective (SFDR Article 9)

In July 2021, the European Commission provided some clarifications on which products fit into which category above. These are summarised below.

	Article 8 – products promoting environmental or social characteristics	**Article 9 – products with sustainable investment as their objective**
Investments	The SFDR does not prescribe eligible investment targets or a minimum investment threshold.	Underlying assets must qualify as "sustainable investments"[1] (with some exceptions for hedging and liquidity purposes).
Application	"Promotion" is interpreted broadly and encompasses any type of claim that investments consider sustainability characteristics in policies or objectives.	If the objective is a reduction in carbon emissions, the product must track an EU climate benchmark or, where no suitable benchmark exists, come with a detailed explanation of efforts to attain the objective.
Investment practice	The SFDR is neutral as to the design and investing approach of the product.	The SFDR is neutral as to the design and investing approach of the product.

In their efforts to comply with the SFDR, investors have taken different approaches to product classification based on varying interpretations of the regulation. The result is a wide range of ESG approaches represented by Article 8 and 9 products, with similar strategies featuring in both categories.

It is important to keep in mind that the SFDR was designed to be a disclosure framework, not a labelling scheme. End-investors therefore should seek to understand the specific underlying characteristics of products and not treat the Article 8 or 9 designation as a label guaranteeing a certain standard of sustainability performance.

The European Commission has said that it will consider developing "minimum sustainability criteria" for products categorised as Article 8 under the SFDR.

[1] SFDR Article 2(17) states that sustainable investment is an investment in an economic activity that contributes to an environmental or a social objective, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices.

DISCLOSURE REQUIREMENTS IN DETAIL

ENTITY-LEVEL DISCLOSURE REQUIREMENTS

The following statements must be published by FMPs and Financial Advisers (FAs) on their websites:

- policies on the integration of sustainability risks in their investment decision-making, or in their investment or insurance advice (SFDR Article 3);
- a statement relating to principal adverse sustainability impacts for FMPs (SFDR Article 4);
- a statement relating to adverse sustainability impacts for FAs (Article 10 of the draft RTS);
- information on how their remuneration policies are consistent with the integration of sustainability risks (SFDR Article 5).

POLICIES ON THE INTEGRATION OF SUSTAINABILITY RISKS IN DECISION-MAKING OR ADVICE (SFDR ARTICLE 3)

FMPs and FAs shall publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process or advice.

STATEMENT RELATING TO PRINCIPAL ADVERSE SUSTAINABILITY IMPACTS – FOR FINANCIAL MARKET PARTICIPANTS (SFDR ARTICLE 4)

The entity-level PAI statement should provide information of the FMP's due diligence policies on the negative impacts of investment decisions on sustainability factors. This statement must contain:

- a description of the principal adverse sustainability impacts, including the disclosure of 16 PAI indicators and actions taken or planned to avoid or reduce the PAIs identified;
- description of policies for identifying and "prioritising" PAIs;
- engagement policies;
- a reference to adherence to international standards.

The detailed contents of the PAI statement are set out in Box 1.

The statement is mandatory for FMPs with more than 500 employees. Those below that threshold are required to comply or explain, meaning that if they do not consider the PAIs of their investment decisions, they must clarify why they do not and when they intend to consider them (Article 11 of the draft RTS).

BOX 1: What PAI statement must contain

According to Table 1 in Annex I of the draft RTS from February 2021 (page 59).

Description of principal adverse sustainability impacts

This shall include (as per Article 6 of the consolidated draft RTS):

- a description, for the reference period*, of adverse impacts of the FMP's investment decisions on sustainability factors that qualify as principal; including
  - all the indicators related to PAIs on sustainability factors, as set out in Table 1 of Annex I – for example, the greenhouse gas emissions and the gender pay gap of investee companies;
  - at least two additional indicators related to PAIs specifically on an environmental and social/governance factor that qualifies as principal, as set out in Tables 2 and 3 of Annex I;
  - any other indicators used to identify and assess additional PAIs on a sustainability factor;
- a description of the actions taken during the reference period* and actions planned or targets set by the FMP for the next reference period to avoid or reduce the PAIs identified;
- a historical comparison of the current reference period* with the previous reference period. FMPs shall continue to include further historical comparisons within that statement for at least five previous reference periods.

* For an explanation of reference periods, see the section on the disclosure timeline and reference periods in PAI statements lower down.

