

Ania

Associazione Nazionale
fra le Imprese Assicuratrici

2021 Edition

ANIA Exploring **SUSTAINABILITY** Focus on SFDR and Taxonomy Regulation

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Sustainability is rapidly becoming a key issue for insurance companies, which – both as investors and as providers of protection - play a central role towards a sustainable transformation of the economy and the achievement of the ambitious sustainable goals set at international, European and national level.

Sustainability factors - covering all three ESG dimensions (Environmental, Social and Governance) – need to be integrated in every single process: from corporate governance to reporting and disclosure, and from underwriting policies to investment strategies.

*The regulatory framework is moving fast in this direction, with particular regard to the European legislation, and ANIA has decided to launch a new series of newsletter: “**ANIA Exploring SUSTAINABILITY**”.*

“ANIA Exploring SUSTAINABILITY” aspires to provide useful information about the rapidly evolving regulatory context of sustainability, starting from disclosure, with a focus on the Sustainable Finance Disclosure Regulation (SFDR).

The series will subsequently deal with other important pieces of European legislation, such as the Taxonomy Regulation.

The newsletters will be issued on a regular basis, in a one-page format, and each issue will focus on specific features of the legislation in question.

The newsletters will be collected in a single volume to form a practical - and easy to use - reference guide.

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The **Sustainable Finance Disclosure Regulation** (SFDR) is one of the first regulatory action to implement in a comprehensive and integrated manner European Union agenda for sustainable development. It was published in the Official Journal of the European Union on 9 December 2019, amended in June 2020 with the adoption of Regulation (EU) 852/2020 (the so-called “**Taxonomy Regulation**”) and it aims to require the **financial market participants** - and **financial advisers** - to disclose specific information regarding:

- their approach for the **integration of sustainability risks in their decision-making processes** on investments and the **adverse impacts on sustainability factors** arising from such processes;
- the **sustainability characteristics or objectives** of the financial products and their sustainability performance.

The content, the methodologies and the presentation of the disclosure requirements set out by the SFDR, both at entity and at product-level, are to be specified in the **Regulatory Technical Standards** (RTS), which will provide detailed templates for the delivery of most of the disclosure requirements.

Scope

The SFDR applies to financial market participants and financial advisers: therefore, the **entities** falling under the scope of the regulation should comply with its requirements to the extent that they **manufacture financial products** (financial market participants) or they provide **investment or insurance advice** (financial advisers) in the European Union.  Art. 1



The SFDR defines different levels of disclosure requirements for financial products, based on their sustainability *ambitions* (particularly for *light-green* and *dark-green* products), to be published in the company **websites**, in the **pre-contractual** information and in the **periodic** reports.  Art. 6, 8, 9



Entry into force

The core provisions of the SFDR applies from **10th March 2021**, while the requirements linked with the Taxonomy Regulation will be applied in 2022 and 2023.  Art. 20



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For proper application of the SFDR requirements, both at subjective level (i.e. the entity) and at objective level (i.e. the sustainability objective), a set of **definitions** are introduced.  Art. 2

First, the regulation introduces the definitions of **sustainability risks** and **sustainability factors**. These represent the **two sides of sustainability**:

- the sustainability **risks** represent **the way the company is or could be impacted**: environmental, social or governance events or conditions that, if they occur, could have a negative impact on the investment value;
- the sustainability **factors** represent **the way the company can affect the surrounding environment and society**, with reference to environmental, social, employee, respect for human rights, anti-corruption and anti-bribery matters.

The **subjective** scope of application includes **financial market participants and financial advisors**.

The **financial market participant** is a financial undertaking that **provides financial products to retail customers**. The SFDR details the possible declinations of these financial activities.



For the **insurance sector**, the regulation applies to an insurance company, authorized under the Solvency II regime, **when providing to retail customers insurance-based investment products (IBIPs) or pension products**. The SFDR includes a list of other types of financial market participants, spanning from credit institutions providing portfolio management services to management companies of UCITS.

The **financial adviser** is an **intermediary** or an **undertaking** that provides investment or insurance advice regarding financial products. In the **insurance context**, the financial adviser could be an **insurance intermediary** or an **insurance undertaking which provides advice on IBIPs**.



