

# **MFSA Report on Operational and Compliance Readiness by Financial Market Participants and Financial Advisers**



Sustainable Finance

12 April 2022

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# 1. Introduction

Sustainable finance has taken centre stage in key financial policy fora and is considered as a key catalyst for economic recovery at EU and national levels. MFSA's Strategic Plan 2019-2021 had already recognised the increasing importance of sustainability aspects in finance and the [EU Commission's work stream](#) in this area. This has been re-iterated in the [MFSA Strategic Update](#) (April 2021) wherein the Authority undertook to accelerate its work to align with the increased focus on this policy area by EU and at national level, and is taking active participation in the EU discussions and negotiations under way. Further to that, other preparatory work is being undertaken with a view to adopting a more holistic and strategic approach to sustainable finance for our national context.

Sustainable finance is also one of the three cross-sectoral themes in focus as included in the [MFSA Supervisory Priorities 2022](#). In particular, work in this area will focus on integrating the requirements emanating from the applicable legislative instruments relating to sustainable finance with other supervisory requirements. The Authority will continue to participate in the development and eventually follow the guidelines issued by the European Supervisory Authorities (ESAs).

The MFSA intends to focus on raising awareness and guiding market participants to assist them in better addressing the challenges in this new supervisory area and ensuring a stable regulatory environment. For that reason, it is essential for the Authority to assess the state of operational readiness and compliance status of the market participants.

This report intends to present the state of compliance of financial market participants and financial advisors following the entry into force of the Sustainable Finance Disclosure Regulation (SFDR)<sup>1</sup>. The report also intends to increase awareness on sustainable finance among the entities under the Authority's supervision and improve the state of readiness as it is important that sustainable finance becomes an integral part of their business and their day-to-day operations.

## 1.1 MFSA's Supervisory Competence

The MFSA issued a number of [Circulars on Sustainable Finance](#) concerning the different legislative instruments already in force and for which the Authority has full or partial supervisory competence. Owing to the nature of the legislative instruments themselves, i.e. Regulations, the requirements are directly applicable to financial market participants and financial advisors.

The supervisory perimeter and the scope in each of the instruments are established by same and have been vested to the MFSA as follows.

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<sup>1</sup> Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector.

## 1. [Regulation \(EU\) 2019/2088](#) on sustainability-related disclosures in the financial services sector (SFDR)

Article 14 of the Regulation states:

1. *Member States shall ensure that the competent authorities designated in accordance with sectoral legislation, in particular the sectoral legislation referred to in Article 6(3) of this Regulation, and in accordance with Directive 2013/36/EU, **monitor the compliance of financial market participants and financial advisers with the requirements of this Regulation. The competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under this Regulation.***

2. *For the purposes of this Regulation, the competent authorities shall cooperate with each other and shall provide each other, without undue delay, with such information as is relevant for the purposes of carrying out their duties under this Regulation.*

This monitoring function was incorporated under the MFSA Act through [Act XLVI of 2021 – Various Financial Services Laws \(Amendment\) Act](#) as follows:

- Amendment of Article 2 to include the SFDR; and
- Amendment of Article 4, new sub-article 1B, as follows:
  - *(1B) Without prejudice to the functions of the Authority under this or any other law, it shall also be the function of the Authority **to monitor the compliance of Financial Market Participants and Financial Advisers, as defined in Article 2 of the Disclosure Regulation, with the requirements of the said Regulation.***”;

## 2. [Regulation \(EU\) 2020/852](#) on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (Taxonomy Regulation)

Article 21 of the Regulation, concerning ‘Competent authorities’, states:

1. *Member States shall ensure that the competent authorities referred to in Article 14(1) of Regulation (EU) 2019/2088 (SFDR) **monitor the compliance of financial market participants with the requirements laid down in Articles 5, 6 and 7 of this Regulation. Member States shall ensure that their competent authorities have all the necessary supervisory and investigatory powers for the exercise of their functions under this Regulation.***

