

A full-page background image of a surfer in a black wetsuit riding a white surfboard inside the barrel of a massive, curling blue wave. The water is turbulent and white with foam, creating a tunnel-like effect around the surfer. The scene is captured from a low angle, emphasizing the scale and power of the wave.

Deloitte.

**Sustainable Finance
Disclosure Regulation**

Is the financial industry ready
for the Big One?

An international overview

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Introduction



Climate change is considered to be one of the most significant threats to financial stability. According to the World Economic Forum (WEF), the cost of natural disasters worldwide was USD165 billion in 2018, more than the gross domestic product (GDP) of Hungary in 2018 (EUR157 billion).

A National Climate Assessment study forecasted that climate-related natural disasters will reach 10 percent of the global GDP by the end of the century¹. The debt market has kept up its sustainability efforts, even amid the COVID-19 crisis, and the latest outlook and direction reports from the Climate Bonds Initiative (CBI) for the past 12 months have reported that, overall,

the performance of the combined sustainable debt market (green, social, sustainability, etc.) was very strong in H1 2020, with over USD250 billion issued compared to USD341 billion for 2019².

The financial sector must take swift action to preserve its stability and limit damages caused by climate change. A series of recent regulations indicate that European regulators will use the financial sector to build and finance a low carbon economy. These include the European Union (EU) Taxonomy to define a common sustainability narrative for investors; the integration of sustainability preferences into the Markets in Financial Instruments Directive (MiFID, Directive 2014/65/EU); and the revision of the EU Non-Financial Reporting Directive (NFRD, Directive 2014/95/EU)³.

1. (<https://nca2018.globalchange.gov/>)

2. Climate Bonds Initiative (CBI) Global Sustainable Debt report: H1 2020 review of green, social, sustainability & pandemic markets

3. Articles 8 and 9 of the 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

Of these recent regulations, the **Sustainability Related Financial Disclosure Regulation** (SFDR) is the closest to being applied and will require Financial Market Participants (FMPs) and financial advisors to evaluate and disclose sustainability-related data and policies at entity, service and product level. This is to prevent greenwashing and ensure a systematic, transparent and comparable approach to sustainability within financial markets.

Although FMPs are working against the clock to get ready to meet the requirements of the “sustainable finance regulatory framework”, some players are also actively negotiating with supervisors and regulators to defer the application of the Regulatory Technical Standards (RTS) on sustainability-related disclosures. Many

financial debates of the past few months have highlighted serious concerns that the SFDR’s target population may not be adequately prepared to address these changes. Some of the current timelines are rather tight or even unachievable; by 10 March 2021 (less than six months from now), the majority of the SFDR provisions are supposed to take effect. Another major obstacle is the lack of finalized guidelines. The European Supervisory Authorities (ESAs) have until the end of the year to submit precise templates; meaning that, until then, the target population will have to base their disclosures on a “principle-level” and a “best-efforts” basis. Though this is generally still feasible, it leaves a lot of unanswered questions around product disclosure and compliance with principal adverse impacts⁴.



Many financial debates of the past few months have highlighted serious concerns that the SFDR’s target population may not be adequately prepared to address these changes.

4. Article 4 of the 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

On the 23rd of April the European Supervisory Authorities have issued a consultation paper setting out a proposal for Regulatory Technical Standards (RTS) providing details on content, methodologies and presentation of disclosures under the SFDR. Comments were invited on all aspects of the consultation to get a sense of how the industry was already performing on these issues and what were common practices identified.

It is in this context that we issued this survey, which is primarily aimed at taking the temperature of FMPs regarding their understanding, perception and level of preparedness regarding the major changes foreseen by the SFDR directive. We wanted to know FMPs' opinion of the best way forward, taking into account the many layers of complexities involved; to assess their main concerns regarding Environmental, Social and Governance (ESG) data; to evaluate the integration of level I and level II; and to find out which role they think national competent authorities (NCAs) should play in the SFDR implementation.



Methodology

We surveyed the players in the scope of the SFDR, namely asset managers, bankers, financial advisors and insurers. Professionals from 21 countries responded to the eight-questions survey.

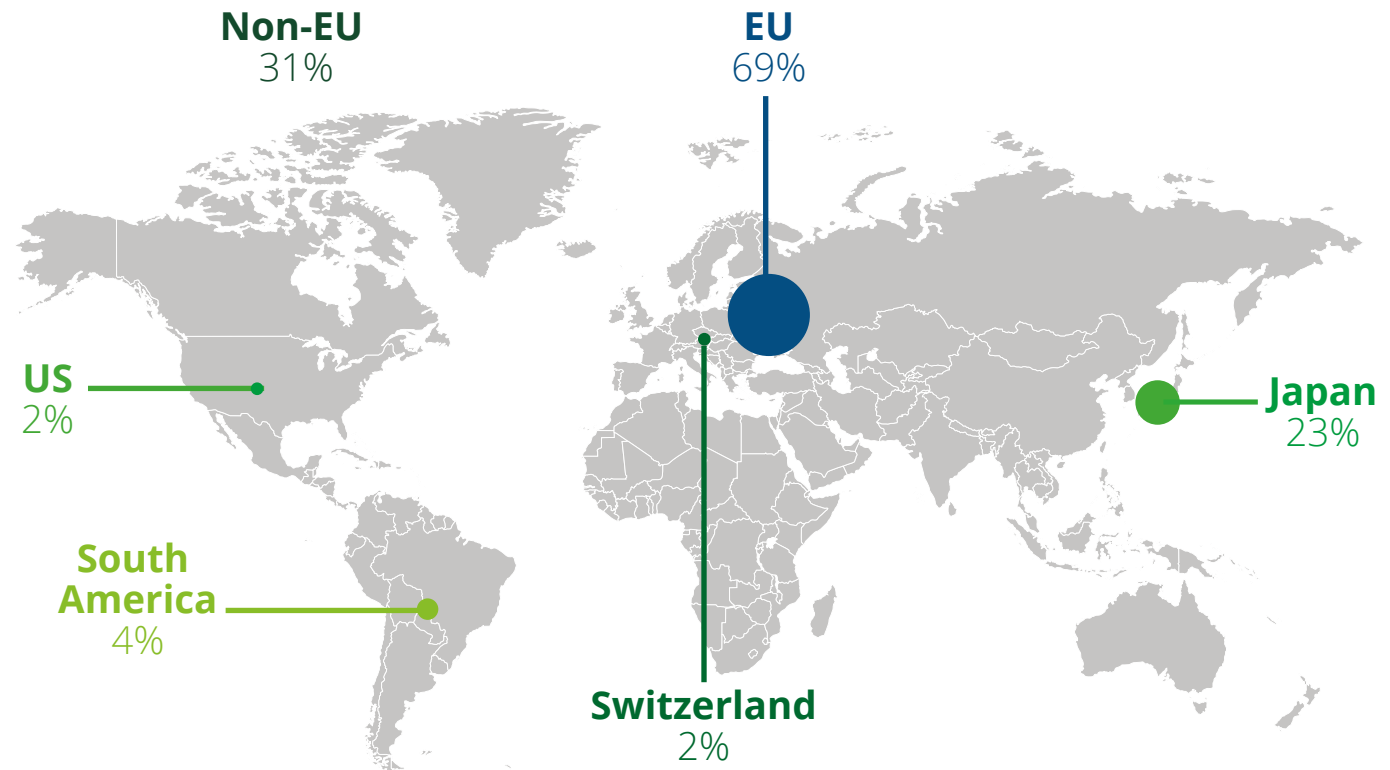


The responses encompass a representative panel of market concerns. The survey aimed to include a range of international responses, given the pressure felt by firms not headquartered in Europe but still in the scope of the SFDR due to the distribution aspect of their activities. Therefore, while European respondents are the most represented, we also obtained numerous responses outside of Europe, particularly from Asia.

Some of the issues we focused on include:

- The link between expected sustainability risk disclosures and the EU taxonomy (if it is perceived as realistic, concerns around the lack of unanimity of taxonomy definitions, etc.)
- The need to strike the right balance between reporting and accountability
- The relationship/alignment with current rating protocols and existing frameworks
- The level of readiness of NCAs
- The future evolution of indicators

Collecting these perspectives also provided a picture of FMPs' current level of knowledge, prompting recommendations on how to increase awareness of the SFDR and develop a stronger inter-stakeholder dialogue to help smooth its entry into force.