Description of policies to identify and prioritise principal adverse sustainability impacts

The description shall include at least the following (Article 7 of the draft RTS):

- the date of approval of the policies by the FMP's governing body;
- the allocation of responsibility for the implementation of the policies;
- a description of the methodologies to select the indicators to identify and assess PAIs and, in particular, how those methodologies take into account the probability of occurrence and severity of adverse impacts;
- an explanation of any associated margin of error within those methodologies and a description of the data sources used.

BOX 1: What PAI statement must contain (continued)

Engagement policies

FMPs shall publish on their websites brief summaries of engagement policies in accordance with Article 3g of the Shareholder Rights Directive.

The draft RTS state that this shall also include:

- a description of the indicators for adverse impacts considered in those policies and how those policies are adapted where there is no reduction of the PAIs over more than one reference period (Article 8(2) of the draft RTS);
- a brief summary of any other engagement policies related to reducing PAIs (Article 8(1)(b) of the draft RTS).

References to international standards

This section shall contain a description of the FMP's adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of the FMP's alignment with the objectives of the Paris Agreement (Article 9 of the draft RTS). The description shall contain:

- the adverse impact indicators used in the assessment of principal adverse sustainability impacts over the reference period to measure that adherence or alignment;
- the methodology and data used to measure that adherence or alignment, including a description of the scope of coverage, data sources and how the methodology forecasts the future performance of investee companies;
- where a forward-looking climate scenario is used, the name of the scenario, its provider and when it was designed; and if such a scenario is not used, an explanation why.

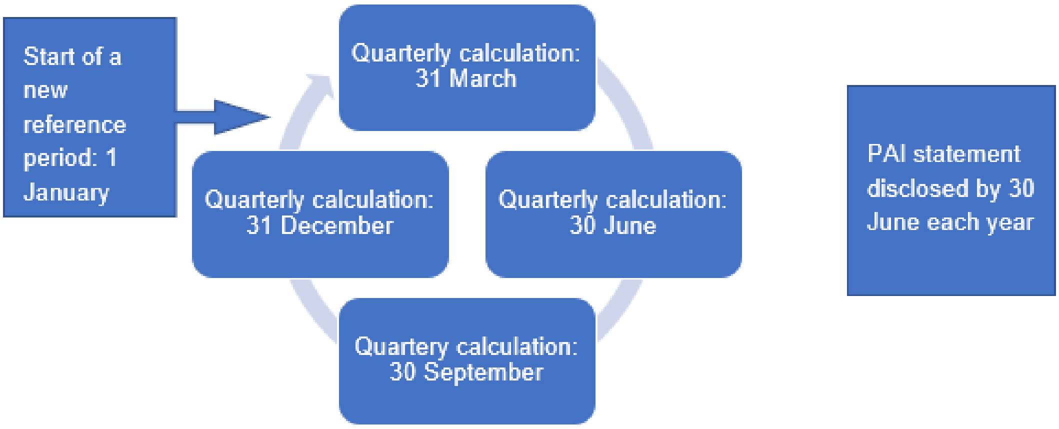
Disclosure timeline and reference periods in PAI statements

FMPs must publish statements on their principal adverse sustainability impacts by **30 June each year** (Article 4(1) of the draft RTS). Disclosures must cover a reference period, defined as the period from 1 January to 31 December of the preceding year (Article 1(1) of the draft RTS).

The description of principal adverse impacts and actions taken shall be based on the average of at least four calculations of PAIs made by the FMP on 31 March, 30 June, 30 September and 31 December during the reference period. Therefore, if the RTS apply from 1 January 2023 (as planned by the European Commission), the first PAI disclosures will have to be made by **30 June 2023 based on a 2022 reference period.**

Where the FMP has provided a description of principal adverse sustainability impacts for a previous reference period, the statement shall contain a historical comparison of the current reference period with the previous reference period and shall continue to include further historical comparisons for at least five previous reference periods.

Figure 3: Quarterly calculation for PAI statement



CONSIDERATION OF ADVERSE SUSTAINABILITY IMPACTS – FOR FINANCIAL ADVISERS

FAs shall publish and maintain on their websites information as to whether they consider principal adverse impacts on sustainability factors, in line with SFDR Article 4(5).