2. *For the purposes of this Regulation, the competent authorities shall cooperate with each other and shall provide each other, without undue delay, with such information as is relevant for the purposes of carrying out their duties under this Regulation.*

This monitoring function of the disclosure requirements established by Articles 5, 6 and 7, was also incorporated under the MFSA Act through [Act XLVI of 2021 – Various Financial Services Laws \(Amendment\) Act](#) as follows:

- The Taxonomy Regulation was also added under Article 2 of the MFSA Act; and
- Article 4 was amended as follows:  
 (1B) Without prejudice to the functions of the Authority under this or any other law, it shall also be the function of the Authority to monitor the compliance:
  - (a) ..... [SFDR]
  - (b) of Financial Market Participants, as defined in Article 2 of the Taxonomy Regulation, with the requirements of Articles 5, 6 and 7 of the said Regulation.";

It is pertinent to note that MFSA's competence under the Taxonomy Regulation concerns only the disclosure requirements established under Articles 5, 6 and 7.

## **2. Sustainable Finance Disclosure Regulation – Operational and Compliance Readiness by Financial Market Participants and Financial Advisers**

### **2.1 Background**

The SFDR has been in force since 10 March 2021. This Regulation contains new requirements for sustainability-related disclosures (ESG factors) in the financial services sector. The Regulation is intended to provide investors with greater insight into sustainability risks and to improve the comparability of financial products with respect to sustainability.

The SFDR forms part of the EU's wider Sustainable Finance Framework which is backed by a broad set of new and enhanced regulations. It goes hand in hand with the [EU Sustainable Finance Action Plan](#) which aims to promote sustainable investment across the EU, and a new EU Taxonomy to create a level playing field across the whole EU.

The degree of transparency required depends on the level of ambition with respect to sustainability. Products that have sustainable investment as their objective are subject to the most extensive transparency obligations. To clearly distinguish these products, Article 2(17) of SFDR gives a strict definition of what is meant by 'sustainable investment'. It defines sustainable investments as investments in an economic activity that contributes to the realisation of an environmental goal (E) or the achievement of a social goal (S) without significant harm to other environmental or social objectives, provided that the investee companies observe good governance practices (G).

The SFDR requires financial market participants and financial advisors to provide prescript and standardised disclosures on how ESG factors are integrated at both an entity and product level.<sup>2</sup>

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<sup>2</sup> Vide Annex 1: Disclosure requirements at the level of the entity and of the product.

## 1) Entity-Level Disclosures

Requirements to disclose information on their corporate website apply to financial market participants and financial advisers, in the context of the proposition of, among others, portfolio management and investment advice services, insurance-based investment products, pension products as well as the management of Alternative Investment Fund and UCITS products:

- Sustainability risk policy (integration of sustainability risks into the investment decision-making process);
- Principal Adverse Sustainability Impact (adverse effects on sustainability of the investment decision and/or in the investment advice or the rationale behind 'no adverse impact', if deemed the case);
- Consistent alignment of the remuneration policies with the sustainability objectives.

## 2) Product-Level Disclosures

Under the SFDR, financial market participants and financial advisers are required to disclose product information related to sustainability for both ESG-related products and non-ESG products. The Regulation requires entities to classify the products or advice they offer into one of the three following categories: products promoting environmental or social characteristics; products with sustainable investment objectives; and mainstream products that do not fall within the previous two categories. Product-level disclosure requirements affect pre-contractual disclosure (client information, brochures, etc), product website disclosures, and periodic product reports.

### **2.2 Context**

Following the [MFSA Circular](#) dated 30 July 2021 on the application of SFDR and the MFSA request for information, the MFSA carried out a review among financial market participants and financial advisers to understand how they have implemented some of the new requirements emanating from SFDR.