Disclosure and definitions



Sustainable investments are deemed to be products that promote sustainability or achieve a sustainable objective. There has never been one

accepted definition for a sustainable product, either Europe-wide or globally; however, some players have attempted to propose definitions⁵.

A rather comprehensive definition proposed at European level, has been an important source from which the European Commission could start drafting its blueprint of a sustainable finance strategy and first action plan, this was: “Sustainable and Responsible Investment (SRI) is a long-term oriented investment approach, which integrates ESG factors in the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement with an evaluation of ESG factors in order to better capture long term returns for investors, and to benefit society by influencing the behavior of companies.”⁶

In parallel, industry players have added their own understanding and considerations that have further increased the level of complexity, especially when measuring the impact of these investments.

As stated in the ESAs consultation document, negotiations were “on-going on the draft taxonomy regulation while Article 2(17) SFDR defined ‘sustainable investments’ without reference to the taxonomy regulation”. These negotiations, which determined the proposal of the text rather than focusing on a set definition, used only a series of taxonomy components that were the main elements of this reference framework. In particular, the SFDR refers to specific types of disclosures for different types of product categories that, according to articles 8 and 9, require additional pre-contractual content.

5. Mostly industry-led associations (Eurosif, GSIA, PRI) and financial players

Disclosure requirements apply **under article 8 to products that promote also environmental or social characteristics**, whereas disclosure requirements apply **under article 9 to products that have sustainable investment as their objective**. This forces asset managers to determine whether their products come under the scope of either article 8 or article 9 at a very early stage of their implementation project. The SFDR does not prescribe how FMPs should determine to which category their products belong, but it does provide key elements that can be considered when making these evaluations regarding marketing communications or mandatory investor disclosures.

These have important implications for the existing SRI taxonomy, which has been developed by and for the industry over the past 15 years to shape and determine industry trends around

these specific types of investments. Periodic reviews of the sustainable and responsible investment market have been a useful way to track SRI strategy measures in both Europe⁷ and globally. While a wealth of parties have produced similar sets of definitions to classify investment approaches, it is fair to consider these seven as the main approaches:

1. Sustainability themed investments
2. Best-in-Class investment selection
3. Exclusions/negative screening
4. Norms-based screening
5. ESG integration
6. Engagement and voting
7. Impact investing

Over the years, the relevance of these approaches has varied. Product manufacturers have grown increasingly interested in mixing strategies when composing their portfolios, leading to

an increased blurring between approaches in more recent years. This is also an important consideration regarding “greenwashing”, which has pushed regulators to install defined metrics and standards not only in the processes but also around the definitions that pertain to SRI products.

Industry players have added their own understanding and considerations that have further increased the level of complexity, especially when measuring the impact of these investments.

The ESAs consultation flags the differences between articles 8 and 9 and proposes some level of guidance. Under article 8, products that must be indicated are the planned proportion of sustainable investments in the pre-contractual information, and to report on the **proportion of sustainable investments in periodic reports**. And, as opposed to article 9 products, the products under the scope of article 8 should only apply ESG strategies to select their investments but not to commit to objectives (which apply under article 9).

Looking back to the seven SRI investment approaches, investors could consider ESG integration and, potentially, also the other first four investment approaches⁸ for the definition of their 'article 8' products. On the other hand, only impact investing focused products, as they focus

specifically on attainment of objectives, would fall under the category 'article 9' products⁹.

This leaves out engagement and voting investment approaches, which are deemed to play a pivotal role for asset managers to be able to exert influence on the companies in their portfolio and therefore play an active role throughout their investments. Not giving enough possibilities for investors to opt for active strategies through which they can promote their preferences would impair the industry, which has demonstrated very positive efforts through this approach.

Several respondents to the ESAs consultation have also stressed their support for incorporating SRI investment strategies that are already widely used by the market to "avoid confusion and distortion".



7. The European Forum for Responsible Investment has been tracking the evolutions of AuM since 2006 and the Global Sustainable Investment Alliance (GSIA) has been doing this at a global level since 2012

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Further to that, the industry has been tracking investment flows using the categorization of investment strategies we have already described. We would expect that whatever new classification would make clear and obvious links with what the industry has been using so far.

Given that the SFDR's main objective is to bring clarity and transparency to the market on sustainable investment, we deem it paramount

that FMPs are given further clarity on the categorization of products and the reporting expectations for these types of products.

The SFDR focuses around three main types of disclosures: those relating to the disclosure of risks that sustainability present to investments¹⁰, and conversely, that investments present to sustainability matters¹¹ (with a so-called "double materiality" lens), and those relating to product disclosures¹². In terms of the latter, the SFDR distinguishes between "sustainable investments" able to concretely refer to specific objectives (Article 9) and investments that merely promote the ESG characteristics of an investment (Article 8 of the SFDR).

As it is expected that the EU taxonomy will replace the voluntary categorization schemes with

a single EU classification system, starting with environmental categorizations, FMPs will need to familiarize themselves with the EU taxonomy and use it to "redefine" or "re-categorize" their products. The success of the taxonomy implementation is crucial, as it will hopefully create, in the medium to long term, a level playing field for international investors keen to ensure their sustainable investments are genuine. The EU taxonomy framework will also inevitably become the new gold standard for SRI investment, potentially retiring all pre-existing voluntary schemes that the industry has used in the past for a lack of a better option.

Against this backdrop and a wealth of considerations, we asked our survey participants to give us their views regarding the regulatory alignment and clarity to date.

8. Sustainability-themed, best-in-class, exclusions, and norms-based screening

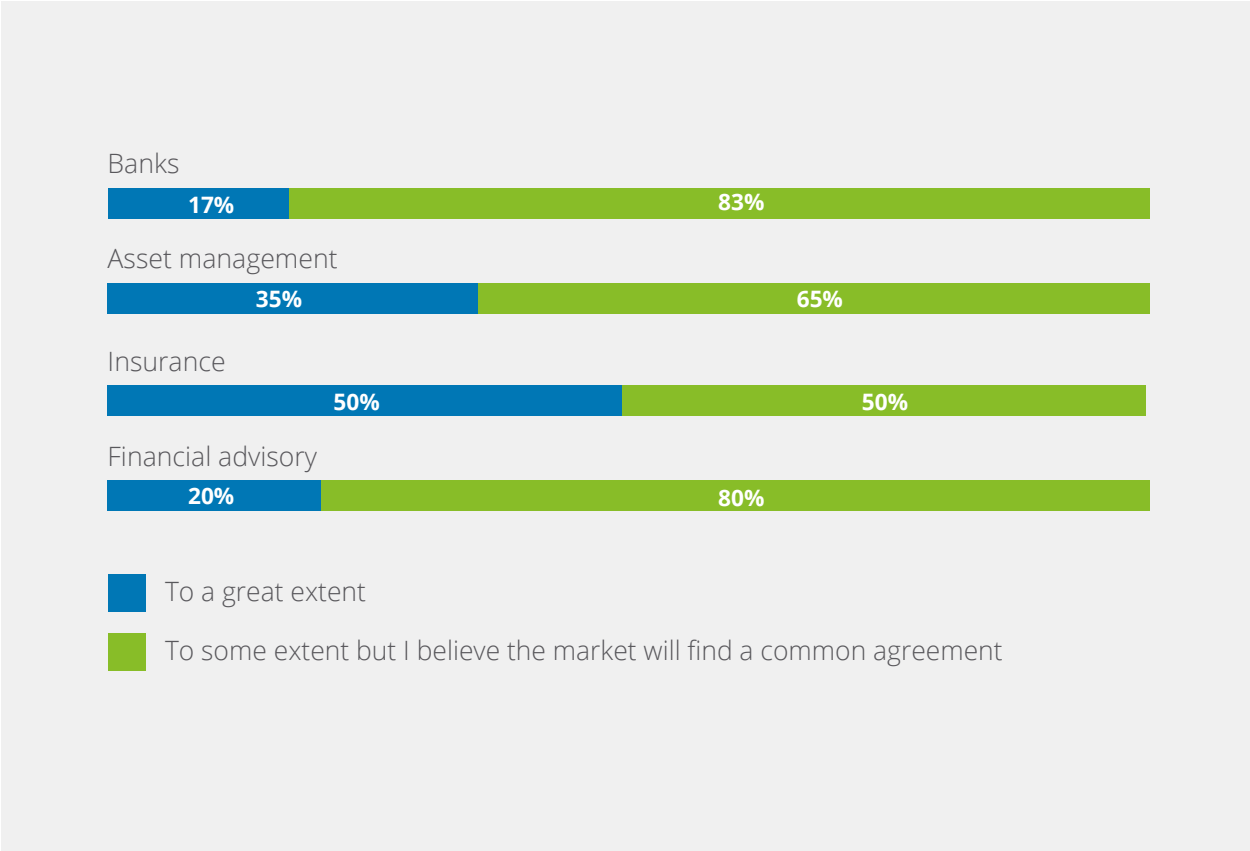
9. Engagement and voting could potentially offer some tracking and measures in line with article 9

10. Articles 3, 5 and 6 of the 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, which require firms to disclose how they integrate sustainability risks into their investment decision-making process.