Consideration of adverse sustainability impacts

The statement published by FAs that consider PAIs shall include:

- how the information referred to in this regulation published by FMPs is used;
- whether the FA ranks and selects financial products based on at least the indicators in Table 1 of Annex I of the first draft RTS and, where applicable, a description of the ranking and selection methodology used;
- any criteria or thresholds used to select financial products and advise on them based on those impacts.

No consideration of sustainability adverse impacts

FAs that do not consider the PAIs of their investment decisions on sustainability factors (SFDR Article 4(5)(b)) shall publish the information referred to in Article 12 of the consolidated draft RTS ("No consideration of sustainability adverse impacts") – namely, a prominent statement that the FA does not consider the adverse impacts of its investment decisions on sustainability factors, clear reasons why is does not do so and whether and, if so, when it intends to consider those adverse impacts by reference to at least the indicators in Table 1 of Annex I in the draft RTS from February 2021.

REMUNERATION POLICIES (SFDR ARTICLE 5)

FMPs and FAs shall state in their remuneration policies how these are consistent with the integration of sustainability risks (SFDR Article 5). There is no further explanation on this in the draft RTS.

PRODUCT-LEVEL DISCLOSURE REQUIREMENTS

ALL PRODUCTS

FMPs must disclose in their pre-contractual documents:

- how sustainability risks are integrated into investment decisions and their likely impact on the return of the financial product (comply or explain) (SFDR Article 6);
- by 30 December 2022, whether and how PAIs are considered for the product (SFDR Article 7).

FMPs not marketing products that promote environmental and/or social characteristics or that have a sustainable investment objective must accompany the above disclosures with a disclaimer stating: "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments." (Article 7 of the Taxonomy Regulation)

FINANCIAL PRODUCTS PROMOTING ENVIRONMENTAL AND/OR SOCIAL CHARACTERISTICS ("ARTICLE 8 PRODUCTS")

Pre-contractual disclosures for Article 8 products

FMPs marketing products that promote environmental and/or social characteristics must provide a description of these characteristics, details of how they are met and, if a reference index is used, information on the benchmark, including its methodology (SFDR Article 8).

This information should be disclosed in an annex to the document referred to in SFDR Article 6(3) (depending on the type of institution) in accordance with the template set out in Annex II of the draft RTS (Article 13 of the draft RTS).

The annex should start with a statement explaining:

- that the financial product promotes environmental or social characteristics but does not have sustainable investment as its objective;
- whether there is an intention to make sustainable investments.

The annex must also present the following information, as set out in Box 2 below (Article 13(3) of the draft RTS):

- the environmental and social characteristics promoted by the financial product (including a more detailed "do no significant harm" analysis for sustainable investments);
- whether the product's PAIs are considered;
- the product's investment strategy;
- the asset allocation planned for the product, including the breakdown of investments that are aligned with sustainability characteristics, sustainable investments and taxonomy-aligned investments where relevant.

BOX 2: Pre-contractual disclosures for FMPs marketing Article 8 products

Annex II of the consolidated draft RTS provides a template (page 35) for product disclosures according to SFDR Article 8.

What environmental and/or social characteristics are promoted by this financial product?

A description of the environmental or social characteristics promoted by the financial product and a list of the sustainability indicators used to measure their attainment.

Where there is a commitment to make sustainable investments, FMPs will also need to demonstrate how the sustainable investments contribute to a sustainability objective and do not significantly harm any of the other sustainability objectives. This includes an explanation of:

- how the adverse impact indicators are considered;
- how the sustainable investments will be aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles for Business and Human Rights.

Does this financial product consider principal adverse impacts on sustainability factors?

Whether and how PAIs are considered.

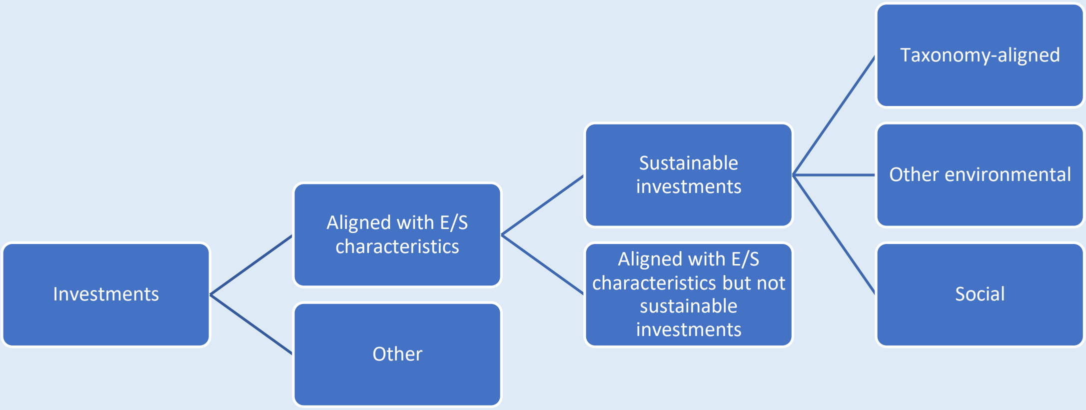
What investment strategy does this financial product follow?

