



Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector. International Bulletin of February 2020.

Introduction: Last December, Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector was published in the Official Journal of the European Union (Disclosure Regulation) in response to one of the items included in the European Commission's Action Plan to finance sustainable economic development. This Action Plan was created to comply with the international commitments of the European Union (EU) within the framework of the United Nations 2030 Agenda and the 2015 Paris Agreement; it aims to:

1. reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
2. manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. foster transparency and long-termism in financial and economic activity.

To this end, the Action Plan sets out a series of actions to be carried out by several actors in the financial sector to implement the commitments on sustainability; one of these actions is the clarification, by means of a legislative proposal, of the obligations of institutional investors and asset managers in relation to sustainability factors (i.e., environmental, social and good governance elements). The objective is twofold: a) to explicitly require institutional investors and asset managers to integrate sustainability considerations into their decision-making processes and b) to increase transparency for end-investors on how they integrate these sustainability factors into their investment decisions, in particular with regard to their exposure to sustainability risks.

After several months of work, the legislative proposal crystallised in the aforementioned Regulation (EU) 2019/2088, which aims to respond to the lack of harmonised transparency rules for financial products with environmental, social and governance (ESG) characteristics or objectives. This makes it difficult to compare products in terms of their risks, objectives and sustainability characteristics or objectives.

The scope of this Regulation is very broad, both in terms of the number of financial products it covers and the subjects it addresses. The Regulation aims to harmonise the obligations of certain financial market participants and financial advisers in respect of banking, insurance and securities market products; however, in this article we will focus only on the details affecting the latter area.

Subjective and Objective Scope of the Regulation: In the area of CNMV's supervision, the application of this Regulation affects, on the one hand, financial market participants, i.e., investment firms and credit institutions providing portfolio management services, managers of alternative investment funds, as well as managers of qualifying venture capital and social entrepreneurship funds and management companies of collective investment institutions in transferable securities (UCITS); and, on the other hand, financial advisers, meaning credit institutions, investment firms, alternative investment fund managers and management companies of undertakings for collective investment in transferable securities providing investment advice.

Obligations: The Regulation develops a series of innovative concepts and obligations for the financial sector. The reporting obligations on sustainability factors, both at the entity and product level, imposed by this Regulation are as follows,

1. In relation to the **entity-level obligations**, transparency of policies relating to sustainability risks is required (Article 3), which implies that financial market participants and financial advisers shall publish information on their websites about their policy for integrating sustainability risks into their decision-making process or investment advice, respectively.

In addition, in accordance with the provisions of Article 4, financial market participants shall publish on their website a statement on their due diligence policies regarding the adverse impacts of their investment decisions on sustainability factors. Financial advisers, on the other hand, are required to report on their website whether they take into account principal adverse impacts on sustainability factors when providing investment advice. The proportionality principle is applied to this obligation in both cases: financial market participants and financial advisers may choose whether or not to publish this statement; if they do not publish it, they must indicate the reasons for not doing so and whether and when they plan to do so. In addition, investment companies providing investment advice with fewer than three employees are exempt from complying with any of the obligations contained in the Regulation. However, those market participants that exceed 500 employees are required to publish and maintain this statement on their website.

Another new obligation for both financial market participants and financial advisers is the publication on their website of information on the consistency of their remuneration policies with the integration of sustainability risks (Article 5). It should be noted that the Regulation itself defines sustainability risk as: “Any environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”.

2. As regards **reporting obligations at the product level**, it is first necessary to distinguish between the two product categories established by the Regulation: those that promote social or environmental characteristics (Article 8) and those whose objective is a sustainable investment (Article 9), this being, according to the Regulation “any investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular any investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or any investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance”.

Obligations regarding products refer to pre-contractual information, periodic reports and information that must be published on the website.

2.a. The reporting obligations on the products in the **pre-contractual phase** include the following contents:

The integration of sustainability risks (Article 6). In particular, financial market participants and financial advisers will have to describe how they integrate these risks into their investment or advisory decisions, respectively, as well as the results of the assessment of the potential impact of sustainability risks on product performance.