Question 1

The SFDR defined “sustainable investments” without making a clear reference to the EC’s taxonomy regulation. At the same time, an existing SRI “taxonomy” is being used by different actors informally but is already quite engrained in the industry. To what extent do you think this lack of unanimity on the terms is likely to increase confusion among FMPs?

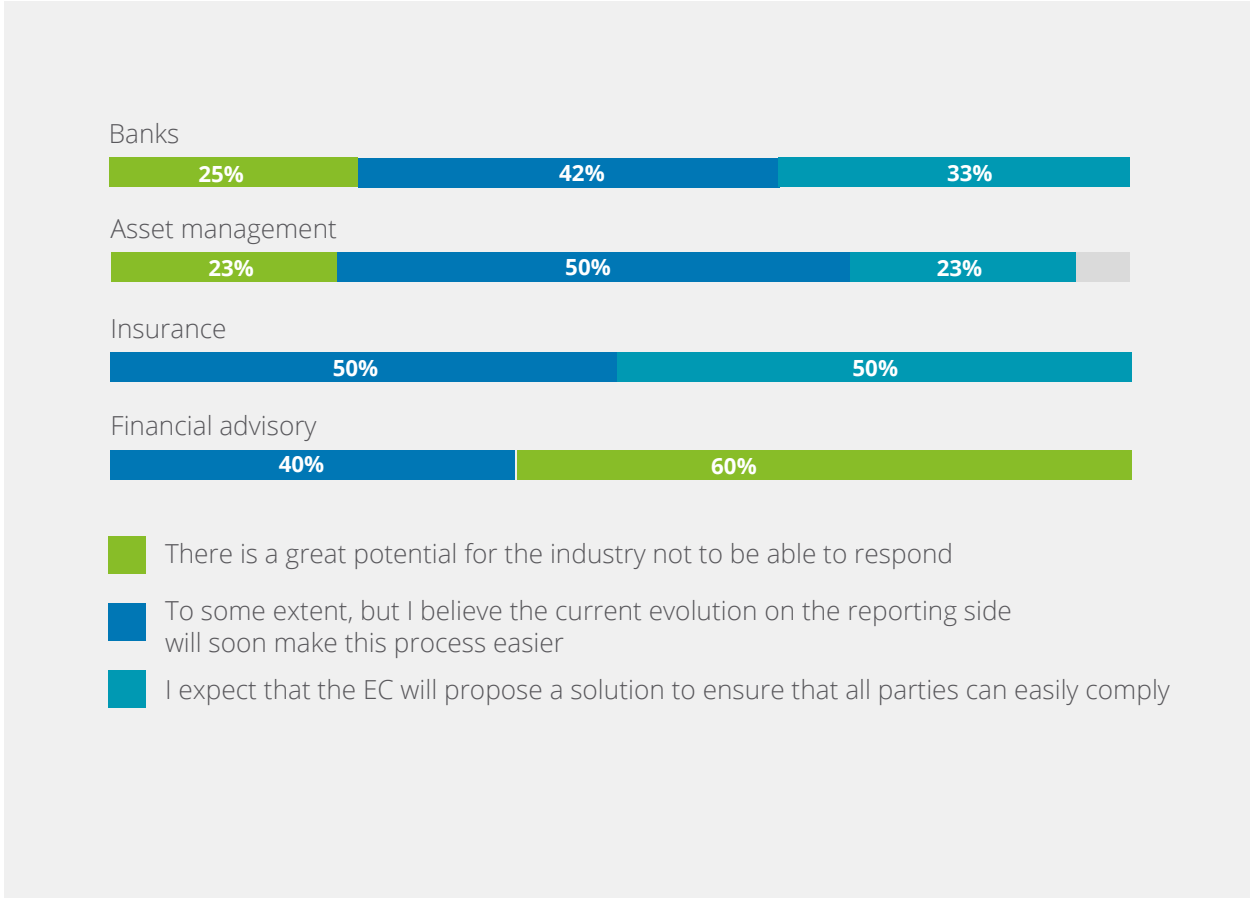
A significant majority of respondents believe that the market will find a common agreement, while others strongly believe that a high degree of confusion will still pervade the market. There was a higher degree of confidence among European respondents compared to other geographies, most likely because of a better understanding of the issues at stake and related effects. The insurance industry players in Luxembourg believe that the market will find a common agreement, while Swiss actors foresee confusion in the market due to the current lack of unanimity on “sustainable investment” terms.



Question 2

It is notable that the taxonomy regulation indicates that FMPs should specify how and to what extent (in a form of a percentage) the investment meets the criteria for “environmentally sustainable economic activities”. To what extent, and with a view to the current ESG reporting landscape, do you think this is realistic today and what do you think could help to make significant strides towards a concrete solution to this issue?

The response to this question demonstrates a lower level of optimism among financial advisors, with 60 percent believing it very likely that the industry will be unable to assess how sustainable their investments are. However, 40 percent trust that the current evolution of the reporting side will soon make the process easier. European respondents are divided in their responses, with UK and some Luxembourg participants being the most optimistic.





The EU Taxonomy Regulation also introduces new disclosures for corporates subject to the Non-Financial Reporting Directive (NFRD)¹³. Specifically, article 8 requires these entities to disclose in their non-financial statements, "... information on how and to what extent their activities are associated with environmentally sustainable economic activities under Articles 3 and 9 (of the Taxonomy)". The entities in scope will have to report the percentage of "...their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9," and "...the proportion of their capital expenditure and

the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9."

The European Commission is meant to adopt a Delegated Act by June 1st, 2021, requiring the exact content and presentation of the information to be disclosed and the methodology used, taking consideration of the technical screening criteria established under the Taxonomy Regulation.

But where exactly do we stand regarding the NFRD, and what is the current state of data and

company reporting in general?

The NFRD, which came into effect on 1 January 2017, requires certain large corporates, banks, and insurance companies to publicly report on ESG matters including employment, board diversity, human rights, anti-corruption, and bribery. As part of a normal periodic revision of its directives, and given its communication on the European Green Deal, the EC announced the revision of this directive "as part of a strategy to strengthen the foundations for sustainable investment" at the end of December 2019.

11. Articles 4 and 7 of the 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, which establish disclosure obligations that require firms to specify the "principal adverse impacts" on sustainability factors posed by their products, decisions, and advice.



A consultation¹⁴ followed, which allowed the EC to stress its renewed ambition for this directive: “The NFRD identifies four sustainability issues (environment, social and employee issues, human rights, bribery and corruption) and with respect to those issues and subject to the company’s materiality assessment, requires companies to disclose information about their business model, policies (including implemented due diligence processes), outcomes, risks and risk management (including risks linked to their business relationships), and KPIs relevant to the business.” In both the consultation and the background documents, the EC clearly stresses that the data published under the NFRD is necessary for firms to meet their obligations under the Sustainability Disclosure Regulation and the ongoing EU Taxonomy Regulation.

Similarly to sustainable and responsible investments, companies that are in scope of reporting are free to do it using international,

European or national guidelines¹⁵ and cannot rely on one single standard. The EC has issued guidelines to help companies with their environmental and social disclosures. These were later coupled with another specific set of guidelines on reporting climate-related information, a new addition that linked the existing guidelines with the work carried out by the Task Force on Climate-Related Financial Disclosure (TCFD)¹⁶.