- a description of the investment strategy used to attain the environmental or social characteristics promoted by the product, the binding elements of that strategy to select the investments to attain each of those characteristics and how the strategy is implemented on a continuous basis;
- where there is a commitment by the FMP to reduce by a minimum rate the scope of investments considered prior to the application of a strategy to attain environmental or social characteristics, an indication of that rate;
- a short description of the policy used to assess good governance practices of the investee companies.

BOX 2: Pre-contractual disclosures for FMPs marketing Article 8 products (continued)

What is the asset allocation planned for this financial product?

- a narrative explanation of the investments of the financial product, including:
  - the minimum proportion of the investments used to attain the environmental or social characteristics promoted by the product (including the minimum proportion of sustainable investments where there is a commitment to make such investments);
  - the purpose of the remaining investments of the product ("other"), including a description of any minimum environmental or social safeguards.



Breakdown of investments required for Article 8 disclosures

- where the financial product uses derivatives to attain the environmental or social characteristics it promotes, a description of how the use of those derivatives attains those characteristics;
- where the financial product makes sustainable investments with an environmental objective, a pie chart with the minimum taxonomy alignment of aggregated investments (see Box 3 for the specific methodology for reporting taxonomy alignment). See Box 4 for details on how this should be calculated and presented.

Is a specific index designated as a reference benchmark to determine whether this financial product is aligned with the environmental and/or social characteristics that it promotes?

This section only applies if an index is designated as a reference benchmark for the purpose of attaining the environmental or social characteristics promoted by the financial product. It must contain:

- an explanation of how the reference benchmark is continuously aligned with each of the environmental or social characteristics promoted by the financial product and with the investment strategy;
- an explanation of how the designated index differs from a relevant broad market index;
- an indication of where the methodology used for the calculation of the designated index can be found.

Can I find more product-specific information online?

A statement indicating where more product-specific information can be found on the website.

Periodic reports for Article 8 products

FMPs shall include a description of the promotion of environmental and/or social characteristics according to SFDR Article 11 in the sections set out in Table 4 below (based on Article 58 of the draft RTS).

Table 4: Periodic disclosure requirements for FMPs marketing products that promote environmental and/or social characteristics under SFDR Article 8

Questions to answer in periodic disclosures	Reference in draft RTS
To what extent were the environmental and/or social characteristics promoted by this financial product met? ▪ How did the sustainability indicators perform? ▪ And compared with previous periods?	Article 59 and Article 71
If the product made sustainable investments: ▪ What was the objective and how did the sustainable investments contribute to the objective? ▪ How did the investments not cause significant harm to other sustainability objectives? (includes adverse impact analysis and minimum social safeguards)	Article 59
What were the top investments of this financial product?	Article 60
A description of the investments of the product, including: ▪ the proportion of investments that attained the promoted environmental or social characteristics; ▪ the purpose of the remaining investments; ▪ the proportion of investments in different sectors (including fossil fuel sectors)	Article 61
If the financial product included a commitment to make sustainable investments: To what extent were the sustainable investments with an environmental objective aligned with the EU Taxonomy? See Box 4 lower down for how this should be calculated and presented.	Article 61a
What actions were taken to meet the environmental and/or social characteristics during the reference period?	Article 62
For a financial product that designated an index as a reference benchmark, how did this financial product perform compared with the designated reference benchmark?	Article 63

Website disclosures for Article 8 products

FMPs shall publish all the information above on their websites in accordance with SFDR Article 10 and Article 32 in the draft RTS as set out in Table 3 below.

The information should be contained in a separate section titled "Sustainability-related disclosures", in the same part of the website as the other information relating to the financial product, including marketing communications. FMPs shall clearly identify the financial product to which the information in this section relates and prominently display the environmental or social characteristics of that financial product (Article 31 of the draft RTS).

