

EU: Impact Assessment Becomes a Standard

The EU Sustainable Finance Disclosure Regulation (SFDR) and its significance for the financial industry

The EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR) requires an impact assessment of investments. In doing so, the EU aims at reducing information asymmetries with regard to sustainability impacts and risks. This should enable investors to better compare financial products and take informed investment decisions. The SFDR sets the following requirements for financial market participants and financial advisers: 1) Reveal “principal adverse impacts” of investments on people and planet and what actions are taken to address these. 2) Show how sustainability risks affect financial returns of investments. 3) Adhere to minimum standards if investments are marketed as “sustainable”.

Actions required at entity/group level

Financial market participants are required to publish information about principal adverse impacts of investment decisions on sustainability factors, how they are assessed and what measures are implemented. In addition, information needs to be provided on the integration of sustainability risks in investment decision-making processes.

These actions will be mandatory. Only smaller companies have the option to comply or explain with regard to principal adverse impacts.

Actions required at product level

For all financial products, information needs to be provided on principal adverse impacts and sustainability risks. In case principal adverse impacts are not considered, a clear statement and reasons need to be provided.

For financial products either advertised as sustainable or as promoting environmental or social characteristics additional information is needed. This shall include an explanation on how the objective of sustainable investment is to be attained or how sustainability characteristics are met.

Key Benefits

- Inrate provides substantial data required for disclosure according to the SFDR.
- With its ESG Impact and Climate Impact Methods, Inrate has long-standing experience with positive and adverse impact measurement.
- The Inrate Impact Matrix assesses environmental and social impacts of more than 440 economic activities along entire value chains. Our Matrix is an approximation of the EU Taxonomy.
- Inrate also reviews minimum social and environmental safeguards as well as whether a company does any significant harm.
- The Inrate Impact Methods are extensive, scientifically founded, pragmatic and have been successfully applied for many years.

Common EU definitions of sustainability

Sustainable investments:

Investments in economic activities that contribute to environmental or social objectives, provided that such investments “do no significant harm” to any of those objectives and that investee companies follow good governance practices.

Investments with environmental or social characteristics:

Investments that promote environmental or social characteristics, but do not qualify as sustainable.

Principal adverse impact:

The (likely to be) material impact of investment decisions on sustainability factors, i.e. environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Sustainability risks:

An environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative effect on the value of the investment.

Principal adverse impacts and sustainability risks



Indicators and data according to EU regulatory technical standards

The SFDR designated the European Supervisory Authorities (ESAs) to elaborate further guidance on the disclosure requirements in the form of regulatory technical standards (RTS). In the draft RTS provided on 23 April 2020, the ESAs proposed a set of 32 mandatory indicators for assessing the principal adverse impacts. Another draft set of additional indicators was offered to help identify, assess and prioritise additional principal adverse impacts. The extent and depth of information that financial market participants will have to disclose according to the RTS is challenging, particularly because the data for some impact indicators are not readily available. In addition, this information has to be provided within a limited period of time once the RTS are in force.

EU sets standards for sustainable investments

The SFDR has a strong link to the EU Taxonomy Regulation. Both regulations contribute to a common definition of sustainable financial products and set standards with regard to impact assessment. The intention is to shift capital flows towards more sustainable economic activities and to help market participants to invest in truly green opportunities. The regulations have effects beyond the EU. Thus, many Swiss financial service providers are also taking actions, because they operate internationally, do not want to jeopardize their credibility or anticipate potential changes of Swiss regulations.

Examples of draft principal adverse impact indicators

- carbon emissions broken down by scope 1, 2 and 3
- solid fossil fuel sector exposure
- board gender diversity
- number and nature of identified cases of severe human rights issues and incidents

Inrate's impact assessment

With its ESG Impact and Climate Impact Methods, Inrate provides data and ratings to financial market participants for impact assessments. In addition, we support required impact-related disclosure of investments and financial products.

Timeline



About inrate

Inrate is a leading independent sustainability ratings provider based in Switzerland. Since 1990, we link our in-depth sustainability analysis with innovative investment solutions for the financial markets. Our ratings are a measure of the impact companies have with their behavior and products on society and the environment as well as their willingness and ability to effectively tackle the corresponding challenges.

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