SFDR For North American Investors: 3 Key Points to Know

A summary of recent updates regarding the EU Sustainable Finance Disclosure Regulation (SFDR) and wider related developments.

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SFDR For North American Investors

Sustainable Finance Disclosure Regulation

The Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy form key pillars in the EU's plan by the European Union (EU) to embed sustainability and ESG factors across the financial sector.

The emerging regulatory environment for sustainable finance in Europe represents both a challenge and opportunity for the investment industry. New regulations can add costs but also enable investors to act on their net-zero commitments. That, in turn, can provide a uniform basis for sustainable products and support the rerouting of capital toward a greener economy.

This brief summarizes recent developments and what North American investors can anticipate going forward.

Three key points:

1. Early scoping – North American investors should start to explore whether and how the new SFDR proposals may impact them.

2. An eye on the U.K. – The Financial Conduct Authority's (FCA) approach to sustainability disclosures may look to build on work already undertaken by the SFDR.

3. International context - The SFDR fits within a wider trend toward greater disclosure on sustainability.

Upcoming timeline

	Q4 2021	Q1 2022	Q2 2022
EU - SFDR	European Commission is expected to publish an EU Taxonomy Delegated Act toward the end of 2021; the act is expected to clarify which		The expected application date for the SFDR single rulebook is January 2023.

	economic activities most contribute to meeting the EU's environmental objectives.		
U.K. – Sustainability Disclosure Requirements	The FCA has published an initial consultation paper on the SDR.		The FCA is expected to publish policy proposals on the SDR.
Global – International Sustainability Standards Board	The ISSB has produced prototypes for climate-related disclosures and general requirements for sustainability-related financial information.	The ISSB will officially start its work program from the beginning of 2022.	

1. Early Scoping

Final SFDR reporting details are proposed

On Oct. 22, 2021, the European Supervisory Authorities (ESAs) delivered to the European Commission their final report on draft Regulatory Technical Standards (RTS) on taxonomy-aligned disclosures pursuant to the SFDR.

The draft RTS aim to:

- Guide disclosures regarding the investments of financial products in environmentally sustainable activities,
- Provide investors with comparable information to make informed investment choices; and
- Establish a single rulebook for product-related sustainability disclosures under the SFDR and the Taxonomy Regulation that amends it.

The proposals set forth in the RTS aim to clarify the SFDR's requirements with guidance for disclosures that indicate the extent to which investments are taxonomy-aligned. SFDR Level 1 requirements are supplemented by more detailed Level 2 requirements, which will now come into force in 2023.

Proposals will now be considered by EU institutions

The European Commission, which has three months to consider the draft RTS for endorsement, has indicated its intention to adopt the RTS by the end of the year. Adoption by the commission triggers a three-month period for consultation by both the European Parliament and Council .

On Nov. 29, 2021, in a letter sent to the European Parliament and Council, the European Commission informed them of its decision to delay the application of the Delegated Act of the 13 RTS to Jan. 1, 2023.

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We encourage North American investors to explore whether and to what extent their products and services may fall within the scope of the SFDR in order to give themselves the knowledge and time needed to comply with the reporting requirements, which remain extensive. Several large U.S. asset managers, for instance, have decided to partially apply the SFDR on a voluntary basis to their U.K. entities.

2. An eye on the U.K.

Placing the SFDR in a wider context

The development of the SDFR is taking place amid a global regulatory focus on sustainability-related disclosures. Investors operating across multiple jurisdictions are likely to see greater proliferation of local disclosure requirements that may or may not align with European frameworks.

U.K. announces its own sustainability disclosures

On Nov. 3, 2021, the FCA published a discussion paper seeking views on new Sustainability Disclosure Requirements for asset managers and FCA-regulated asset owners. The paper includes a new classification and labeling for sustainable investment products.

The FCA has indicated that it will look beyond the SFDR in some respects. The FCA may, for example, use a five-tiered product classification and labeling, compared with the three-tiered classification suggested by the SFDR. That would effectively produce a greater level of differentiation when it comes to categorizing the sustainability of a particular fund.

At the same time, the FCA, in a welcome announcement, said it would consider alignment between the emerging U.K. framework and the SFDR. The FCA said it would consider how products classified under the SFDR can map to the U.K. framework. The U.K. agency said it recognizes "that many U.K. firms are subject to the SFDR in their EU business and have already invested in systems and processes to classify products according to SFDR provisions.

3. International context

IFRS announces the International Sustainability Standards Board (ISSB)

The IFRS Foundation announced at COP26 the creation of an International Sustainability Standards Board (ISSB) to develop climate and sustainability disclosure standards that align with the TCFD.

The ISSB will be well placed to promote gradual convergence of the numerous current reporting standards into a common global baseline. The IFRS Foundation has also produced prototypes for climate-related disclosures and general requirements for sustainability-related financial information.

The ISSB has announced a coordination mechanism with the EU and other jurisdictions to promote future alignment where possible, including with the SFDR.

For North American-based investment firms that conduct business across multiple jurisdictions, the harmonization of sustainability reporting around the world would reduce duplication while clarifying reporting expectations.

Still, while it is encouraging to see the creation of climate disclosure standards, regulation such as the SFDR will remain the primary lens through which investors will need to disclose actions they are taking, or not, to embed sustainability.

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