CDP Policy Explainer on the EU Sustainable Finance Disclosure Regulation (SFDR)

Including links with CDP's disclosure system

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About the SFDR

The SFDR establishes sustainability-related disclosure requirements for financial market participants (FMPs)[1], financial advisers and financial products. It improves the quality of information about the sustainability-related performance of manufacturers of financial products as well as financial advisers and the financial products they offer to end investors.

Financial market participants – including all entities offering financial products and managed funds, i.e., asset managers, institutional investors, insurance companies, pension funds, etc. and financial advisers – are required to be transparent about the **integration of sustainability risks** in their investment processes.

In addition, the SFDR includes disclosure obligations regarding **adverse impacts on sustainability matters at entity and financial products levels**, i.e., whether financial market participants and financial advisers consider negative externalities on the environment and social justice of the investment decisions/advice and, if so, how this is reflected at the product level.

Context of the SFDR

In its conclusions of 20 June 2017, the Council of the European Union confirmed the commitment of the EU and its Member States to the coherent, comprehensive, and integrated implementation of the 2030 Agenda for Sustainable Development in close cooperation with other stakeholders.

The SFDR is a **fundamental pillar of the EU's sustainable finance agenda**, having been introduced by the European Commission as a core part of its "Action Plan: Financing Sustainable Growth" from 2018. The agenda aims to catalyze the transition to a sustainable, low-carbon, resource-efficient, and circular economy in line with the Sustainable Development Goals, as well as the 'Paris Agreement', which seeks to strengthen the response to climate change by, among other things, **aligning financial flows with low greenhouse gas emissions and climate resilient development**. The successful adherence by the EU to both international ambition streams is crucial for the EU's long-term competitiveness.

CDP Europe therefore welcomes the EU Commission's 'Sustainable Finance Disclosure Regulation' ((EU) 2019/2088). Harmonized rules for financial market participants and financial advisers on transparency regarding the **integration of sustainability risks, the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information for financial products** is essential to improve comparability and availability of information for investors to make sustainable investment decisions.

The need for the SFDR

Given the EU's increasing exposure to the consequences of climate change and other sustainability-related issues, urgent action is needed from both public policies and the financial services sector to mobilize capital. Therefore, **financial market participants and financial advisers should be required to disclose specific information regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts**.

[1] Non-EU FMPs are covered by SFDR except where specific requirements are defined in sectoral legislation.

Disclosures to end investors are underdeveloped due to **the lack of harmonized requirements.** This applies to the integration of sustainability risks, as well as the consideration of adverse sustainability impacts, sustainable investment objectives or the promotion of environmental or social characteristics in investment decision-making and in advisory processes. Such a lack of transparency can result in greenwashing practices.

The SFDR aims to reduce information asymmetries by requiring financial market participants and advisers to provide pre-contractual and ongoing disclosures to end investors regarding sustainability risks, adverse sustainability impacts, environmental or social characteristics, and sustainable investment.

Incorporating sustainability factors into investment decision-making and advisory processes can yield benefits beyond financial markets. It can increase the resilience of the real economy and the stability of the financial system ultimately impacting the risk-return of financial products. It is therefore essential that financial market participants and financial advisers provide the information necessary to enable end investors to make informed investment decisions.

Definitions

'Sustainability risk' means an 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.

'Sustainability factors' mean environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters.

'Sustainable investment' means an investment in an economic activity that contributes to an environmental objective, as measured (for example) by key resource efficiency indicators: the use of energy, renewable energy, raw materials, water, and land; production of waste, and greenhouse gas emissions; impact on biodiversity and the circular economy. It can also refer to an investment in an economic activity that contributes to a social objective, especially by tackling inequality or fostering social cohesion, social integration, and labor relations. Additionally, it encompasses investments in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of these objectives. Furthermore, investee companies are expected to adhere to good governance practices, including sound management structures, employee relations, staff remuneration and tax compliance.

'Principal adverse impacts' (PAI) refers to the negative effects on sustainability factors that arise from investment decisions and advice.