Currently, there are several voluntary standards and norms that companies can use. These have been set up by the Global Reporting Initiative (GRI), the Climate Disclosure Standards Board (CDSB), the Sustainability Accounting Standards Board (SASB), and the Carbon Disclosure Project (CDP). All these standards, while valid in their own terms, are far from helpful for companies and investors to determine a one-size-fits-all approach. However, as these voluntary standards have been in place for many years, companies will have relied on them for their extra-financial reporting by default.

12. Articles 8,9,10-11 of the 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

13. (Directive (EU) 2014/95 – “NFRD,” which amends Directive 2013/34/EU - the “Accounting Directive”), came into effect on 1 January 2017

Incidentally or not, the institutions behind the above-mentioned standards declared six months ago that they would be working together to provide a “globally harmonized system” that could “deliver on the pillars set out by the TCFD... across all sustainability targets,” and invited the International Financial Reporting Standards Foundation to join them. This project has recently delivered a “summary of alignment discussions among leading sustainability and integrated reporting organizations”, where the main framework-and-standard-setting institutions of international significance are collaborating to help resolve the current confusion on reporting, showing a clear commitment to creating a comprehensive corporate reporting system¹⁷.

In parallel, the EC recently set a new project in motion. With the help of the European Financial Reporting Advisory Group (EFRAG), the EC intends to develop a European reporting standard, a

Leading sustainability reporting organizations have come together to agree on a shared vision to resolve the confusion surrounding sustainability disclosure and develop what they describe as a more coherent and comprehensive corporate reporting system. The organizations indicated they would publish a joint statement of intent towards this goal, which would be achieved by working together and engaging with key actors, including IOSCO and the IFRS, the European Commission, and the World Economic Forum’s International Business Council.

Between them, these organizations guide most of the sustainability reporting currently available. GRI, SASB, CDP and CDSB set frameworks and standards for sustainability disclosure, while the International Integrated Reporting Council (IIRC) provides a

unique platform that reporting companies and investors could refer to and that would take stock of the voluntary standards developed so far.

It makes sense to consult and collaborate with all the major stakeholders involved in reporting so

framework that connects sustainability disclosure to reporting on financial “...and other capitals”.

These organizations have called for support and engagement from sustainability disclosure users, asking them to provide feedback on the ideas expressed in their paper and recognize that their frameworks and standards, “...naturally form part of a coherent eco-system, and can be used in a complementary way, especially in view of our description of dynamic materiality”. According to the organizations’ paper, their joint statement of intent will also serve as a “summary of alignment discussions”, and was facilitated by the Impact Management Project, World Economic Forum and Deloitte.

far to develop a future common reference, as it is more likely to receive the necessary political and financial consensus to deliver the value that all financial players are expecting.

14. In line with that commitment, on 20 February 2020, the Commission launched a public consultation on the review of the NFRD

15. For instance, they can rely on: the UN Global Compact, the OECD guidelines for multinational enterprises, or even the ISO 26000

16. The Task Force on Climate-related Financial Disclosures (TCFD) – was set up in 2016 to define an approach related to climate reporting

17. Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, <https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>

Notably, a group of European asset management associations involved in long-term European investments has teamed up to promote their support for a transition to a more sustainable economy and in tackling climate change. These associations wrote a letter to the EC requesting the setting up of a centralized electronic register for ESG data at the European level.

The aim of this group is that FMPs would be able to meet the requirements of the SFDR by having access to comparable robust and reliable ESG data at the company level. These companies, in turn, will have to report in line with the EU taxonomy to meet the upcoming reporting requirements. This consortium of players invokes EC's support to build an infrastructure platform to meet the EU sustainability objectives both under the Action Plan on Sustainable Finance and the EU Green Deal¹⁸.

While comparability is an essential part of the debate around data, especially ESG data, quality is also paramount for investment analysis. As previously stated, there is no universal approach for companies to determine the best reporting standard to apply and also to determine the materiality level of these issues. Investors are constantly striving to find solutions for their daily investment activities, while asset owners are struggling with the challenges posed by either too much or irrelevant data.

The number of ESG rating agencies has grown exponentially over the years, together with the number of different ratings provided per asset. The pervasive lack of standardization and transparency in these providers' data collection and scoring methodologies pose enormous challenges to investors. As part of its unique selling proposition, each agency uses

different rating and scoring systems that are counterintuitive to its "transparency" and business model overall. This is because the proprietary methodologies used by each provider aggregate and weigh ESG factors differently in their summary scores, as they are judgments made by each provider.

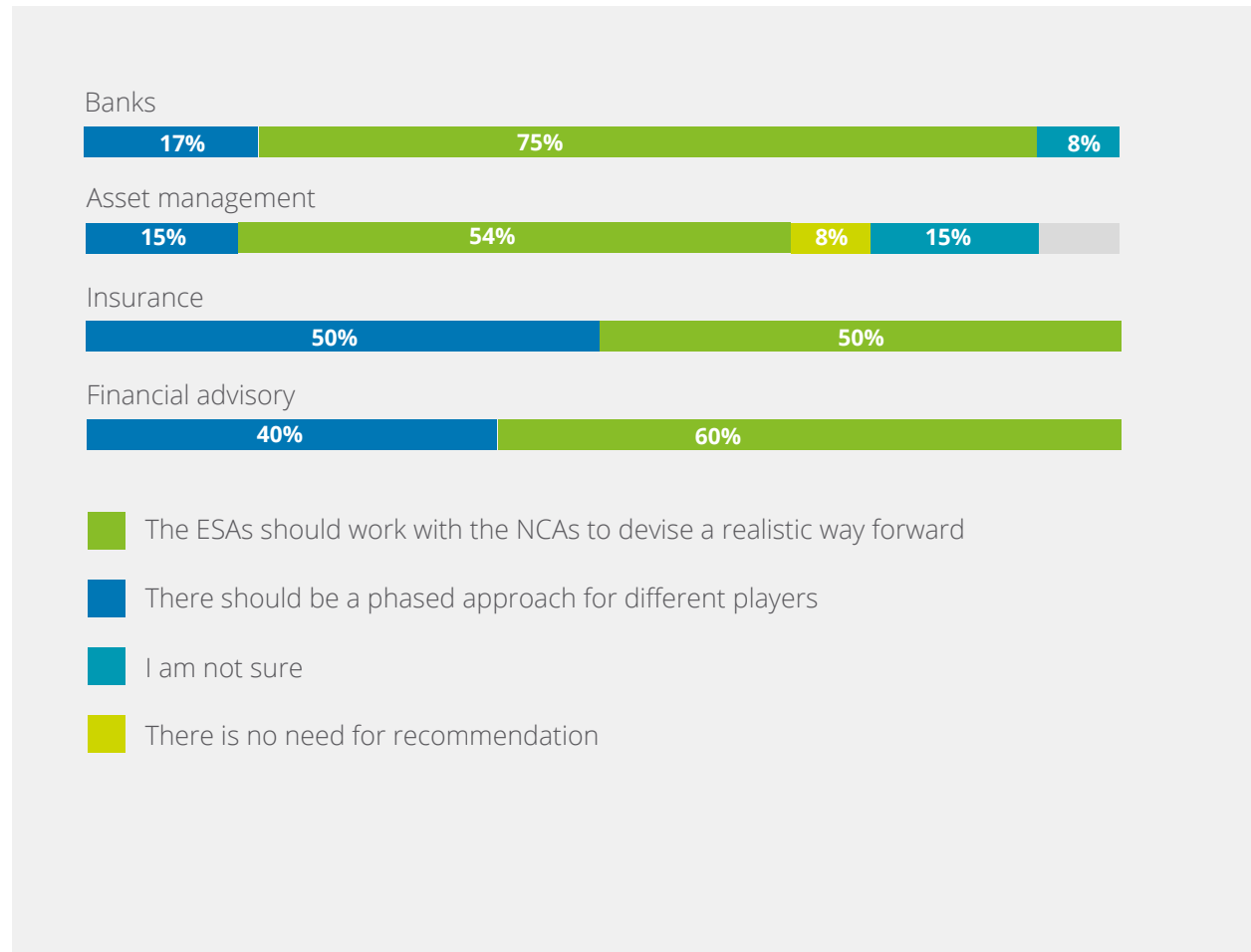


18. https://www.efama.org/Publications/20-024%20Joint%20industry%20letter%20ESG%20EU%20data%20register_EACB_EBF_EFAMA_ESBG_IE_PE.pdf

Question 3

The ESAs are looking at “a single set of uniform pre-contractual disclosures for various types of documents which serve different purposes and apply divergent approaches to pre-contractual disclosure granularity”. This wide scope can hamper the level of quality of the information provided and, therefore, put the success of the SFDR goals for FMPs at risk. What are some recommendations you believe are necessary to avoid any pitfalls?