Finally, another key element on which the SFDR builds the largest part of the product-level disclosure is the concept of **sustainable investment**, namely an **investment in an economic activity that contributes to**:



- an **environmental objective** (for example, efficiency on the use of renewable energy, water and land, etc.); or
- a **social objective** (for example, tackling inequality, fostering social cohesion, labor relations, etc.).

To be considered sustainable, **such investment must**, in addition, **not significantly harm any of the objectives detailed by the SFDR and the investee company should follow good governance practices** (sound management structures, employee relations, etc.). The application of the “**do no significant harm**” principle (DNSH) in the sustainability disclosure will be further detailed in the RTS.

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SFDR: Entity-level disclosure on sustainability risks

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The SFDR requires financial market participants and financial advisers to disclose information to the end investors on **how they integrate the sustainability risks in their activities**.

From the insurance sector perspective, this means that **insurance undertakings** which make available IBIPs, as well as **insurance intermediaries** and **insurance undertakings** which provide insurance advice with regard to IBIPs, must disclose on their **websites** the entity-level information necessary to describe how the sustainability risks are integrated within their business practices.

The information to be disclosed at entity-level by an **insurance undertaking which makes available an IBIP** cover two areas:

- the **decision-making process on investments**: the SFDR asks entities to **include, among the other financial risks**, the assessment of the **sustainability risks** that might have a relevant impact on their investments;  Art. 3
- the **remuneration policy**: entities should represent how their remuneration policies promote **sound risk management practices** with respect to the sustainability risks. The information should explain how the remuneration structure considers sustainability risks (for instance, describing how the remuneration is linked with risk-adjusted performance and how it does not encourage excessive risk-taking).  Art.5

The same information must be disclosed by an **insurance intermediary** or an **insurance undertaking which provides insurance advice regarding IBIPs**.

In this case, the integration of sustainability risks in the decision-making process relates to the **advice**. The SFDR asks advisers to explain how they integrate sustainability risks in their advisory process, whether material or likely to be material.

As for the remuneration policies, the disclosure requirements for advisers are the same as for market participants.

The entity-level disclosure obligations introduced by the SFDR are fulfilled by publishing the required information on the website of the entity, both for financial market participants and for financial advisers.

These disclosure requirements entered into force on 10th March 2021.

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SFDR: Entity-level disclosure on sustainability factors

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The SFDR requires financial market participants and financial advisers to inform end investors about how their investment activities and advice are affecting the surrounding environment in terms of sustainability (i.e. **principal adverse sustainability impacts**).

This means that:

- **insurance undertakings which make available IBIPs and consider principal adverse impacts of investment decisions on sustainability factors** and
- **insurance intermediaries and insurance undertakings which provide insurance advice with regard to IBIPs and consider within their advice the principal adverse impacts on sustainability factors**, shall **publish and maintain on their websites the entity-level information** necessary to describe the adverse impacts.  Art. 4

On the contrary, if they **do not consider any adverse impact**, they shall however disclose why they do not do so and, where relevant, describe as to whether and when they intend to consider it.  Art. 4

An **insurance undertaking placing IBIPs and considering principal adverse impacts** of investment decisions on sustainability factors, shall **disclose on its website** at least:

- information about its **policy on the identification and the prioritization of the sustainability impacts**;
- an **assessment of the main impacts of entities' investments on the sustainability factors and the related actions planned and taken**;
- a brief summary of the **engagement policy adopted**;
- a reference to its **adherence to responsible business conduct codes or international standards for due diligence and reporting**.

Here though, it should be noted that disclosure of such information is **mandatory** for insurance undertakings that have exceeded, on average, **more than 500 employees** in the last financial year.

Similarly, an **insurance intermediary or an insurance undertaking which provides insurance advice on IBIPs and considers in its advice the principal adverse impacts on sustainability factors**, should disclose information on **how** they reflect these impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they advise on.