Table 3: Website disclosures for FMPs marketing products that promote environmental and/or social characteristics under SFDR Article 8

Section	Reference in draft RTS
Summary	Article 33
No sustainable investment objective	Article 34
Environmental or social characteristics of the financial product	Article 35
Investment strategy	Article 36
Minimum proportion of investments used to attain the environmental or social characteristics	Article 37
Monitoring of environmental or social characteristics	Article 38
Methodologies	Article 39
Data sources and processing	Article 40
Limitations to methodologies and data	Article 41
Due diligence	Article 42
Engagement policies	Article 43
Designated reference benchmark (where an index is designated as a reference benchmark for the purpose of attaining the environmental or social characteristics promoted by the financial product)	Article 44

FINANCIAL PRODUCTS WITH A SUSTAINABLE INVESTMENT OBJECTIVE (“ARTICLE 9 PRODUCTS”)

Pre-contractual disclosures for Article 9 products

The pre-contractual disclosure template for Article 9 products (as set out in Annex III of the draft RTS) is similar to the template for Article 8 products, with some differences. Unlike Article 8 products, Article 9 products must have sustainable investment as their objective, and the underlying assets must qualify as sustainable investments (with some exceptions for hedging and liquidity purposes).

For a financial product with an index as a reference benchmark, pre-contractual disclosures must also include information on how the index is aligned with the objective, an explanation of why and how the index differs from a broad market index and where the benchmark’s methodology can be found.

For a financial product without an index as a reference benchmark, pre-contractual disclosures must include information on how the objective is to be attained.

BOX 3: Pre-contractual disclosures for FMPs marketing Article 9 products

Annex III of the consolidated draft RTS (page 40) covers product disclosures according to SFDR Article 9.

What is the sustainable investment objective of this financial product?

A description of the sustainable investment objective and a list of the sustainability indicators used to measure the attainment of the objective (Article 21 of the draft RTS).

- Investments pursuing an environmental objective (falling under Article 5 of the Taxonomy Regulation) will need to list the environmental objectives – set out in the taxonomy – to which they contribute.
- Products with the objective of reducing carbon emissions must indicate whether an EU climate benchmark was used and, if not, how the continued effort of attaining the objective is ensured in view of achieving the objectives of the Paris Agreement.

FMPs will also need to demonstrate how the sustainable investments contribute to a sustainability objective and do not significantly harm any other sustainability objectives. This includes an explanation of:

- how the adverse impact indicators are considered;
- how the sustainable investments are aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles for Business and Human Rights.

Does this financial product consider principal adverse impacts on sustainability factors? (Article 22 of the draft RTS)

Whether and how the financial product considers PAIs.

What investment strategy does this financial product follow? (Article 23 of the draft RTS)

- a description of the type of investment strategy used to attain the sustainable investment objective, the binding elements of that strategy and how it is implemented on a continuous basis;
- a short description of the policy used to assess the good governance practices of the investee companies.

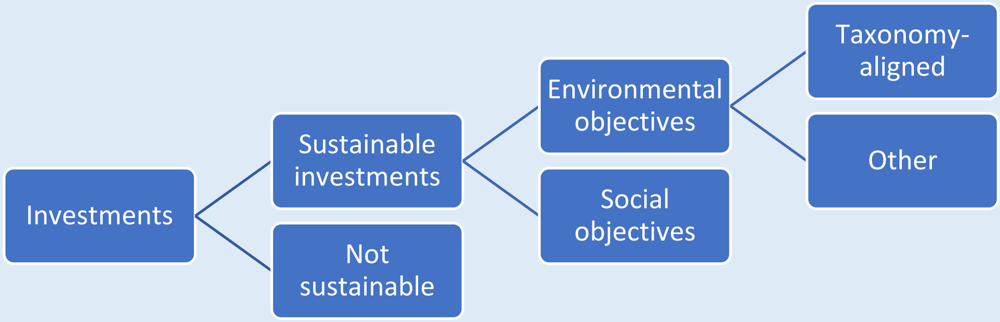
What is the asset allocation planned for this financial product? (Article 24 of the draft RTS)

- a narrative explanation of the investments of the financial product, including:
    - the minimum proportion of the investments used to attain the sustainable investment objective in accordance with the binding element of the investment strategy;
    - the purpose of the remaining proportion of the investments, including a description of any minimum environmental or social safeguards, how they do not affect the delivery of the sustainable investment objective and whether they are used for hedging or liquidity or are investments for which there is insufficient data.
- where the financial product uses derivatives to attain its sustainable investment objective, a description of how the use of those derivatives attains that sustainable investment objective.