See the definitions of the following terms in Article 2 of the SFDR, page 7 and following:

- 'alternative investment funds' or 'AIFs'
- 'alternative investment fund manager' or 'AIFM'
- 'European long-term investment fund' or 'ELTIF'
- 'financial adviser'
- 'financial market participant'
- 'financial product'
- 'institution for occupational retirement provision' or 'IORP'
- 'insurance advice'
- 'insurance-based investment product' or 'IBIP'

- ‘insurance intermediary’
- ‘insurance undertaking’
- ‘investment advice’
- ‘investment firm’
- ‘pan-European Personal Pension Product’ or ‘PEPP’
- ‘pension product’
- ‘pension scheme’
- ‘portfolio management’
- ‘professional investor’
- ‘retail investor’
- ‘UCITS management company’
- ‘undertaking for collective investment in transferable securities’ or ‘UCITS’

Links with other legislation

The disclosure rules of the SFDR supplement the provisions of Directives:

- 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (**UCITS**);
- 2009/138/EC on the taking-up and pursuit of the business of Insurance and reinsurance (**Solvency II**);
- 2011/61/EU on alternative Investment Fund Managers (**AIFMs**);
- 2014/65/EU on markets in financial instruments and amending (**MiFID II**);
- (EU) 2016/97 on insurance distribution (**IDD**);
- (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (**IORPs**); and

Regulations:

- (EU) No 345/2013 on uniform requirements and conditions for managers of collective investment undertakings that wish to use the designation '**EuVECA**' in relation to the marketing of qualifying venture capital funds in the EU;
- (EU) No 346/2013 on uniform requirements and conditions for managers of collective investment undertakings that wish to use the designation '**EuSEF**' in relation to the marketing of qualifying social entrepreneurship funds in the EU;
- (EU) 2015/760 on uniform rules on the authorization, investment policies and operating conditions of EU alternative investment funds (**EU AIFs**) or compartments of EU AIFs that are marketed in the EU as European long- term investment funds (**ELTIFs**);
- (EU) 2019/1238 on a pan-European Personal Pension Product (**PEPP**).

Related CDP Policy Explainer

- CDP Policy Explainer on the 'EU Taxonomy Regulation' (EU Taxonomy)
- CDP Policy Explainer on the 'Corporate Sustainability Reporting Directive' (CSRD) and the 'European Sustainability Reporting Standards' (ESRS)

SFDR overview[2]

When do the reporting rules come into force?

- **9 December 2019**: The SFDR entered into force.
- **10 March 2021**: First application date for the disclosure requirements at entity-level and in pre-contractual documents of all in-scope financial products, **in accordance with the principles-based requirements of the SFDR.**
- **30 June 2021:** Disclosure by financial product manufacturers (500+ employees) of their policies in consideration of PAI on sustainability factors.
- **1 January 2022:** For financial products with ESG characteristics or objectives in sustainable investment, first application date for the disclosure requirements in periodic reports at least in accordance with the principle-based requirements of the Regulation. Product disclosures under Article 5 and 6 of the Taxonomy Regulation start to apply for climate change mitigation and adaptation.
- **1 January 2023:** Entry into application of the Regulatory Technical Standards (RTS) to be used by financial market participants when disclosing sustainability-related information. This Delegated Regulation **specifies the exact content, methodology and presentation of the information to be disclosed**. Under these rules, financial market participants provide detailed information about how they **identify and reduce adverse impacts** that their investments may have on the environment and society.
- **20 February 2023**: Entry into application of complementary (to 1 January 2023 RTS) Climate Delegated Act, requiring financial market participants to disclose the extent to which their portfolios are exposed to gas and nuclear-related activities that comply with the EU Taxonomy.

[2] Further reading: European Supervisory Authority Q&A

- **30 June 2023**: Disclosure in **compliance with the RTS** on FY 2022[3] of PAI indicators by financial market participants.