The review provided the MFSA with insight into where financial market participants and financial advisers stand on sustainable finance and ESG objectives, in particular, the steps taken by the licence-holders to apply the SFDR requirements in their day-to-day operations and to establish the level of compliance. In this context, the MFSA is glad to share its findings with the market so that financial market participants and financial advisers can make any necessary improvements to the information they provide in relation to sustainability.

## 3. The Review

### 3.1 Overall Summary of Results from All Sectors

The results of the survey seem to indicate an overall compliant determination by licence-holders with existing regulatory requirements under SFDR, but also expose the fact that licence-holders did not seem to exhibit deep involvement when it comes to sustainability-related products and strategies.

Effectiveness of compliance with any regulatory provisions depends directly on the level of available resources of the entity, including its human resources. The Authority attempted to assess the level of resources employed to comply with the new regulatory framework.

Based on the review, it emerged that the majority of licence-holders evaluated employ fewer than 10 employees and more than **50%** of entities reported having no employees currently responsible for SFDR-related matters and no SFDR-related trainings had been performed at the time.

It emerged that licence-holders found it difficult or at times deemed it ineffective to allocate resources to SFDR-related matters.

The main findings relate to the following points:

- Fund managers consider themselves to be compliant with existing regulatory requirements. At the same time the Licence-holders did not show significant involvement and interest in sustainability-related products. Fund managers, thus, may need to consider creating further stimulus and initiative for the investors to consider sustainability-related products.
- Sustainable finance-related risk factors need to be integrated into investment firms' existing risk management frameworks, in line with their business strategy and risk appetite. However, most investment firms seem to be in the early stages of evaluating the potential effects of sustainability risks and do not appear to have as yet established a clear and concrete ESG integration strategy. Nonetheless, some of the investment firms displayed a commitment to use ESG considerations in decision-making in the future.
- It was also observed that some investment firms may have had a lack of clarity in relation to the applicability of the SFDR framework. The Authority noted that a significant number of investment firms – even though they are not exempt under Article 17 of the SFDR – marked some of the questions as N/A (not applicable) in relation to requirements stemming from SFDR. They also contested whether they fall within the definition of financial advisers, even though they provide investment advice. Considering the overall mandatory nature of the SFDR provisions, the Authority encourages the licence-holders to seek their own legal advice to ensure proper interpretation of SFDR obligations.

- A number of Retirement Scheme Administrators (“RSAs”) may not be compliant with the Regulation. For instance, almost two-thirds of RSAs have failed to publish on their website information about their policies on the integration of sustainability risks in their investment decision-making process.
- Universal feedback received from all RSAs confirmed that they have not received any demand for sustainability-related products.
- Most insurance entities are still internally and externally consulting to fully understand their duties under the SFDR. They foresee numerous challenges that could be encountered when it comes to compliance with the requirements laid down in the same Regulation.

The results of the survey brought up two main concerns that the Authority believes are within the licence-holders’ responsibilities.

- Resources – A large number of licence-holders reported few to no staff responsible for SFDR-related matters as well as no training considered or performed by nearly **50%** of the licence-holders’ population. This, in the short to medium term, may result in potential lack of compliance, if the licence-holders do not build up awareness and prepare their staff for the new regulatory requirements. Licence-holders are encouraged to invest more resources in this area.
- Interpretation of mandatory provisions – It has been identified that a number of licence-holders may have misinterpreted the mandatory nature of certain requirements emanating from the SFDR. Licence-holders should seek their own legal advice to ensure proper interpretation of SFDR obligations.

In addition, the survey brought to the surface a number of challenges encountered by licence-holders in the course of ensuring compliance with the provisions of the SFDR:

- Incompleteness of the regulatory framework and, in particular, [deferred application to 2023 of the 13 delegated acts \(RTSs\)](#) create uncertainty as to exact requirements and ways of compliance, and could discourage the licence-holders from further investing in sustainability-related products.
- Lack of appetite for sustainable products disincentivises the licence-holders themselves to further invest in compliance with SFDR.
- Absence of – or the high cost of obtaining – sufficient information to feed into reporting. This is further exacerbated by [potential divergence](#) in disclosure of ESG factors by credit ratings as identified by ESMA.