BOX 3: Pre-contractual disclosures for FMPs marketing Article 9 products (continued)

Under Article 5 of the Taxonomy Regulation, SFDR Article 9 products pursuing an environmental objective must also disclose a pie chart with the taxonomy alignment of aggregated investments. See Box 4 lower down for details on how this should be calculated and presented.

Figure 4: Breakdown of investments required for Article 9 disclosures. Source: Annex III in draft RTS



Is a specific index designated as a reference benchmark to meet the sustainable investment objective?

This section only applies to financial products with an index as a reference benchmark. As per Article 26 of the draft RTS, it must contain:

- an explanation of how the consideration of sustainability factors within the methodology of the reference benchmark is continuously aligned with the sustainable investment objective of the product;
- an explanation of how the alignment of the investment strategy with the methodology of the index is ensured on a continuous basis;
- an explanation as to why and how the designated index differs from a relevant broad market index;
- an indication of where the methodology used for the calculation of the designated index can be found.

Can I find more product-specific information online?

A statement indicating where more product-specific information can be found on the website.

Periodic reports for Article 9 products

SFDR Article 11 requires FMPs to make disclosures on the promotion of environmental and/or social objectives. The specific requirements are set out in Table 6 below, as per Article 64 of the draft RTS.

Table 6: Periodic disclosure requirements for FMPs marketing products with a sustainable investment objective under SFDR Article 9

Questions to answer in periodic disclosures	More information in draft RTS
To what extent was the sustainable investment objective of this financial product met?	Article 65 and Article 71
What were the top investments of this financial product?	Article 66
What was the proportion of sustainability-related investments?	Article 67
For investments pursuing an environmental objective, the extent to which they are taxonomy-aligned (see Box 4 lower down)	Article 67a
What actions were taken to attain the sustainable investment objective during the reference period?	Article 68
If relevant, how did this financial product perform compared with the reference sustainable benchmark?	Article 69

Website disclosures for Article 9 products

FMPs shall publish all the information above on their websites in accordance with SFDR Article 10 (corresponding to Article 31 in the draft RTS) and Article 45 of the draft RTS, as set out in Table 5 below.

This should be found in a separate section titled "Sustainability-related disclosures", in the same part of the website as the other information relating to the financial product, including marketing communications. FMPs shall clearly identify the financial product to which the information in this section relates and prominently display the sustainable investment objective of that financial product (Article 31 of the draft RTS).

Table 5: Website product disclosures for FMPs marketing products with a sustainable investment objective under SFDR Article 9

Section	Reference in draft RTS	Further reference
Summary	Article 46	
No significant harm to sustainable investment objectives	Article 47	Article 18 of the Taxonomy Regulation
Sustainable investment objective of the financial product	Article 48	
Investment strategy	Article 49	
Minimum proportion of investment used to attain the sustainable investment objective	Article 50	
Monitoring of the sustainable investment objective	Article 51	
Methodologies	Article 52	
Data sources and processing	Article 53	
Limitations to methodologies and data	Article 54	
Due diligence	Article 55	
Engagement policies	Article 56	
Attainment of the sustainable investment objective	Article 57	

TAXONOMY-RELATED DISCLOSURES

Taxonomy disclosures will apply to a subset of Article 8 and 9 products. For investments that are part of Article 8 products, only those that are "sustainable investments" with environmental objectives, as described in Article 2(17) of the SFDR, are in scope[1]. With regard to Article 9 products, only those that invest in economic activities that contribute to environmental objectives are in scope.

For those investments, FMPs must disclose how and to what extent the EU Taxonomy has been used to determine the sustainability of the underlying investments, the environmental objective(s) to which the fund contributes and the percentage of the underlying fund that is taxonomy-aligned (as required by Articles 5 and 6 of the Taxonomy Regulation).

The consolidated draft RTS published in October 2021 detail what these taxonomy disclosures should entail and how they should be presented in pre-contractual and periodic documents (see Box 4 below).