Our respondents considered NCAs to be the savviest about these issues, certainly in the long-term. 75 percent of the banking sector participants thought that ESAs should work with NCAs to devise a realistic way forward and are convinced that NCAs will find a more realistic pre-contractual disclosure solution. Investment service companies were unanimous in this opinion, and the majority of financial advisory players (60 percent) and asset managers (54 percent) also agreed.



NCAAs will have to become the leading reference point to guide investors in the transposition of sustainable finance directive and the industry looks up to them in this sense. All of our European respondents are unanimous about this point.

After consulting on the disclosures, the ESAs launched an EU survey to receive feedback on the proposal for the specific template format the industry players will need to use, pursuant to articles 8, 9 and 11 of the SFDR (including pre-contractual and periodic disclosures). Almost in parallel, the EC ventilated the possibility for a deferral of the SFDR requirements for the level 2 RTS. Though a specific new deadline is not yet known, the majority of players foresee it to be January 2022.

In the meantime, the provisions that do not require level 2 RTS measures and that will apply as from March 2021 are those relating to sustainability risks in the investment decision-making process and in accordance with articles

3, 5 and 6. Therefore, FMPs will have to report how they consider sustainability risks in their internal processes, regardless of the existence of RTS. And, regarding the disclosures on adverse sustainability impacts at entity level as foreseen under article 4, the EC specifies that FMPs will have to adopt the “comply or explain” rule. To meet these reporting requirements, FMPs will be able to use the disclosures they are already reporting on under the NFRD¹⁹. Naturally, there should be a good degree of alignment regarding the different kinds of communications at the entity and product level and also for pre-contractual disclosures, even if the RTS are absent.

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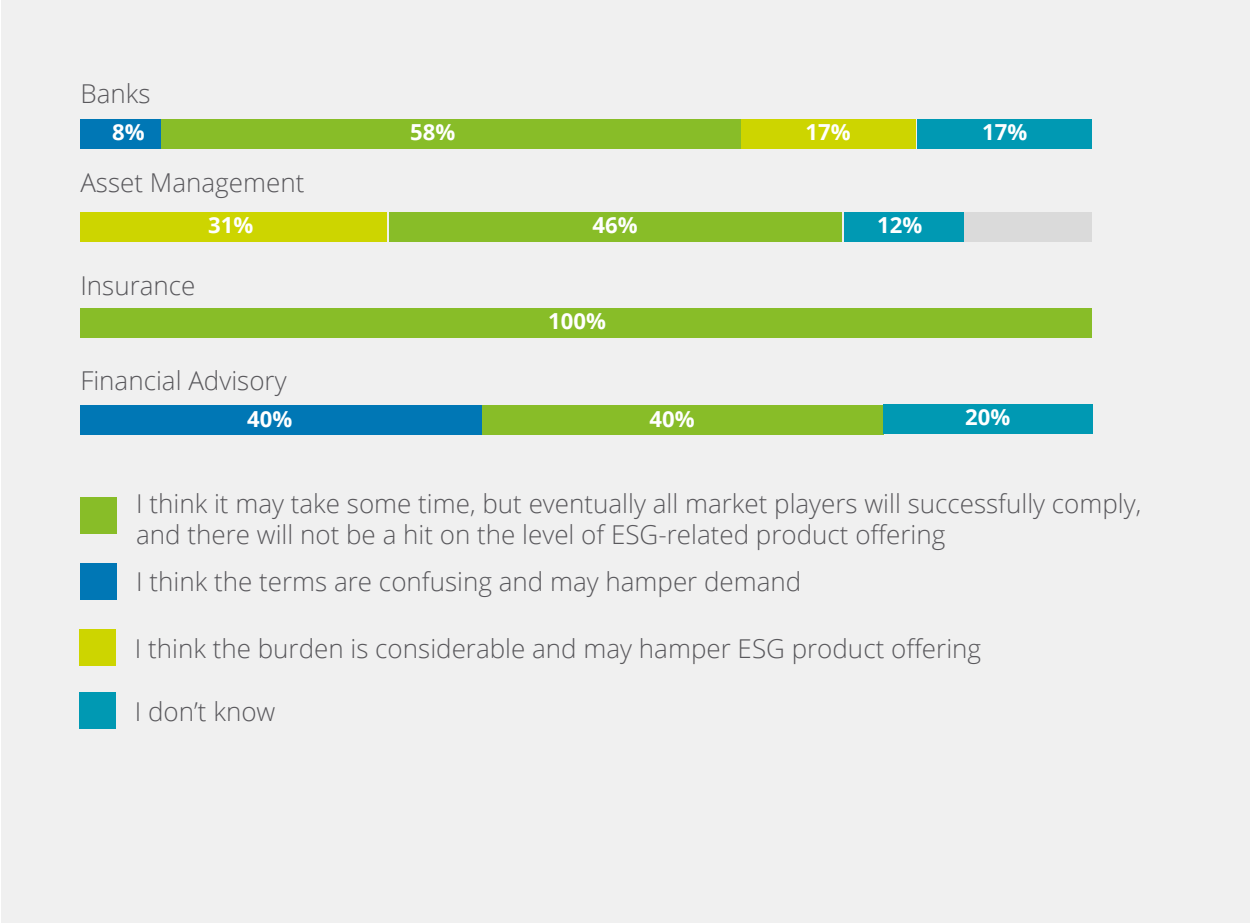


19. Non-Financial Reporting Directive under the Accounting Directive and provided the entities are in scope

Question 4

The ESAs consultation underlines the importance of striking the right balance between an increased level of reporting and the level of responsibility and accountability of FMPs and their products for end-consumers. In your opinion, will clearer reporting guidelines and responsibilities for FMPs players make it easier or more difficult to strike this balance? What repercussions do you envisage, if any, for the growth of sustainable investments?

Even in this context, the respondents are quite positive overall and agree across all categories that, even though it may take some time, all players will eventually find a successful way to comply. This belief is shared not only by European players but also by players outside Europe, including a third of American respondents. Less than 10 percent of the banking respondents felt that the burden was considerable and may affect the industry negatively. This feeling was also shared by Asian financial market players, including 25 percent of Japanese respondents.





The next two survey questions really test the validity of the tools and benchmarking that the industry has developed and relied on so far. ESG ratings have been a great stand-in for reporting the sustainability of financial products and their components. ESG rating agencies assess the ESG policies and targets of companies, countries and other types of securities issuers (local governments, supranational organizations, etc.). This analytical work is primarily based on publicly available data that is reported by companies, as well as information produced by non-governmental organizations (NGOs), governmental organizations and trade unions. Their analysis and resulting ratings are used to compare the ESG practices of the various issuers of both listed and unlisted securities, and by investment managers to build SRI funds.

The number of these ESG rating agencies has substantially reduced in the past five years, mainly

due to mergers and acquisitions but also because some credit rating agencies are incorporating ESG ratings in their work. While there are fewer players on the market today, it is important to stress that each agency has defined a proprietary methodology that defines their unique service offering, hence the way they score companies. This means that drawing comparisons amongst investee companies on the side of investors is a very daunting task, many investors will end up with a different score, or set of scores, per company.