## 3.2 Next Steps

The MFSA is aware that the SFDR requirements have only been in force since March 2021, and that there are still uncertainties with regard to the correct interpretation of some requirements, partly because the European Commission published its [Q&A](#) in July 2021, and also due to the lack of definitive technical standards (RTS).

A [letter](#) by the European Commission informs that the draft RTS under Articles 8(4), 9(6) and 11(5) of the SFDR requires additional time prior to the adoption process.

The letter goes on to say that since the grounds for the transitional arrangement envisaged in Article 4(3) of the draft RTS are no longer relevant, and in view of the overall deferral of the application of the delegated act, the ESAs envisage that financial market participants, which publish the statement referred to in Article 4(1), point (a), of the SFDR, or paragraphs 3 and 4 of Article 4 of that Regulation will have to comply with the disclosure requirements on principal adverse impacts on sustainability matters laid down in the delegated act for the first time by 30 June 2023, i.e. the first reference period under the RTS would be 1 January 2022 to 31 December 2022.

The MFSA acknowledges that there is still room for improvement, hence findings from the review are presented to the market on a generic basis per sector rather than on an individual basis. The MFSA, however, expects financial market participants and financial advisors to incorporate the insights of the review in their further implementation of the SFDR and the associated technical standards.

The MFSA will continue to exercise ongoing supervision of compliance with the SFDR requirements and the implementation of the RTS. In addition, the MFSA will take further action in conjunction with the initiatives outlined in [ESMA's Sustainable Finance Roadmap 2022-2024](#).

ESMA's sustainable finance work in the period 2022-2024 intends to tackle greenwashing and promote transparency, establish a common supervisory culture in the field of sustainable finance across the EU, and monitor and assess ESG markets and risks.

On 25<sup>th</sup> March 2022, the three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) updated their [joint supervisory statement](#) on the application of the Sustainable Finance Disclosure Regulation (SFDR). This includes a new timeline, expectations about the explicit quantification of the product disclosures under Article 5 and 6 of the Taxonomy Regulation, and the use of estimates.

The MFSA will be following the recommendations of the ESAs. It also encourages financial market participants and financial advisors to make use of the current interim period from 10 March 2021 until 1 January 2023 to prepare for the application of the [Commission Delegated Regulation containing the Regulatory Technical Standards \(RTS\)](#).

The Authority remains committed to actively participate in the relevant forums, conscious of the fact that only by ensuring common application of the rules at European and international level can the financial markets facilitate cross-border investment and contribute meaningfully towards the achievement of sustainable development goals.

## **4. Sectorial Analysis of Financial Market Participants and Financial Advisors Operational Readiness and Compliance Status with the Provisions of the SFDR**

The MFSA would seek to avoid a fragmented approach by different sectors and entities. Therefore, it is the intention of the MFSA to ensure consistency and coherence across sectors, in its implementation work and compliance approach.

### **4.1 Investment Firms and Credit Institutions Authorised to Provide Investment Services in Terms of MiFID II**

The findings and recommendations outlined below relate to the analysis of the replies provided by the investment firms and credit institutions which provide investment advice and/or portfolio management services which replied to the survey.

It was noticed that the majority of investment firms who replied to the questionnaire fall within the applicability of the SFDR. A small percentage of investment firms indicated that they are exempt in terms of Article 17, however, the Authority positively noted that some of them do not exclude having in the near future the necessary arrangements in place in order to comply with the requirements of the SFDR.

Certain representatives remarked that currently the local securities market may not provide opportunities to invest in sustainable investments and local retail clients may still prefer to invest in local issuances. In fact, most of the firms indicated that they do not have under their management any financial products that promote ESG characteristics or have sustainable investment as an objective, in accordance with Articles 8 and 9 of SFDR, respectively. Moreover, around **69%** of the entities did not encounter any specific demand for sustainability-related products.

