Sustainable Investment – Regulation

SFDR (Sustainable Finance Disclosure Regulation)

The acronym refers to the EU regulation* which **clearly defines what can and cannot be communicated as „sustainable investment".** For financial institutions, it constitutes a guide to determine the extent of environmental or social features of their products and the level of sustainability of the products' goals and investment.

Features of sustainability

To be described as „sustainable", the investment **must be targeted to companies that contribute to environmental or social goals** („Environment" or „Social") and simultaneously follow **good governance procedures** („Governance"). Therefore, the classification of „sustainable investment" can sometimes be found under another abbreviation – ESG.

Distribution of companies according to the level of investment sustainability

A The companies which do not include sustainability in their investment strategy, although their manufactures (e.g. portfolio managers) may take it into consideration, but not to the extent that is sufficient for them to be considered sustainable as in cases B and C.

B The companies which support social and/or environmental („E" or „S") features and can invest in sustainable investment, but sustainability is not their main goal.

C The companies which always have the goal of sustainable investment.

Who must follow the SDFR

The rules of the regulation apply to:

- **Product manufactures,** such as insurance companies that provide insurance products with an investment component or investment firms that offer portfolio management.
- So-called **financial advisors,** such as credit institutions or investment firms providing investment advice.

What financial products can be sustainable

The SDFR applies to portfolio management, alternative investment funds; insurance products with an investment component; pension products, pension plans, undertakings for collective investment in transferable securities (SKIPCP, aka UCITS); or the pan-European personal pension product (PEPP).

Financial institutions must disclose how they **assess sustainability risks of their products and whether they monitor adverse effects on sustainability factors.**

*Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector („SFDR")

PAIs (Principle Adverse Impacts)

Companies can monitor and, above all, publish **the negative impacts of their production and services.** A detailed distinction is made in which areas companies assess these impacts.

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Categories of negative impacts

- Greenhouse gases (e.g. greenhouse gas emissions, carbon footprint)
- Biodiversity
- Water (emissions to watercourses)
- Waste (hazardous waste ratio)
- Social and employment issues (e.g. gender pay gap, violations of the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises)

+ other indicators. There are a total of 18 indicators compulsorily reported by companies.

TAXONOMY

This EU regulation ** sets out how the EU economy must change to comply with the Green Deal, including achieving climate neutrality by 2050. It **presents common terminology and a clear definition of what is „sustainable“ and „green“ from an environmental perspective within the six basic objectives.**

The end of „greenwashing“

Taxonomy helps investors decipher what to invest in. It protects them against „greenwashing“, a situation in which a company claims to be environmentally friendly but does not really do anything important in terms of sustainability. Or, when a financial product creates a false impression to be „green“ or „sustainable“ but does not even meet basic environmental standards.

Clear rules will also help companies to be more climate-friendly. They will **enable the unification of product naming in the market** and make it easier to shift investment to activities that are truly sustainable.

Ecological and climate goals

- Climate change mitigation (e.g. afforestation, wetland restoration, production of renewable energy technologies, etc.)
- Adaptation to climate change (e.g. electricity generation using solar photovoltaic technology or wind energy, bio-waste composting)
- Sustainable use and protection of water and marine resources
- Transition to circular economy
- Pollution prevention and control
- Protection and restoration of biodiversity and ecosystems

Taxonomy is considered **the main classification tool of economic activities for European companies.** Companies must **contribute to at least one of the environmental goals** without significantly damaging any other of the stated goals and they must also comply with the specified minimum guarantees.

**Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 („Taxonomy“)

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