



## An Insurer's Perspective on the Sustainable Finance Disclosure Regulation

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### OVERVIEW

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The Sustainable Finance Disclosure Regulation (**SFDR**), a key facet of the European Commission's *Action Plan on Sustainable Finance*, first came into effect on 10 March 2021.

SFDR introduces mandatory reporting requirements for in-scope firms (known as 'financial market participants' or 'financial advisers' under the regulation) on their sustainable practices and environmental, social and governance (**ESG**) matters along with product-level rules mandating disclosures in respect of products marketed with either an ESG element and/or objective. The harmonisation of disclosure standards across the EU is intended to facilitate greater transparency and comparability of different financial products and services.

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## APPLICATION OF SFDR TO INSURERS AND INSURANCE INTERMEDIARIES

SFDR applies to a broad range of regulated firms across the EU financial services sector including banks, insurance companies, pensions funds and investment firms. In-scope firms may, depending on their activities be deemed a 'financial market participant' and/or a 'financial adviser' under SFDR and subject to associated assessment and disclosure obligations. Both terms are broadly defined in the regulation, and from the insurance industry's perspective they include:

- Financial Market Participant (**FMP**):
  - > insurers that make available an insurance-based investment product (**IBIP**);
  - > manufacturers of pension products; and
  - > institutions for occupational retirement provision (**IORP**).
- Financial Adviser:
  - > insurers who provide insurance advice on IBIPs;
  - > insurance intermediaries who provide insurance advice on IBIPs; and
  - > investment firms who provide investment advice to both retail and professional investors (e.g. in an Irish context, an intermediary registered under Investment Intermediaries Act 1995 (in addition to the Irish Insurance Distribution Regulations 2018)).

It is clear from the above that an in-scope insurer could, depending on the nature of its activities, be acting as a FMP and/or a financial adviser under SFDR and it must ensure that it complies with its SFDR obligations accordingly.

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## IRELAND ELECTS NOT TO APPLY SFDR SMALL FIRM EXEMPTION

While SFDR allows Member States discretion to exempt smaller (i.e. fewer than three employees) in-scope insurance intermediaries and investment firms, Ireland has, following a public consultation process undertaken by the Department of Finance, elected not to implement this exemption.

As such, smaller insurance intermediaries and investment firms are subject to the SFDR rules in Ireland. However, in order to provide the affected entities with sufficient time to prepare, Ireland has delayed the application of SFDR to such entities for a period of one year, until 10 March 2022.

## KEY SFDR OBLIGATIONS FOR FMPS

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An insurer in-scope of the SFDR rules for FMPS must publish and maintain on its website:

- information about its policies on the integration of sustainability risks in its investment decision-making process;
- if it considers principal adverse impacts of investment decisions on sustainability factors, a statement on its due diligence policies about those impacts OR if they elect not to consider such impacts, clear reasons for why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts.
- An insurer/insurance group can avail of the above option to explain non-compliance provided it has fewer than an average of 500 employees during its relevant financial year. However, those exceeding the employee threshold must assess and disclose adverse impacts by 30 June 2021 i.e. the 'explain' aspect of this requirement falls away for larger entities from this date;
- the principal adverse impact statement must include:
  - > information about its policies on the identification and prioritisation of principal adverse sustainability impacts and indicators;
  - > a description of the principal adverse sustainability impacts and of any related actions taken or, where relevant, planned;

- > brief summaries of engagement policies (if applicable);
- > a reference to its adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of its alignment with the objectives of the Paris Agreement on climate change;
  - information on how its remuneration policies are consistent with the integration of sustainability risks.

An in-scope insurer must include the following in its pre-contractual disclosures:

- how sustainability risks are integrated into investment decisions; and
- result of the assessment of the likely impacts of sustainability risks on the returns of the financial products it makes available

If sustainability risks are assessed as not relevant, an in-scope insurer must give a clear and concise explanation of the reasons why.

In addition to the above, in-scope insurers may also be in scope of the SFDR product-level rules. The product-level rules mandate pre-contractual, periodic and website disclosures by FMPS in respect of in-scope products (including IBIPs, pension products and pension schemes) which have a sustainable element or objective.

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## KEY SFDR OBLIGATIONS FOR FINANCIAL ADVISERS

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In-scope insurance intermediaries, insurers (acting as financial advisers) and investment firms must publish and maintain on their websites:

- information about their policies on the integration of sustainability risks in their insurance or investment advice;
- information as to whether they consider, in their insurance or investment advice, the principal adverse impacts on sustainability factors;
- if relevant, the reasons why they do not consider adverse impacts of investment decisions on sustainability factors in their insurance or investment advice, and, where relevant, including information as to whether and when they intend to consider such adverse impacts; and
- information on how their remuneration policies are consistent with the integration of sustainability risks.

They must include in pre contractual disclosures:

- how sustainability risks are integrated into investment or insurance advice; and
- result of the assessment of the likely impacts of sustainability risks on the returns of the financial products they advise on.

If sustainability risks are assessed as not relevant, insurance intermediaries, insurers (acting as financial advisers) and investment firms must give a clear and concise explanation of the reasons why.

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## DRAFT REGULATORY TECHNICAL STANDARDS

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On 4 February 2021, the three European Supervisory Authorities (**ESAs**) published their Final Report incorporating draft proposed Regulatory Technical Standards (**RTS**) or Level 2 measures setting down detailed compliance standards for the above SFDR rules.

The RTS will, subject to adoption by the European Commission as a delegated regulation, come into effect on 1 January 2022. In the current interim period (i.e. 10 March 2021 – 1 Jan 2022), the ESAs have recommended that the draft RTS be used as a reference by in-scope firms when applying the relevant provisions of the SFDR.

This recommendation triggered much industry concern due to the more onerous nature of the RTS. However, the use of the draft RTS during the interim period to inform industry's compliance with the above SFDR rules remains encouraged although it is not compulsory at present.

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## **FUTURE SFDR DEADLINES FOR FMP'S**

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The majority of the SFDR provisions came into effect on 10 March 2021. However, the following provisions are yet to take effect:

- mandatory assessment and disclosure of principal adverse impacts by larger FMPs – effective 30 June 2021;
- Level 2 measures setting down detailed compliance standards for SFDR rules – effective 1 January 2022 (anticipated);
- periodic disclosures for in-scope products – effective 1 January 2022; and
- product-level principle adverse impact disclosures for those entities complying with the FMP requirement to assess and disclose the adverse impacts of their investment decisions – effective 30 December 2022.

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## **HOW CAN WILLIAM FRY HELP?**

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As in-scope entities commence preparations for SFDR compliance post-10 March 2021, it is clear there are several significant and challenging requirements taking effect in the course of 2021 and beyond. If you wish to discuss any of the above topics, please get in touch with your usual William Fry contact or any member of the Insurance and Reinsurance team.

## CONTACT US

For more information, please contact Eoin Caulfield, Ian Murray or John Larkin or your usual William Fry contact.



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