Around **61%** of the sample have one employee or none dedicated to sustainable finance-related matters. Nevertheless, the Authority has positively noted the work carried out so far by firms in order to comply with the SFDR requirements, including undertaking an assessment of the training needs for staff members (including the members of the Board of Directors). It was noted that several firms have created awareness on SFDR requirements and encouraged staff members to undergo training on sustainable finance and get better understanding of the implications these requirements will have on the firms' operations.

A few entities indicated that they either do not have a website or have added a disclosure on the website stating that they do not currently factor in ESG criteria and

sustainability risks in their investment decision-making process. It is important that financial market participants and financial advisors abide by the disclosure requirements provided in Article 3 of SFDR which require them to publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process.

The Authority is concerned to note that some of the entities currently do not factor sustainability factors and/or the principal adverse impacts of investment decisions on sustainability into their business model and advisory strategies. Although it may be challenging for firms to report on their due diligence processes when considering the principal adverse impacts of investment decisions on sustainability factors, the Authority emphasises that financial market participants and financial advisers are obliged to be transparent in considerations made in relation to the principal adverse impacts of investment decisions. It is acknowledged that having available and accessible financial instrument-linked ESG data presents a key challenge for firms in integrating ESG factors. Firms may experience exorbitant costs for collecting data, to integrate additional reporting into their current IT systems, and to cover additional human resources required.

On the other hand, the Authority has positively noted the work undertaken by several firms who have documented their assessment processes as part of their policies and procedures. Some firms have already amended their client fact finds to include questions on the client's ESG preferences. Nevertheless, the Authority is concerned to note that a few entities have indicated that they have not yet made a formal update of their policy since they consider that it is up to the client to specify the nature and details of the ESG preferences. **The Authority expects financial advisors, as from 2 August 2022, to take into consideration sustainability factors of investment products as part of their policies and procedures as referred to in the recommendations section below.**

Insofar as technical standards are concerned, firms are still at the very early/initial stages of assessing the impact of the new requirements, i.e. still in the process of assessing how to integrate sustainability risks and ESG preferences into their risk management, internal processes, governance and products. Firms are encouraged to continue monitoring the developments in the regulatory landscape and in assessing the impact of such regulation on their business operations.

### **Recommendations**

Firms are expected to update their internal systems and controls, governance practices, risk-management and relevant policies and procedures to ensure compliance with the relevant disclosure requirements emanating from the SFDR and integrate sustainability-related risks and opportunities.

In addition, firms need to also take the necessary steps to enhance their operational preparedness in complying with the following ESG changes to MiFID II requirements, which will have a broader scope than SFDR:

- [Commission Delegated Regulation \(EU\) 2021/1253 of 21 April 2021 amending Delegated Regulation \(EU\) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms](#) (applicable as from 2 August 2022); and
- [Commission Delegated Directive \(EU\) 2021/1269 of 21 April 2021 amending Delegated Directive \(EU\) 2017/593 as regards the integration of sustainability factors into the product governance obligations](#) (applicable as from 22 November 2022).

The following are recommendations and/or expectations for firms to improve their state of operational readiness and compliance:

