Regulatory Handbook

August 2023

This handbook will give you an overview of all the sustainability-related regulations and frameworks impacting the European financial markets. You will also be able to quickly have a sense of how much these regulations and frameworks might still change in the near future, so you can be prepared.

The content of this handbook was created by Datia's team to help investors navigate this complex and dynamic regulatory landscape. If you have further questions or wonder how we can help your organization, please contact hello@datia.app.

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Overview

REGULATION	WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
SFDR	Financial market participants	Disclosures on the integration of sustainability risks and impacts within financial services and products in periodic and pre-contractual reports and on websites.	New regulatory technical standard open for consultation (April 2023)	Automate portfolio and entity-level calculations, and generate PAI statement
EU Taxonomy	EU Corporations and Financial market participants	EU classification system and reporting regulation over financial flows towards environmentally sustainable activities. Asset managers and investors need to disclose the proportion of taxonomy alignment of their portfolios.	Technical screening criteria for objective 3-6 open for consultation (April 2023)	Monitor alignment and generate reports
MiFID II	Financial market participants	Portfolio managers and financial advisors need to ask clients about their sustainability preferences of their investments, and take the sustainability profile of the clients into consideration in the investment/advisory process.	No proposed changes or updates	Generate portfolio-level reports on alignment with sustainability profile of end-clients
CSRD	EU (and non-EU) corporations and Financial market participants	Corporations and financial institutions need to disclose regarding their sustainability impacts, risks and opportunities. The disclosure is to be made in the annual report of the organization in accordance with the European Standards for sustainability reporting (ESRS).	Final versions of ESRS adopted by European Commission in July 2023	Collect, aggregate and consolidate data from annual reports from corporations
CSDD	EU corporations and Financial market participants	Large EU companies are required to set up due diligence practices to identify, prevent and manage human rights impacts across the value chains. Institutional investors need to apply measures to induce investee companies to reduce the adverse impacts of their activities.	Final report passed in plenary vote (June 2023)	Enable monitoring in compliance with frameworks such as UNGC, OECD, etc.
EET	Financial market participants and distributors	Industry-led Excel template in machine-readable format to harmonize and simplify the collection of ESG-related information on investment firms and their financial products.	EET will be revisited and restructured during 2023	Enables generation of EET files through a step-by-step questionnaire

Sustainable Finance Disclosure Regulation (SFDR)

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
Financial market participants	Disclosures on the integration of sustainability risks and impacts within financial services and products in periodic and pre-contractual reports and on websites.	New regulatory technical standard open for consultation (April 2023)	Automate portfolio and entity-level calculations, and generate PAI statement

Overview

The Sustainable Finance Disclosure Regulation (SFDR) introduces reporting requirements that financial market participants must adhere to in order to promote transparency and provide consistent information to investors. The regulation mandates the disclosure of information on how sustainability factors are integrated into investment decisions. Financial institutions are required to disclose how they consider adverse sustainability impacts in their investment processes and provide details on their policies for addressing sustainability risks.

Furthermore, the SFDR specifies specific content that needs to be included in the pre-contractual and periodic reports provided to investors. This includes information on the integration of sustainability risks, the consideration of adverse sustainability impacts, and the alignment of investment strategies with environmental and social objectives. The reports must also outline how the financial institution's remuneration policies are consistent with the integration of sustainability risks.

By enforcing these reporting requirements, SFDR aims to ensure that investors receive comprehensive and comparable information regarding the sustainability characteristics and impacts of financial products and services, fostering greater transparency and accountability in the financial sector.

Timeline

Into effect since March 2021. Level 1 provisions apply from January 1 2022. Level 2 provisions (RTS) applicable from January 1 2023. The current RTS is under review from ESA's with proposed amendments to disclosure requirements.

Complexity

FDR mandates extensive disclosure obligations for financial market participants to be made in pre-contractual documents, periodic reports, and on websites, following specific formats and methodologies outlined in regulatory technical standards. The regulation and delegated acts are similar to other EU regulation formed quite vaguely, leading to a lot of uncertainty from the capital markets. The ESAs continue to provide guidance and clarify certain aspects of the regulation, but gaps and uncertainties may persist, requiring market participants to monitor updates and adapt their practices accordingly.

Useful links

- Regulation
- Delegated act with annex 1
- Consolidated Q&A
- Joint consultation (proposed changes)

EU Taxonomy

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
EU corporations and Financial market participants	EU classification system and reporting regulation over financial flows towards environmentally sustainable activities. Asset managers and investors need to disclose the proportion of taxonomy alignment of their portfolios.	Technical screening criteria for objective 3-6 open for consultation (April 2023)	Monitor alignment and generate reports

Overview

The Taxonomy Regulation for asset managers is a European Union regulation that establishes a framework for classifying economic activities based on their environmental sustainability. Introduced in 2020, the regulation aims to provide clarity and consistency regarding what can be considered environmentally sustainable investments. The Taxonomy Regulation sets out six environmental objectives: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems.