Review of SFDR Delegated Regulation RTS regarding entity and financial product level disclosures: Regulatory technical standards with regard to the content, methodologies, and presentation of sustainability disclosures pursuant to Article 2a(3), 4(6), 4(7), 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) of Regulation (EU) 2019/2088, expected to be applicable from 2025 (subject to changes following review of public consultation due 4 July 2023).

Which capital market actors are required to report and on which products?	- **For entity-level disclosures**: Financial market participants (FMPs) located in the EU and outside the EU marketing and/or managing financial products in the EU (precise definition can be found in Article 2 of the SFDR), - **For entity-level disclosures:** Financial advisers located in the EU and outside the EU providing investment advice on financial products in the EU (precise definition can be found in Article 2 of the SFDR), - **For product-level disclosures**: Financial market participants and advisers located in the EU and outside the EU for financial products they market and/or manage for the EU market: - Portfolios managed by credit institutions or investment firms; - Alternative investment funds (AIFs) and UCITS; - Insurance-based investment products (IBIPs); - Pension products, workplace pension products regulated under the IORP directive and PEPP.

SFDR reporting requirements

Reporting area	SFDR reporting requirements	RTS
Transparency of sustainability risk policies -Article 3-	**Financial market participants**: - shall publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process. **Financial advisers**: - shall publish on their websites information about their policies on the integration of sustainability risks in their investment advice or insurance advice.	

[3] Financial market participants that publish the statement for the first time, the information 'Transparency of adverse sustainability impacts at entity level' covering the period from the date on which the principal adverse impacts of investment decisions on sustainability factors were first considered until 31 December of that year. Those financial market participants shall publish the information in the statement referred to in paragraph 1 by 30 June of the following year.

Transparency of adverse sustainability impacts at entity level -Article 4-	**Financial market participants** shall publish and maintain on their websites: - where they consider principal adverse impacts of investment decisions on sustainability factors, a statement on due diligence policies with respect to those impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they make available; including at least: (a) information about their policies on the identification and prioritization of principal adverse sustainability impacts and indicators; (b) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned; (c) brief summaries of engagement policies in accordance with Article 3g of the 'EU Shareholder Rights Directive' (2007/36/EC), where applicable; (d) a reference to their adherence to responsible business conduct codes and internationally recognized standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement; or - where they do not consider adverse impacts of investment decisions on sustainability factors, clear reasons for why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts. This second option is not available to financial market participants or parent undertakings of a large group exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year. These large financial market participants must apply the first option. **Financial advisers** shall publish and maintain on their websites: - information as to whether, taking due account of their size, the nature and scale of their activities and the types of financial products they advise on, they consider in their investment advice or insurance advice the principal adverse impacts on sustainability factors; or - information as to why they do not to consider adverse impacts of investment decisions on sustainability factors in their investment advice or insurance advice, and, where relevant, including information as to whether and when they intend to consider such adverse impacts.	Annex I

Transparency of remuneration policies in relation to the integration of sustainability risks -Article 5-	**Financial market participants and financial advisers** shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks and shall publish that information on their websites.
Transparency of the integration of sustainability risks -Article 6-	**Financial market participants** shall include descriptions of the following in pre-contractual disclosures: - the manner in which sustainability risks are integrated into their investment decisions; and - the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available. Where financial market participants deem sustainability risks not to be relevant, the descriptions shall include a clear and concise explanation of the reasons. **Financial advisers** shall include descriptions of the following in pre-contractual disclosures: - the manner in which sustainability risks are integrated into their investment or insurance advice; and - the result of the assessment of the likely impacts of sustainability risks on the returns of the financial products they advise on. Where financial advisers deem sustainability risks not to be relevant, the descriptions shall include a clear and concise explanation of the reasons.
Transparency of adverse sustainability impacts at financial product level -Article 7-	**For each financial product where a financial market participant considers or must consider principle adverse impacts** of investment decisions on sustainability factors (see Article 4), the disclosures referred to in Article 6 shall include the following: - a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors; - a statement that information on principal adverse impacts on sustainability factors is available in the information to be disclosed pursuant to Article 11. Where information in Article 11(2) includes quantifications of principal adverse impacts on sustainability factors, that information may rely on the