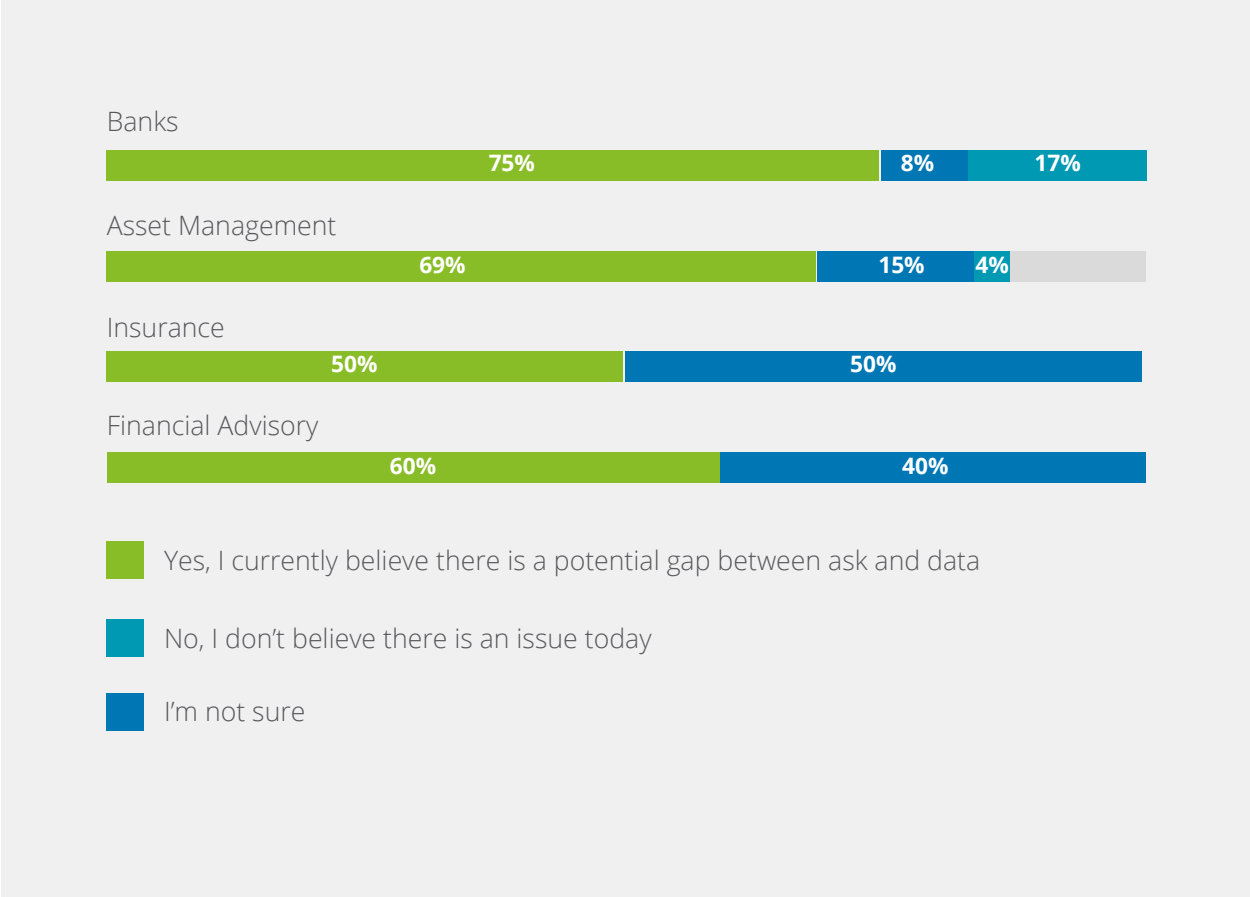
Going forward, and keeping in mind the EU taxonomy's aim to assess which categories of investments are truly sustainable, it will be important to define a clear alignment between ESG rating methodologies and some more standardized metrics. This will certainly improve not only the transparency of the data but also the comparability for end investors.


Question 5

How will the SFDR disclosure requirements be able to meet the methodological screening of ESG rating agencies? Is there a need for further alignment in terms of requirements and reporting standards?

Of the banking sector respondents, 75 percent consider that there is a potential gap in the industry between ask and data, due to the lack of consistency and clear common standards. This point of view is shared by 33 percent of our Luxembourg-based respondents, 22 percent of German respondents and 11 percent of Japanese respondents.

For asset managers, the issue is more complicated, with 69 percent of respondents believing there is a potential gap in the industry between ask and data, due to the lack of consistency and clear definition. This point of view was shared by 45 percent of our Luxembourg-based respondents and 18 percent of our Japanese respondents.



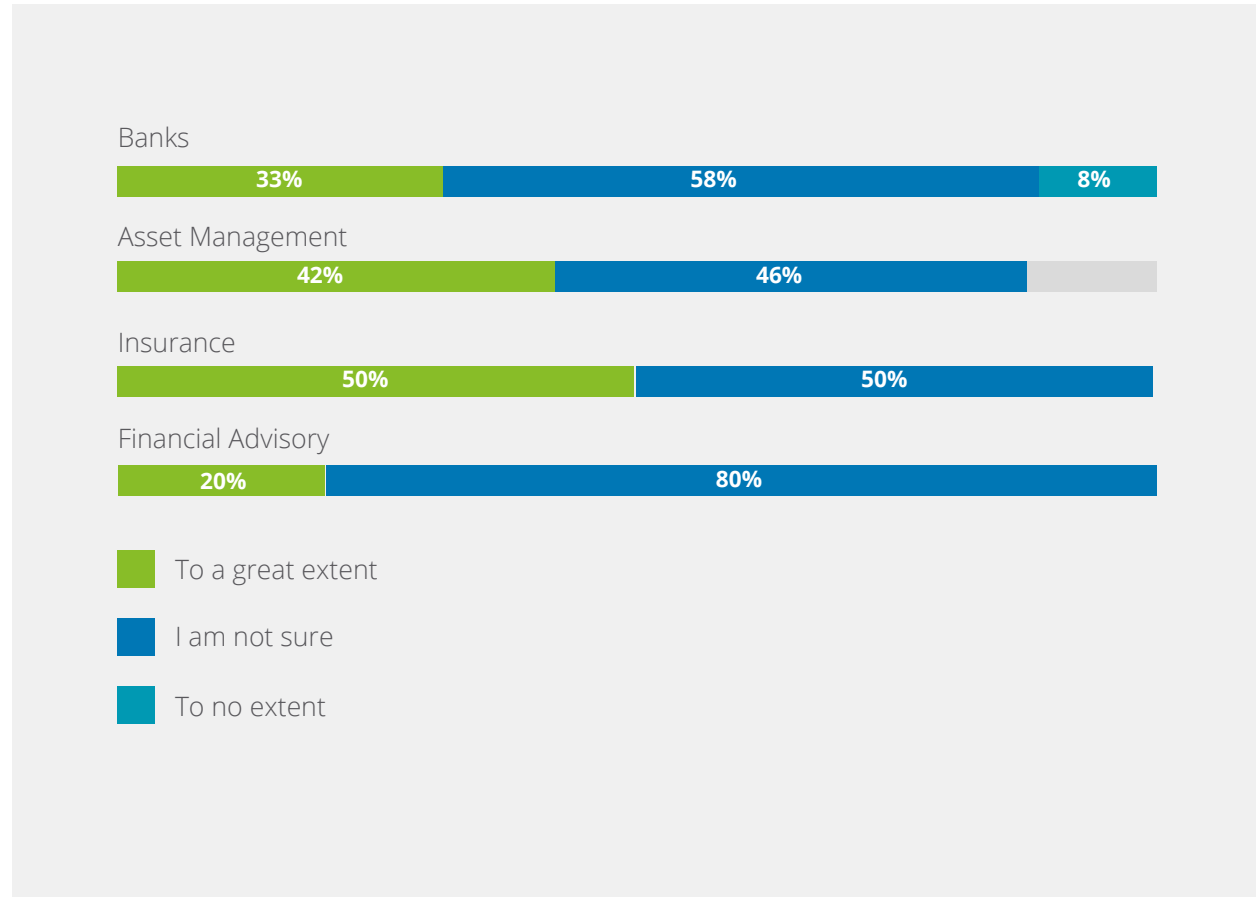


Today, only very few players have developed adequate tools and processes to truly evaluate their ESG credentials. As SRI increases in importance, most asset managers are moving towards fully integrating ESG into their products and processes. However, there is still much to be done and this is a very opportune time for actors to devise and implement solutions.

Question 6

The ESAs stressed the extent to which most of the disclosure requirements contained in the draft RTS are already part of industry initiatives, such as the Eurosif Transparency Code. To what extent do you believe that the requirements should mirror the existing frameworks already used by the industry?

There is no consensus amongst players on the extent to which reporting standards should refer or be based on existing frameworks. The asset management segment is equally split on the topic, while financial advisors clearly feel this is uncharted territory. Investment service company respondents tend to agree that the standards used by the industry today should continue to be a valid source of reference.