Asset managers are required to disclose information on the extent to which their investment products align with the taxonomy criteria. They must assess and report on the proportion of their investments that qualify as environmentally sustainable based on the taxonomy's technical screening criteria. The regulation also mandates the disclosure of the proportion of investments that do not meet the taxonomy criteria, providing transparency about potentially unsustainable activities. By implementing the Taxonomy Regulation, asset managers play a crucial role in promoting environmentally sustainable investments and helping investors make informed decisions that support the transition to a more sustainable economy.

Timeline

Climate mitigation & adaptation: Large entities need to disclose complete taxonomy reporting (eligibility and alignment) for FY2022; financial large corporates need to disclose complete taxonomy reporting (eligibility and alignment) for FY2023. Complete reporting including remaining objectives is expected by FY2024.

Complexity

The taxonomy's complexity lies in its technical criteria that assess activities' contributions to different environmental objectives. This needs to be assessed on activity level (as opposed to organizational level) which adds challenges in terms of assessment, in combination with the complex criteria of the taxonomy. Additionally, the constant updates and iterative nature of the Taxonomy to reflect evolving scientific knowledge and policy developments further add to its intricacy. There are also various reporting requirements related to calculating and disclosing the information.

Useful links

- European Commission’s overview of EU Taxonomy
- EU Taxonomy: a practical guide for fund and asset managers (Datia’s article)

MiFID II

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
Financial market participants	Portfolio managers and financial advisors need to ask clients about their sustainability preferences of their investments, and take the sustainability profile of the clients into consideration in the investment/advisory process.	No proposed changes or updates	Generate portfolio-level reports on alignment with sustainability profile of end-clients.

Overview

MiFID is the Markets in Financial Instruments Directive. It has been applicable across the European Union since November 2007. It is a cornerstone of the EU's regulation of financial markets seeking to improve their competitiveness by creating a single market for investment services and activities and to ensure a high degree of harmonised protection for investors in financial instruments. The main objective of the MiFID sustainability preferences is that clients must be asked about their sustainability preferences. Beyond that, it's important that the end investor understands what sustainability preferences are, and how they can be taken into consideration. The preferences have been suggested to be provided in three possible ways: Taxonomy alignment (minimum proportion), percentage in sustainable investments as defined by the SFDR (contributes to an objective as listed in article 2 point 17), or a quantitative or qualitative consideration of Principal Adverse Impacts (PAIs) where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client.

Once the client chooses one or a combination of these options, the adviser must make sure that the product offered matches the client's sustainability preferences. For existing clients, for whom a suitability assessment has already been performed, investment firms must identify the client's individual sustainability preferences at the next regular update of the assessment.

Timeline

Sustainability preference assessment is in effect since August 2, 2022.

Complexity

MiFID II requires financial advisors to consider clients' sustainability preferences when providing investment advice or portfolio management services. The complexity arises from various factors, including the need to collect and assess additional client information, define specific sustainability indicators, and incorporate them into the investment decision-making process. MiFID intersects with both the Taxonomy and SFDR and this poses challenges in terms of understanding these regulations, as well as making the end clients understand the concepts in order to define their preferences.

Useful links

- Regulation
- ESMA's Guidelines on certain aspects of the MiFID II suitability requirements

Corporate Sustainability Reporting Directive (CSRD)

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
EU (and non-EU) corporations and Financial market participants	Corporations and financial institutions need to disclose regarding their sustainability impacts, risks and opportunities. The reporting is to be made in the annual report of the organization following the European Standards for sustainability reporting (ESRS).	Final versions of ESRS adopted by European Commission in July 2023	Collect, aggregate and consolidate data from annual reports from corporations

Overview

CSRD's purpose is enhance and standardize the reporting of sustainability-related information by companies. CSRD aims to improve the transparency and comparability of environmental, social, and governance (ESG) data provided by corporations. It mandates larger companies to disclose a broader range of ESG metrics in their annual reports, ensuring that investors, stakeholders, and the public have access to consistent and reliable data to assess a company's sustainable performance and its impact on society and the environment.

CSRD requires corporations that are affected by the directive to report according to the European Sustainability Reporting Standards (ESRS), which require companies to disclose on their impacts, risks and opportunities for the sustainability aspects they have identified as material from either a financial and/or impact perspective. The ESRS are delegated acts to CSRD, and will include cross-cutting, topical, and sector specific standards, as well as reporting required for the EU taxonomy. The current topical areas are the following: Climate change, Pollution, Water and marine resources, Biodiversity and ecosystems, Resource use and circular economy, Own workforce, Workers in the value chain, Affected communities, Consumers and end-users, and Business conduct.