	provisions of the regulatory technical standards adopted pursuant to Article 4(6) and (7). **Where a financial market participant does not consider principle adverse impacts** of investment decisions on sustainability factors (see Article 4), the disclosures referred to in Article 6 shall include for each financial product a statement that the financial market participant does not consider the adverse impacts of investment decisions on sustainability factors and the reasons	
Transparency of the promotion of environmental or social characteristics in pre-contractual disclosures -Article 8-	**Where a financial product promotes**, among other characteristics, **environmental** or social **characteristics**, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, the information to be disclosed by financial market participants pursuant to Article 6 shall include the following: - information on how those characteristics are met; - if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics. Financial market participants shall include in the information to be disclosed pursuant to Article 6 an indication of where the methodology used for the calculation of this index is to be found.	Annex 2
Transparency of sustainable investments in pre-contractual disclosures -Article 9-	**Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark**, the information to be disclosed by financial market participants pursuant to Article 6 shall be accompanied by the following: - information on how the designated index is aligned with that objective; - an explanation as to why and how the designated index aligned with that objective differs from a broad market index. **Where a financial product has sustainable investment as its objective and no index has been designated as a reference benchmark**, the information to be disclosed by financial market participants pursuant to Article 6 shall include an explanation on how that objective is to be attained. **Where a financial product has a reduction in carbon emissions as its objective**, the information to be disclosed by financial market participants pursuant to Article 6 shall include the objective of low carbon emission exposure in view of achieving the long- term global warming objectives of the Paris Agreement. **Where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark in accordance with the 'Benchmark Regulation' ((EU 2016/1011) is available**, the information referred to in Article 6 shall include a detailed explanation of how the continued effort of attaining the objective	Annex 3

	of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.	
Transparency of the promotion of environmental or social characteristics and of sustainable investments on websites -Article 10-	**Financial market participants** shall publish and maintain on their websites the following information for each financial product that promotes environmental characteristics, or has sustainable investment as its objective (including GHG emission reduction objective): - a description of the environmental or social characteristics or the sustainable investment objective; the information 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. - 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; - the information referred to in Articles 8 and 9; - the information referred to in Article 11.	
Transparency of the promotion of environmental or social characteristics and of sustainable investments in periodic reports -Article 11-	Where financial market participants make available a financial product that promotes environmental characteristics, or has sustainable investment as its objective (including GHG emission reduction objective), they shall include a description of the following in periodic reports: - for a financial product that promotes environmental characteristics, the extent to which environmental or social characteristics are met. - for a financial product that has sustainable investment as its objective (including GHG emission reduction objective): i. the overall sustainability-related impact of the financial product by means of relevant sustainability indicators; or ii. where an index has been designated as a reference benchmark, a comparison between the overall sustainability- related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators. Financial market participants may use the information provided by companies in management reports and non-financial statements in accordance with Article 19 of the 'Accounting Directive' (2013/34/EU). The information shall be disclosed in the following manner: - for AIFMs, in the annual report referred to in Article 22 of Directive 2011/61/EU;	Annexes 4 & 5

- for insurance undertakings, annually in writing in accordance with Article 185(6) of Directive 2009/138/EC;
- for IORPs, in the annual report referred to in Article 29 of Directive (EU) 2016/2341;
- for managers of qualifying venture capital funds, in the annual report referred to in Article 12 of Regulation (EU) No 345/2013;
- for managers of qualifying social entrepreneurship funds, in the annual report referred to in Article 13 of Regulation (EU) No 346/2013;
- for manufacturers of pension products, in writing in the annual report or in a report in accordance with national law;
- for UCITS management companies, in the annual report referred to in Article 69 of Directive 2009/65/EC;
- for investment firms which provide portfolio management, in a periodic report as referred to in Article 25(6) of Directive 2014/65/EU;
- for credit institutions which provide portfolio management, in a periodic report as referred to in Article 25(6) of Directive 2014/65/EU;
- for PEPP providers, in the PEPP Benefit Statement referred to in Article 36 of Regulation (EU) 2019/1238.