Adverse sustainability impacts at financial product level (Article 7). When market participants publish the due diligence policy statement referred to in Article 4 of the Regulation on their websites, they shall explain in a clear and reasoned manner how the financial product takes into account the main adverse impacts on

sustainability factors and make a statement that this information will be included in the periodic product information. In the event that the market participant makes use of the option not to publish the due diligence policy statement referred to in Article 4, it shall make an additional statement for each financial product indicating that the financial market participant does not take into account the adverse impact of investment decisions on sustainability factors and a reasoned explanation as to why it does not do so.

-Promotion of environmental or social characteristics or a combination of both (only for products covered in Article 8). In particular, information will be given on how these characteristics are met and if an index has been designated as a reference benchmark, whether and to what extent this index is consistent with those characteristics.

-In relation to the sustainable investments of products covered in Article 9:

a) When a benchmark index has been designated, it will be necessary to report on how the designated index aligns with the objective of the product and explain why and how that index differs from a broad market index. When no EU Climate Transition Benchmark or EU Paris-aligned Benchmark is available, information regarding the integration of sustainability risks should include a detailed explanation of how the permanent effort to achieve the objective of reducing carbon emissions is carried out, in order to achieve the long-term global warming objectives of the Paris Agreement;

b) When an index has not been designated, it will be necessary to explain how the financial product achieves its objective;

c) When the product is aimed at reducing carbon emissions, a detailed explanation of how that objective is guaranteed shall be included with a view to meeting the long-term global warming objectives of the Paris Agreement.

2.b. In the **periodic reports**, which will be disclosed taking into account the sectoral legislation of each product, the Regulation (Article 11) establishes that financial market participants must include a description of:

a) In the case of the products covered in Article 8, the degree of compliance with the environmental or social characteristics that the product promotes.

b) In the case of a financial product covered in Article 9, sections 1, 2 or 3, a) the overall impact of the financial product in relation to sustainability by means of relevant sustainability indicators or b) when a benchmark has been designated, a comparison of the overall impact of the financial product in relation to sustainability based on the designated index and a broad market index through sustainability indicators.

2.c. Regarding the information **disclosure obligations on the website** in relation to the products covered in Articles 8 and 9, the financial markets participants must publish and maintain on their websites (Article 10):

a) a description of the environmental or social characteristics of the sustainable investment objective;

b) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product;

c) the pre-contractual information referred to in Articles 8 and 9;

d) the periodic reports referred to in Article 11.

The Regulation also prescribes how the publication must be made on the website, thus it “shall be clear, succinct and understandable to investors. It shall be published in a way that is accurate, fair, clear, not

misleading, simple and concise and in a prominent easily accessible area of the website.”

Review of disclosures (Article 12): The information published by financial market participants regarding policies on sustainability and remuneration risks and product information on the website shall be kept up to date. If such information is amended, a clear explanation of such amendment should be published on the same website. The same obligation applies to the information published by financial advisers regarding sustainability and remuneration risk policies.

Marketing communications (Article 13): Marketing communications made by financial market participants and financial advisers may not contradict the information disclosed in accordance with the obligations contained in the Regulation.

Conclusion: It is expected that this Regulation and its draft regulatory technical standards will reinforce the reorientation of capital flows towards sustainable economic activities and contribute to the harmonisation in the EU of the rules governing sustainable financial products, increasing the transparency of its characteristics, objectives and sustainability risks, which will facilitate the comparability between products and contribute to greater and improved investor protection against practices such as ESG-washing.

Mention should be made of the interaction of this Regulation with the future **Taxonomy Regulation**, the text on which a political agreement was reached at the end of 2019 and which is currently being reviewed by the European Commission’s lawyer-linguist services. This Regulation is expected to amend some provisions of the Disclosure Regulation, in particular those referring to environmental investment characteristics or objectives that refer to the economic activities governed by the Taxonomy Regulation. It will be necessary to make a parallel reading of both legal texts, since many concepts included in the Disclosure Regulation will be defined by the Taxonomy Regulation.

Link of interest:

[Regulation \(EU\) 2019/2088 on sustainability-related disclosures in the financial services sector](#)