The PRI has been working with its signatories to test and implement the EU Taxonomy. Starting in late 2019, over 40 investment managers and asset owners worked to implement the taxonomy on a voluntary basis in anticipation of the regulation. The PRI's Testing the Taxonomy report shares insights from the first set of case studies around how to use the EU Taxonomy. The PRI is currently updating this report following a new round of interviews with signatories.

[1] See page 8 of the draft RTS for taxonomy-related product disclosures.

BOX 4: Disclosing taxonomy alignment

The purpose of these disclosures is to provide information on “how and to what extent”, in the words of the Taxonomy Regulation, the economic activities the product is invested in qualify as environmentally sustainable. The taxonomy-alignment disclosures apply to financial products making sustainable investments contributing to an environmental objective.

The extent to which investments are taxonomy-aligned

The Taxonomy Regulation proposes three KPIs to calculate the alignment of an economic activity with the EU Taxonomy: revenue, capital expenditure (Capex) and operational expenditure (Opex).

- For pre-contractual disclosures, the taxonomy-alignment ratio must be based on turnover by default, with the possibility of disclosing Capex and Opex as an alternative when justified.
- For periodic disclosures, all three indicators need to be used.

For each of these disclosures, two calculations must be made: one including sovereign exposures in the denominator and one excluding them.

Disclosures must also include:

- a breakdown of activities invested in by environmental objectives that they contribute to;
- whether the activities are “enabling” or “transitional” as defined in the Taxonomy Regulation.

Green bonds issued under the future EU green bond standard should count for 100% of their value in the numerator. For other green bonds, the numerator should include the proportion of their value that corresponds to the share of the proceeds of those bonds used for environmentally sustainable economic activities.

How the investments are taxonomy-aligned

The FMP will need to explain whether the taxonomy-alignment information has been subject to an assurance provided by an auditor or a review by a third party.

The consideration of principal adverse impact indicators as part of the “do no significant harm” rule will apply to all sustainable investments, including taxonomy-aligned investments.

For the full reporting methodology, please refer to the consolidated draft RTS, specifically:

- Article 16a and 16b and Article 25 for pre-contractual disclosures;
- Article 61a and Article 67a for periodic disclosures.

FURTHER GUIDANCE

- 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
- ESA letter on priority issues relating to the application of the SFDR (7 January 2021)
- First draft RTS detailing SFDR reporting requirements, including templates (2 February 2021)
- Joint ESA supervisory statement on the SFDR (25 February 2021)
- Commission FAQ responding to the ESAs' questions on the SFDR (July 2021)
- Draft RTS for taxonomy-related product disclosures and consolidated draft RTS (22 October 2021)

GLOSSARY

- **Delegated act:** a non-legislative act adopted by the European Commission to amend or supplement the non-essential elements of a law.
- **European Supervisory Authorities (ESAs):** the three supervisory authorities that handle the micro-prudential supervision of EU financial markets alongside the national supervisory authorities of member states.
- **EU Taxonomy**: a classification system aimed at developing a list of environmentally sustainable economic activities. Sustainable investments with an environmental objective may or may not be aligned with the taxonomy. For the time being, the taxonomy does not cover socially sustainable economic activities.
- **EU Taxonomy alignment:** according to Article 3 of the Taxonomy Regulation, for an investment into an economic activity to be aligned with the EU Taxonomy (and qualify as environmentally sustainable), the activity must:
  - contribute substantially to an environmental objective;
  - not significantly harm any of the environmental objectives (the "do no significant harm" principle);
  - be carried out in compliance with minimum social safeguards;
  - comply with technical screening criteria established by the Commission in delegated acts.
- **Principal adverse impacts (PAIs):** the most significant negative impacts of investment decisions on sustainability factors relating to environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.
- **Indicators of adverse sustainability impacts:** a set of environmental, social and governance indicators and metrics. The first draft RTS provide a table (page 59) of mandatory indicators "that will always lead" to PAIs and two tables of voluntary indicators. A financial undertaking needs to pick two voluntary indicators – one from each of the two tables.
- **Regulatory Technical Standards (RTS):** technical standards prepared by a European Supervisory Authority. Their purpose is to further develop and specify the rules in the basic legislative act. RTS are usually then adopted by the European Commission as a delegated act or regulation.
- **Sustainable investment** (as defined in SFDR Article 2(17)): an investment in an economic activity that: i) contributes to an environmental or social objective, ii) provided that the investment does not significantly harm any environmental or social objective and iii) that the investee companies follow good governance practices.