CDP as the global platform for environmental reporting

TCFD – In 2018, CDP aligned with the recommendations of the Task Force of Climate-related Financial Disclosure.

TNFD – CDP supports the TNFD as a critical framework for understanding and driving action on nature-related risks and opportunities. Once final, CDP's global disclosure system is ideally positioned to mainstream the widespread adoption of TNFD recommendations in a structured, comparable format, as we did for the TCFD.

CDP's questionnaires also support disclosures according to other standards and frameworks including the GRI, GHG Protocol and the CEO Water Mandate.

ISSB – From 2024 CDP's disclosure system will incorporate the IFRS S2 Climate-related Disclosures Standard.

US SEC – CDP disclosure is already in line with what the SEC is likely to use as the foundation for mandatory reporting.

NZAM – CDP is one of the six investor networks coordinating the Net Zero Asset Managers initiative, an international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner.

NZDPU – CDP is working with the Climate Data Steering Committee on efforts to provide a foundational layer of data that will populate the Net-Zero Data Public Utility. The collaboration reflects our commitment to standardized, accessible environmental data.

EU sustainable finance policies in the CDP disclosure system

CDP consistently advocates for the development of impactful and high-quality disclosure standards and frameworks that provide clarity, enhance compliance, and support companies in their reporting needs, including those being developed by the European Union.

CDP's questionnaire now includes taxonomy questions and already covers approximately 20 out of 30 **corporate adverse impact indicators** on climate, forest, biodiversity, and water.

CDP also collects data on 8 out of 9 **SFDR mandatory principle** adverse impacts on environmental issues for corporate exposures. Six can already be calculated leveraging 2022 CDP questionnaire data points (e.g., GHG emissions and renewable and non-renewable energy consumption/production) and 2 of them were included for the first time in 2023 (question C15.4a on activities near biodiversity sensitive areas with potential for negative impact and question W1.2k on emissions to water). Additionally, we collect information for **additional**

adverse impacts including carbon reduction initiatives, water consumption, water sourced from areas of stress, and policies related to water and deforestation.

For more information on how CDP is integrating EU sustainable finance regulations, see here.

For further information

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CDP Europe and the CDP global system

CDP Europe is a charitable organization registered in Brussels and Berlin and on the EU Transparency Register since 2012. It is part of the CDP Global System, a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with more than 740 financial institutions with over $130 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Nearly 20,000 organizations around the world disclosed data through CDP in 2022, including more than 18,700 companies worth half of global market capitalization, and over 1,100 cities, states and regions. Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative. Visit cdp.net or follow us @CDP and on LinkedIn to find out more.

In Europe, CDP Worldwide (Europe) gGmbH is a charitable limited liability company headquartered in Berlin, Germany, registered on the EU Transparency Register since 2012. It is a wholly owned subsidiary of CDP Europe AISBL, a charity based in Brussels, Belgium (together: "CDP Europe"). CDP Europe is part of the non-profit CDP Global System ("CDP"), which refers to three legally separate organizations: CDP Europe (BE), the CDP Worldwide Group (UK), and CDP North America, Inc. (US).

More information on CDP Europe's governance and finances can be found here.

CDP FinACTION project

Under the EU-funded FinACTION project, CDP leverages EU LIFE funding to drive market uptake and scale EU ambition and best practice globally through the CDP system while engaging and enabling companies to disclose and act on their environmental impacts in line with ambitious European regulatory requirements and a science-based transition to a net-zero and nature-positive economy.

More information about this project can be found here.

CDP Europe in European and international media

Important Notice

This document constitutes a non-legal and non-exhaustive guide to regulatory requirements and how reporting through CDP can help CDP stakeholders meet some of these requirements.

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