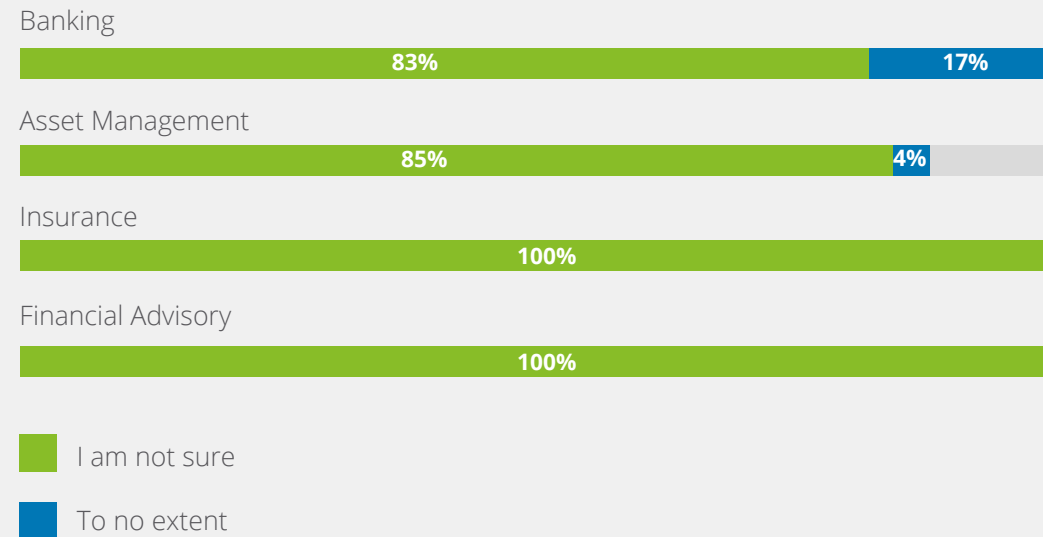
Question 7

To what extent do you think the ESAs need to ensure there is sufficient alignment and know-how across NCAs before the provisions enter into force?

An overwhelming majority of banking respondents (83 percent) are unsure whether ESAs should ensure sufficient alignment and know-how across NCAs before the SFDR comes into force. The remaining 17 percent do not believe there should be any alignment and know-how across NCAs.

European actors are divided on the topic, except for Austrian respondents who do not believe any alignment and know-how should take place across NCAs. The Asian respondents are unsure on this matter, probably because the NCAs in these countries have taken a more consensual approach and demonstrated a great willingness to proceed at the same pace as the industry.

On the 25th of June the Monetary Authority of Singapore (MAS) has issued 3 consultation papers on the proposed Guidelines on Environmental Risk Management for banks, insurers and asset managers. The proposed guidelines we co-created with the FIs and industry association and set out supervisory expectations as per their governance, risk management and disclosure of environmental risks.



NCA: are authorities ready?

Generally, there is a widespread perception that NCAs are not adequately prepared to meet the changes that ESAs and European regulators are implementing regarding sustainable finance. This opinion is also reflected in the responses to question 3 of this survey²⁰.

Although some NCAs have set up dedicated teams to work on these issues, we have not seen any structural changes in how this topic has been addressed to date. So far, efforts have been mostly limited to public consultation engagements and the publication of third-party guides²¹. Some NCAs have already tackled the current and proposed outcomes of the sustainable finance framework, specifically regarding taxonomy and climate reporting²². In an effort to share expertise and raise awareness regarding ESG integration

for risk management, some NCAs are conducting supervisory interviews with selected insurers and institutions for occupational retirement provision (IORPs), and have hosted several workshops for undertakings and associations on climate stress testing and scenarios.

Based on the responses to the survey, and considering NCAs will be tasked with the monitoring of the implementation and maintenance of the SFDR (meaning they will need to approve hundreds or even thousands of prospectuses and pre-contractual documentation between the release of the RTS and the start of the level 1 application enforcement) currently no authority seems to have an adequate level of readiness (both in terms of knowledge and resources) to properly monitor or enforce the application of SFDR.

These results should not come as a big surprise. NCAs are notoriously tasked with several supervisory undertakings that pertain to finance, which usually recur annually and have a well-established set of procedures and resources. In turn, this naturally creates inertia around incorporating obligations that require a non-financial set of competences and a long term scenario view.

Furthermore, assessing sustainability and climate risk impacts has almost solely been a focus of international organizations and research entities for a long time. Consequently, the number of truly experienced resources is relatively limited. Therefore, NCAs may find it difficult to size and determine the funds and type of expertise required to fulfill their “new” responsibilities.

20. Non-Financial Reporting Directive under the Accounting Directive and provided the entities are in scope

21. For example: the guide by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) on integrating climate-related and environmental risks into banking and insurance supervisors' work, published by the Luxembourgish NCA, and the Guide by CFRF with practical recommendations for firms of all sizes on the disclosure of climate-related financial risks, published by the UK FCA

22. For example: the Irish Central Bank consulted on the Renewed Sustainable Finance framework (EU 2020/852 including taxonomy, benchmark and disclosures regulations)

We would recommend, especially in the short term, that NCAs focus their current resources to jointly refine and consult on the regulation, to gain a full understanding of it and to voice concerns and perceived gaps when there is still time to address them. They should also increase their resources, either via direct hiring or through outsourcing, to gain the necessary expertise and staff numbers to both manage the regulatory follow-up and the temporary extra effort required for periodic verification. In this respect, initial outsourcing of expertise could also help fulfill individual authorities' immediate needs, and also to set up a series of internal and intra-stakeholder efforts to raise awareness, which are necessary to create internal and external ecosystems that are receptive of the changes ahead (for example, managing the downstream through dedicated events, workshops, webinars, and publications).

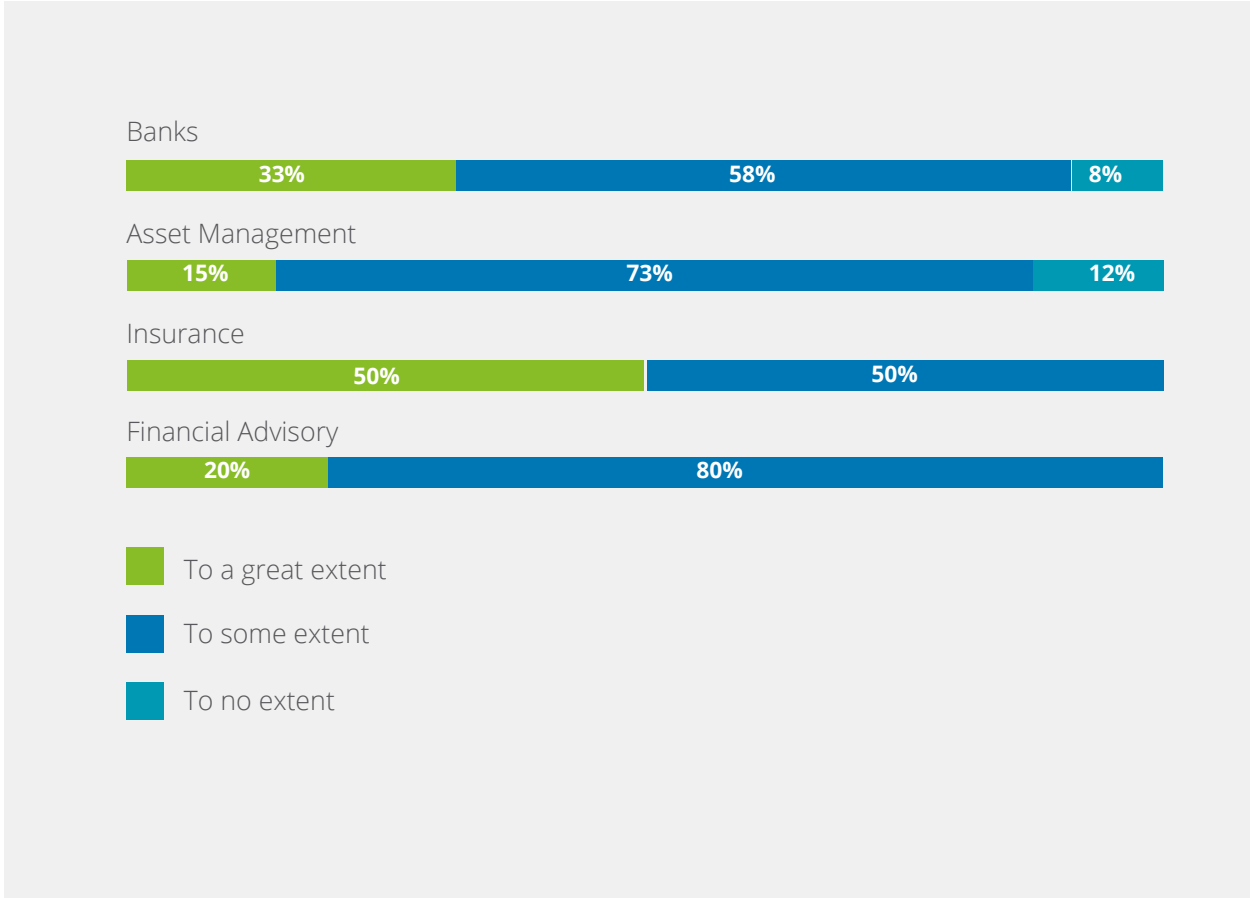


Question 8

To what extent do you think the indicators proposed in the templates should be subject to change and mirror the evolving nature of the taxonomy and other relevant regulations, such as the revision of the NFRD?

