SFDR Snapshot

EU Regulation Series for Companies

December 2021

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What do Companies Need to Know About the EU's Sustainable Finance Disclosure Regulation (SFDR)?

Level I – In effect as of 10th-March-2021

What is Level I of the SFDR?

Level I SFDR disclosure requirements focus on the due diligence of sustainability factors for **Financial Market Participants (FMPs),** which includes asset managers, institutional investors, insurance companies, pension funds etc.

FMPs are required to disclose an array of content relating to their consideration of sustainability risks both at the manager and fund level, including beginning to assess 'Principal Adverse Impacts' of sustainability factors. Where relevant, FMPs are also required to disclose relevant processes for how sustainability factors are integrated and lay out any actions taken in relation to sustainability impacts, including relevant engagement policies.

What is the main element of Level I?

Level I of the SFDR created sustainability labelling for financial products that are based, or operate, in the EU. Funds are labelled under 3 categories, those with:

- no sustainability characteristics (Art.6)

- promoting sustainability characteristics (Art.8)

- sustainability focus is an objective (Art.9)

What does this mean for companies?

Standardised sustainability fund classification may reduce the impact of greenwashing on financial markets and put downstream pressure on companies that wish to be included in funds classed as promoting, or having an objective of, sustainability.

Level II – Expected to come into effect in 2023

What is Level II of the SFDR?

Level II SFDR has established a set of 47 Principle Adverse Impacts (PAI)s, requiring FMPs to provide disclosures on sustainability metrics of investee companies. As can be seen in table 1, the SFDR requires FMPs to disclose quantitative investee data on a total of 14 mandatory PAIs and at a minimum must disclose 2 voluntary indicators from a list of 33.

Does Level II include indirect investments?

For the purposes of the PAIs, indirect investments should be considered. This means the investment portfolios of applicable investees are also eligible for scrutiny, "[FMPs] that have sufficient information… should look through to the individual underlying investments of those companies and consider the total adverse impacts arising from them." (Draft RTS)

Mandatory PAI focus area examples:

Environmental

- Greenhouse gas emissions
- Carbon footprint
- Water pollutants
- Biodiversity management

Social

- Board gender diversity
- Unadjusted gender pay gap
- Unethical business (tobacco etc.)
- UN Global Compact

What does this mean for companies?

The level of disclosure required will put a strain on companies as investors and rating agencies have already begun to request PAI data. These indicators will play a key role in the development of the EU's upcoming company reporting framework, part of the Corporate Sustainability Reporting Directive (CSRD).

Table 1: PAI requirements for FMPs

Mandatory set of PAIs	+ 2 additional PAIs…	…from a list of voluntary PAIs
14 mandatory indicators • 9 environmental • 5 social	2 additional indicators • 1 environmental • 1 social	33 voluntary indicators • 17 environmental • 16 social

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ANNEX I – Mandatory sustainability indicators for FMPs

- List of Principle Adverse Indicators (PAIs) from the European Supervisory Authorities' (ESAs) Regulatory Technical Standards (RTS), published February 2021.
- These indicators, and their underlying metrics, may change before Level II of the SFDR comes into force in 2023.
- FMPs will have to disclose the 14 mandatory indicators, plus **at least** 1 environmental and 1 social indicator of their choice from the additional lists.

**Indicators relating to real-estate, supranational and sovereign investments are not included.*

14 Mandatory Indicators*	
Focus Area	**Adverse Sustainability Indicator**
Greenhouse gas emissions	1. GHG Emissions
	2. Carbon Footprint
	3. GHG intensity of investee companies
	4. Exposure to companies active in the fossil fuel sector
	5. Non-renewable energy consumption and production
	6. Energy consumption intensity per high impact climate sector
Biodiversity	7. Activities negatively affecting biodiversity-sensitive areas
Water	8. Emissions to water
Waste	9. Hazardous waste ratio
Social and employee matters	10. Violations of UN Global Compact/OECD Guidelines
	11. Lack of monitoring of UN Global Compact/OECD Guidelines
	12. Unadjusted gender pay gap
	13. Board gender diversity
	14. Exposure to controversial weapons

16 Additional environment-related indicators*	
Focus Area	**Adverse Sustainability Indicator**
Emissions	1. Emissions of inorganic pollutants
	2. Emissions of air pollutants
	3. Emissions of ozone depletion substances
	4. Investments in carbon-laggard companies
Energy	5. Energy consumption by non-renewable source
Water, waste and material emissions	6. Water usage and recycling
	7. Investees without water management policies
	8. Exposure to areas of high-water stress
	9. Investees producing chemicals
	10. Land degradation, desertification, soil sealing
	11. Investees - non-sustainable agriculture
	12. Investees - non-sustainable ocean practices
	13. Non-recycled waste ratio
	14. Natural species and protected areas
	15. Deforestation
Green securities	16. Share of securities not certified as green under EU Green Bond Standard

17 Additional social-related indicators*	
Focus Area	**Adverse Sustainability Indicator**
Social and employee matters	1. Investees without health & safety policies
	2. Rate of workplace accidents
	3. Number of days lost to injuries, accidents etc.
	4. Lack of a supplier code of conduct
	5. Lack of grievance mechanism for employees
	6. Insufficient whistleblower protection
	7. Incidents of discrimination
	8. Excessive CEO pay ratio
Human Rights	9. Lack of a human rights policy
	10. Lack of human rights due diligence
	11. Lack of ways to prevent human trafficking
	12. Risk of child labour incidents in supply chain
	13. Risk of forced labour incidents in supply chain
	14. Cases of severe human rights incidents
Anti-corruption and anti-bribery	15. Lack of relevant policies
	16. Insufficient remedy for standards breaches
	17. Number of related convictions and fines

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