Strelia
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Update on the Sustainable Finance Disclosure Regulation

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The increasing importance of ESG (environmental, social, governance) factors have already been discussed in our January M&A Series. With the **Disclosure Regulation** (EU Regulation 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector) applicable as from tomorrow, ESG matters will become even more prominent. Financial market participants had already saved 10 March 2021 as the date when strict disclosure requirements will effectively apply to them and their products.

ESG - Sustainable investments and sustainability risks

The Disclosure Regulation—and other sustainable finance regulations and directives, such as the Taxonomy Regulation and the Non-Financial Reporting Directive—are all part of a series of measures that aim to create a more sustainable economy and sustainable businesses. They each, in their own way, pursue a more uniform protection of investors, provide a wide range of financial products for those investors, while setting rules that enable them to make informed investment decisions. It is this last point for which the importance of disclosures comes into play. Amidst the disclosures that need to be made to investors, sustainability risks and the promotion of environmental or social elements are in full bloom. Overarching is the EU Commission's Action Plan for Financing Sustainable Growth, whose objectives are to (i) reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth, (ii) assess and manage relevant financial risks stemming from climate change, resource depletion, environmental degradation and social issues, and (iii) foster transparency and long-termism in financial and economic activity.

Financial market participants and products

The Disclosure Regulation requires financial market participants to disclose sustainability risks, *i.e.,* ESG events, factors, or conditions whose occurrence could cause a negative material impact on the value of any investment. It also requires them to provide evidence of sustainability activities and explain when they consider that a particular risk does not concern or affect them (under the "comply-or-explain" principle). The disclosure requirements must be fulfilled at entity-level (*e.g.,* by disclosing information on the entity's website) and product-level (*e.g.*, by classifying the products and providing periodic product reports).

The Disclosure Regulation also imposes sustainability disclosure obligations on a broad range of manufacturers and providers of financial products and financial advisers (such as investment firms providing portfolio management, alternative investment fund managers, UCITS management companies, credit institutions providing portfolio management, manufacturer of pension products, etc.), which they must fulfill toward the end-investors.

The financial products covered by the Disclosure Regulation include managed portfolios, alternative investment funds, UCITS, pension products, insurance-based investment products, etc.

Joint Committee and Regulatory Technical Standards

Although a large part of the Disclosure Regulation will apply starting 10 March 2021, the related regulatory technical standards (**RTS**) concerning important areas of the Disclosure Regulation, such as the required disclosures that funds with an ESG focus will have to make on their website and periodic reports, will enter into effect only as from 1 January 2022. In short, the contents of the Disclosure Regulation—but not the RTS—will apply from 10 March 2021.

The European Supervisory Authorities (collectively, the **ESA**s) have issued a set of draft RTS in the form of intermediary templates that can be used as base documents. These include (i) a summary, (ii) a description of principal adverse impacts, (iii) a description of policies to identify and prioritize principal adverse sustainability impacts, (iv) a description of actions to address principal adverse sustainability impacts, (v) engagement policies and (vi) references to international standards.

We can already see that certain financial market participants have legitimate concerns about compliance challenges and liability risks, not to mention rightful confusion among investors in the period between the application of the Disclosure Regulation and the RTS. In addition, the ESAs have raised in January this year questions on the interpretation of certain aspects of the Disclosure Regulation itself, but the Commission has not provided any answer yet to date, and we are just one day away from the Disclosure Regulation's application date. We are certainly waiting impatiently for the Commission's response and look forward to the application by the Member States of the draft RTS during the interim period.