Most players agree that there should be some alignment with other regulations. European respondents are divided on the topic, while Asian and Latin American actors agree to some extent. The North American players tend to prefer that the new templates should exist as standalone reporting solutions. The insurance industry's point of view is divided on this question, both in European and non-European countries.

To a large extent, this question is particularly targeted at European respondents as they have been directly exposed to the NFRD requirements since 2017.

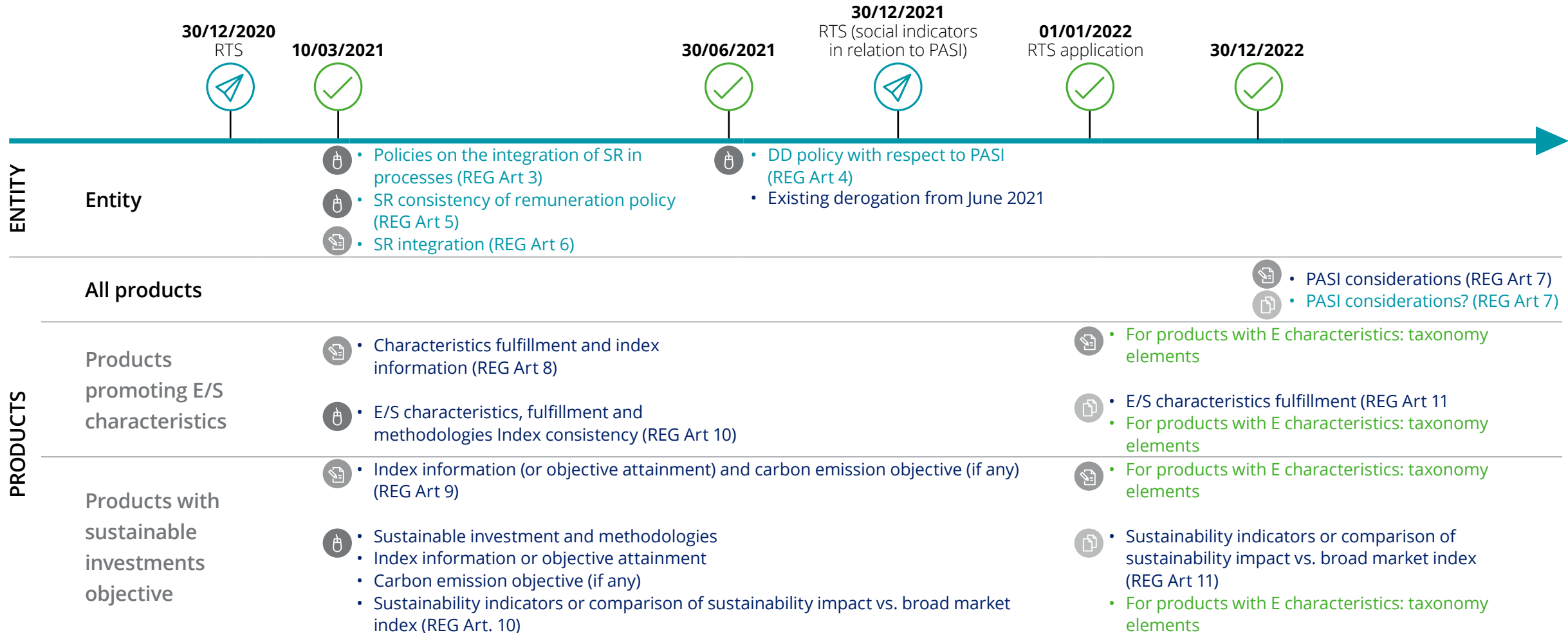


However, as suspected, FMPs involved in SRI are familiar with the transparency and disclosure requirements across geographies, as this lies in the heart of their financial analysis. Across geographies, respondents have shown a good level of trust in how things have been evolving, emphasizing consistent communication and a fair level of education for clients who are the intended beneficiaries of the planned changes. Alignment with current reporting standards is largely encouraged by players across geographies, given the crucial interdependencies that will eventually trickle down to affect FMPs.



Where are we?

	Website		Release	FMPs	Both FMPs and FAs
	Pre-contractual doc.		Milestone	FAs	RTS information
	Periodic report				



PASI: Principal Adverse Sustainability Impacts
SR: Sustainability Risks

RTS: Regulatory Technical Standard

Conclusion

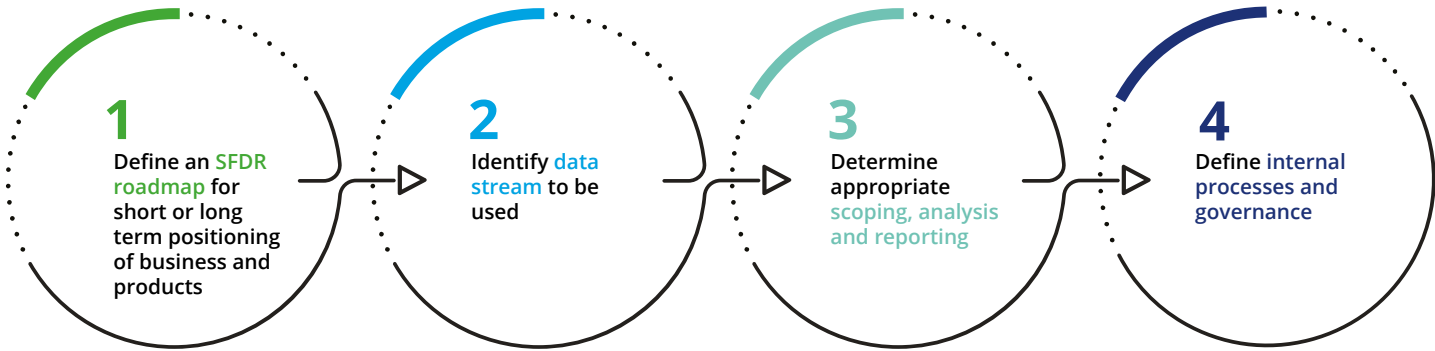
While several elements may be currently blurred and the applicability schedule of the texts is not ideal, the extraordinary changes that the SFDR alone foresees are rather remarkable. The SFDR reflects the main changes that the financial industry must face to overcome climate change hurdles and to integrate sustainability into financial considerations; changes that have been regularly and often called for as the SRI industry developed²³.

Most actors involved have been aware that a radical change to the system would result in many impacts that would spread across the entire industry. And now this time has come.

In the coming months, FMPs will have to continue their analysis of the effects that are most relevant to them, creating a concrete map of what needs to be changed and/or modified in their processes, governance and products. They will have to choose the most appropriate positioning

regarding each aspect of the legislation by drawing an “SFDR roadmap” of where they intend to position their business and products in both the short and long-term. They will also need to identify the data stream they will use and determine the appropriate scoping, analysis and reporting. Finally, and maybe most importantly, they will have to define their internal processes and governance to transform compliance into strategic management, making this the new way of working.

At Deloitte we have built expertise in supporting our clients with the challenges posed by the SFDR to understand how to get the right positioning and define the appropriate strategy through a 4-step approach.



23. Main developments have been tracked officially in Europe since 2006.

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