Timeline

First year of reporting for large, public entities will be FY2024. The regulation, however, applies a phased-in approach in terms of reporting obligations as well as companies subject to the requirements.

Complexity

The complexity of CSRD is considered high due to the large scope of companies affected by the directive, many who very likely has never reported on sustainability before and now will be required to do it in a very extensive way. The CSRD also impose a value chain perspective, meaning that companies need to be aware of, and report on the impacts throughout their value chain. For example, many companies will be needing data from suppliers and customers.

Useful links

- European Commission's overview of CSRD
- How sustainable investment regulations are linked (Datia's article)

Corporate Sustainability Due Diligence Directive (CSDDD)

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
EU (and non-EU) corporations and Financial market participants	Large EU companies are required to set up due diligence practices in terms of identifying, preventing and managing human rights impacts across the value chains. Large investors need to apply measures to induce investee companies to reduce their adverse impacts.	Final report passed in plenary vote June 2023	Enable monitoring and controlling in compliance with frameworks such as UNGC, OECD, etc.

Overview

The CSDDD aims to foster sustainable and responsible corporate behaviour throughout the global value chains. Companies play a key role in building a sustainable economy and society. They will be required to identify and, where necessary, prevent, end or mitigate adverse impacts of their activities on human rights (such as child labour and exploitation of workers), and on the environment (for example pollution and biodiversity loss). For businesses, these new rules will bring legal certainty and a level playing field. For consumers and investors, they will provide more transparency. The new EU rules will advance the green transition and protect human rights in Europe and beyond, enforcing companies with over 500 employees or operating in high-risk sectors to follow the due diligence rules.

As of August 2023 (when this handbook was written), it looks like investors will not be enforced by law to perform sustainability due diligence under the CSDDD. However some countries have already succeeded in regulating corporate responsibility in more ambitious ways. In addition to this, it is likely that investors will apply similar practices to their screening of investments going forward.

Timeline

The European Parliament adopted the final report on the directive on June 1st 2023. The directive is to be implemented into each EU state's jurisdiction.

Complexity

The CSDDD is notoriously famous for its ambiguity and vagueness in terms of the regulation, making it a difficult piece of regulation to work with for market participants.

Useful links

- European Commission's overview of CSDDD

European ESG Template (EET)

WHO IS IMPACTED	REQUIREMENTS	STATUS	HOW DATIA CAN HELP
Financial market participants, distributors	Industry-standard Excel template in machine-readable format to harmonise and simplify the way sustainability and ESG-related information on investment firms and their products is collected.	EET will be revisited and restructured during 2023	Enables generation of EET files through a step-by-step questionnaire

Overview

The European ESG Template (EET) by FinDatEx is a standardized reporting framework designed to enhance transparency and comparability of environmental, social, and governance (ESG) data within the European financial industry. This template enables financial market participants to consistently disclose their ESG-related information, facilitating better-informed investment decisions and promoting sustainable practices.By streamlining ESG data collection and presentation, the EET contributes to a more comprehensive understanding of financial products' ESG performance, ultimately driving positive societal and environmental impacts while fostering responsible investing across the European market.

In addition to above, the EET also facilitates simple and efficient transfer of regulatory information of financial products, as according to previous regulations in this handbook is proven important for certain investors (for example to fulfil requirements according to SFDR and MiFID II). One can simply describe the EET as a digitized version of all SFDR documentation (pre-contractual, periodic, and PAI) in addition to further information regarding a financial product.

Timeline

EET 1.1.1 replaced V 1.0 in April 2023. EET 1.1.1 is expected to be revisited and restructured again during 2023.

Complexity

The complexity from the EET comes from different factors. To begin with, this is a very technical and large excel sheet to be filled with a lot of information with different conditions. In addition to this, the EET is developed mainly to facilitate the transfer of regulatory information under SFDR and the taxonomy mainly. Therefore, updates on those regulations will lead to further updates to the EET files. In addition to this, given the format of the EET, some of the validators have made different assumptions from those made by the FMPs, meaning that validations of the EET can be challenging.

Useful links

- FinDatEx
- Overview of EET (Datia's 30-min webinar)

About Datia

- Climate Fintech based in Stockholm, Sweden
- Automate data gathering, calculation and sustainability reporting following the latest European frameworks: PAI statement, EET, and EU Taxonomy and Sustainable Investments
- Serves Asset Managers, Management Companies (ManCos), Asset Owners and Wealth Managers
- Trusted by some of the most reputable institutions in Europe, with over €200 billion in AUM