The SFDR disclosure requirements entered into force on 10 March 2021, but while the Regulation itself defines the high-level information to be disclosed, the **RTS will further detail their content, methodologies and presentation of information**, in respect of the sustainability indicators in relation to adverse impacts:

- on the climate and other environment-related adverse impacts;
- in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

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When an undertaking makes available or provides advice regarding financial products falling under the SFDR (for the insurance undertakings and intermediaries they refer to **IBIPs** and **Pension products**), the Regulation provides mandatory pre-contractual disclosure requirements for all the following types of products:

- **light-green** products, which promote, among other characteristics, environmental or social ones, or a combination of those two, provided that the companies in which the investments are made follow good governance practices;  Art. 8
 - **dark-green** products, which have sustainable investment as their objectives and an index has been designated as a reference benchmark for the objectives;  Art. 9
 - **mainstream** products, which do not present any sustainability features.
- For all three categories the SFDR requires undertakings to include in the pre-contractual disclosures the information below.

From **March 10th, 2021**:

- the **way sustainability risks are integrated into the investment decisions** (or **into the insurance advice** if they offer advice on such products), otherwise, if they are deemed not to be relevant, a clear and concise explanation of the reasons why they are supposed to be so;  Art. 6
- the **results of the assessment on how sustainability risks could likely impact the product return**.  Art. 6

From **December 30th, 2022**:

- an explanation on **how the principal adverse impacts on sustainability factors are considered by the product**, if the undertakings disclose such impacts at entity-levels;  Art. 7
- a statement indicating that the **information on the principal adverse impacts** on sustainability factors are also **available** in the product-related **periodic reports**.  Art. 7

The **Taxonomy Regulation** has amended the SFDR by requiring that, from **January 1st, 2022**, for all **mainstream products** shall be included in the related pre-contractual disclosures the following statement: *"The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities"*.

For **IBIPs**, all the above-mentioned requirements shall be fulfilled by including the information in the set of pre-contractual disclosures that are already required by the Solvency II and the IDD frameworks, regarding details on the product characteristics (distribution, costs, investment strategy, etc.) and on the insurance company.  Art. 6

For **Pension products**, the information should be disclosed in written form, in plenty of time before a retail investor is contractually bound.  Art. 6

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The **SFDR** introduces **specific pre-contractual disclosure** requirements for **light-green** and **dark-green** products.

More specifically, for **light-green** products, the pre-contractual disclosure shall include:  **Art. 8**

- information on how **environmental or social characteristics** are promoted among others;
- if an **index** has been designated as a reference benchmark, the consistency of the index with the above-mentioned characteristics and where the methodology used for its calculation can be found.

Similarly, **detailed provisions** are provided for the content of the dark-green product disclosure:  **Art. 9**

- how the **sustainable investment objective** (e.g. reduction in carbon emissions) should be achieved;
- the consistency of the index (if designated has a referenced benchmark) with the product's sustainable objective, its **differences from other broad market indices**, and information on where the methodology used for the index calculation can be found.

The **Taxonomy Regulation (TR)** has integrated the SFDR by requiring that, for **light-green** (those promoting **environmental** characteristics) and **dark-green** products, the related pre-contractual disclosures shall also include:

- the information on one or more of the **six objectives**, introduced by the **TR** (see below), to which the investments underlying the **product contribute**;
- a description of how and to what extent the **investments** underlying the product are **in economic activities** that qualify as **environmentally sustainable**.

Moreover, if a **light-green** product promotes **environmental characteristics**, the TR requires to disclose the following statement: *"The "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities"*.

While the SFDR provisions entered into force on **10th March 2021**, the **TR**-related ones shall apply, instead:

- from **1st January 2022**, with respect to the **first two environmental objectives** (climate change mitigation and climate change adaptation);
- from **1st January 2023**, with respect to the **other four environmental objectives** (sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems).

The **RTS** will further specify the content of the pre-contractual information for both **light-green** and **dark-green** products.

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SFDR: Websites and periodic reports disclosures

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2021



In addition to the pre-contractual information, the **SFDR** provides specific requirements for **light-green** and **dark-green** products regarding the periodic disclosure and the information to be reported on the websites.



For both types of products, an undertaking shall publish and maintain, in a prominent easily accessible area of its **website**, the following information (that shall be accurate, fair, clear, not misleading, simple and concise for investors):  **Art. 10**

- a description of the environmental or social characteristics (for **light-green**) or the sustainable investment objective (for **dark-green**);
- information on the methodologies (including data sources, screening criteria for the underlying assets and relevant sustainability indicators) used to assess, measure and monitor the environmental or social characteristics (for **light-green**) or the overall impact of the sustainable investments selected for the financial product (for **dark-green**);
- the same information reported in pre-contractual (previously described) and periodic disclosures (as further detailed below).



With reference to **periodic reporting, detailed and different provisions** are provided for the two types of products:  **Art. 11**

- for **light-green**, a description to the extent to which environmental or social characteristics are met, shall be included;
- for **dark-green**, the following content shall be provided:
 - the overall sustainability-related impact of the financial product by means of relevant sustainability indicators; or
 - if 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.

For **IBIPs**, the periodic information shall be disclosed annually in writing, in accordance with Solvency II and IDD frameworks (i.e. in the same documents describing the services provided to and transactions undertaken on behalf of the investor during the reporting period), whereas periodic disclosures of **pension products** shall be published in writing, in the annual report or in a report in accordance with national law.

The **Taxonomy Regulation (TR)** has integrated the SFDR: the same pre-contractual information it requires for **light-green** products **promoting environmental characteristics** and **dark-green** products are also mandatory to be disclosed in product-related periodic reporting.

The **dates of entering** into force of the **SFDR** and **TR** provisions are the same as for pre-contractual disclosure requirements.

The **RTS** will further specify the content of the website and periodic information for both **light-green** and **dark-green** products.

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The **SFDR** requests financial market participants (**FMP**) - and financial advisers (**FA**) - to ensure the **continuous updating** of the entity-level information they shall disclose concerning sustainability.  **Art. 12**

This also means that for each integration regarding their **decision-making process on investments** (i.e. the assessment of the sustainability risks that might have a relevant impact on their investments) and **remuneration policies** (i.e. how their remuneration policies promote sound risk management practices), they shall publish on their website a clear explanation of the amendments. Furthermore, **FMP** distributing **light-green** and/or **dark-green** products shall also ensure that all the information provided in pre-contractual and periodic disclosures and on their websites should be always brought **up to date**, for instance on:  **Art. 12**

- the description of the environmental or social characteristics and how they are achieved (for **light-green** products), or the sustainable investment objectives and how they are aligned - if applicable - with a designated index (for **dark-green** ones);
- the details on the methodologies used to assess, measure and monitor the environmental or social characteristics (for **light-green** products) or the impact of the sustainable investments selected for the investment product (for **dark-green** ones).

Without prejudice to stricter sectoral legislation, as for instance the IDD Directive for insurance undertakings, **FMP** and **FA** shall ensure that their **marketing communications** do not contradict the information disclosed pursuant to the **SFDR**. To that end, the **RTS** will further specify the standard presentation of information on the promotion of environmental or social characteristics (for **light-green** products) and sustainable investments (for **dark-green** ones).  **Art. 13**

From **30th December 2022**, the European Commission shall **evaluate the application** of the **SFDR** and in particular consider:

- whether the reference to the average number of 500 employees, required to disclose due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors, should be maintained, replaced or accompanied by other criteria, and shall consider the benefits and proportionality of the related administrative burden;
- whether the functioning of the SFDR is inhibited by the lack of data or their suboptimal quality, including indicators on adverse impacts on sustainability factors by investee companies.  **Art. 19**

Member States shall ensure that the competent authorities will monitor the compliance of **FMP** and **FA** with the SFDR requirements. Consequently, the authorities shall have all the necessary supervisory and investigatory powers that are necessary to achieve the SFDR targets and cooperate with each other for the purposes of carrying out their duties.  **Art. 14**

Eventually, the **SFDR** shall not apply to insurance intermediaries that provide insurance advice regarding IBIPs and are enterprises employing fewer than three persons, unless required by Member States.  **Art. 17**

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ANIA, the Italian Insurance Association, founded in 1944, is a voluntary non-profit association. Its main purpose is to develop and spread the culture of safety and prevention in our country, so as to protect both people and companies, and society as a whole, more and better.

Moreover, ANIA represents its members and the Italian insurance market vis-à-vis the main political and administrative institutions, including the Government and Parliament, trade unions and other social bodies.

The Association studies and cooperates in the resolution of technical, economic, financial, administrative, fiscal, social, juridical and legislative issues concerning the insurance industry. It supports and provides technical assistance to members, promotes the education and professional training of those working in the insurance sector.

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