- (a) Reference is to be made to the [Annex \(SFDR Requirements and Applicability\) to the MFSA Circular of 30 July 2021](#) on the application of the SFDR, which outlines various expectations of the Authority in the context of the SFDR requirements;
- (b) The exposure to ESG risks of the assets advised upon by the firm may be limited, however, notwithstanding this firms need to comply with certain obligations in their operations with respect to all type of financial instruments. For instance, in terms of Commission Delegated Regulation (EU) 2021/125, there is an explicit obligation for firms to take into account sustainability risks when complying with the organisational requirements and to integrate sustainability risk into their risk management policies;
- (c) A firm needs to ensure that product-level disclosures and information to investors are updated, as necessary, to include ESG considerations. In particular, sustainability factors of a financial instrument are to be presented in a transparent manner to enable relevant information to clients;
- (d) Firms are required to raise awareness of ESG and sustainability-related matters and provide appropriate training to relevant staff, including with respect to assessing client's sustainability preferences. Firms may also consider having employees dedicated to sustainable finance-related matters;
- (e) Firms need to consider the data needs of their business and whether additional third-party data is required and how this may be sourced;
- (f) A firm needs to integrate sustainability factors within its product governance and approval process, and product distribution process so that sustainability factors and sustainability-related objectives are adequately considered;
- (g) When identifying the types of conflicts of interest which may damage the interests of a client or potential client, firms need to include those types of conflicts of interest that stem from the integration of the client's sustainability

preferences and the integration of sustainability risks in the investment and advice process. This would require a review of conflict of interest policies;

(h) Firms are required to incorporate the collection and analysis of the necessary information about the client's or potential client's ESG/sustainability preferences within their suitability policies and procedures, as part of the client's suitability assessment. In this respect, firms need to:

(i) ensure that (even though, at this stage, the availability of financial instruments with sustainability features may be limited and the introduction of these financial instruments in the firm's product scope might be gradual), "where, at the time the information is collected from the client, firms do not have any financial instruments included in their product range that would meet the client's sustainability preferences, they should nevertheless collect all information concerning sustainability preferences"<sup>3</sup>;

(ii) integrate consideration of client ESG preferences into client suitability assessments and product selection process. This would require firms to update their suitability assessment with additional questions that help identify the client's individual sustainability preferences; this would impact firms' underlying processes, IT systems and databases.

This means that firms integrate client's suitability preferences as a top up to the suitability assessment, so that, firms first identify a range of suitable products for the client (in accordance with the criteria of knowledge and experience, financial situation, and other investment objectives); and then proceed by identifying the products that fulfil the client's sustainability preferences.

## 4.2 Fund Managers

The findings outlined below relate to the specific findings on the level of compliance with SFDR by the fund managers which replied to the Survey.

### Integration of Sustainability Risks in Investment Decision Making Process

Article 3 of SFDR requires the information about the relevant policies on the integration of sustainability risks in their investment decision-making process to be published on the entity's website.

Based on the review of the responses received, it was noted that approximately **28%** of licence-holders had indicated – by the time of submission – that they were not compliant with the obligation of Article 3 of SFDR, with **9%** being non-compliant due to absence of a website.

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<sup>3</sup>Refer to [MFSA Circular regarding Consultation on Guidelines on certain aspects of the MiFID II suitability requirements issued by ESMA](#). In this situation, the firm should clearly indicate that there are currently no products available that would meet those preferences and the client should be given the possibility to adapt the sustainability preferences. This should be documented in the suitability report.

### Consideration of Principal Adverse Impacts

The review showed that **50%** of the licence-holders at this point do not consider principal adverse impacts of investment decisions on sustainability factors as outlined under Article 4 of SFDR. The respondents outlined a number of reasons for this, which can be summarised as follows:

- Resources constraints (size of the entity) – engaging necessary manpower will create additional costs that may lead to disadvantages to an entity and its investors;
- Lack of interest seen from clients due to investment objective/portfolio composition;
- Difficulty in obtaining reliable data to consider principal adverse impacts;
- Uncertainty created by early stage of legal framework’s development.

**64%** of the respondents also confirmed that their remuneration policies were amended with information on how those policies are consistent with the integration of sustainability risks as per Article 5 of the SFDR.

**29%** of the respondents, however, considered the requirement of Article 5 of SFDR not to be applicable to them.

### Pre-Contractual Disclosures

Under Article 6 of the SFDR, the managers of all collective investment schemes, regardless of their sustainable nature and investment strategy, must disclose (in pre-contractual documents) how such schemes integrate sustainability risks in their investment policy and describe the likely effects of sustainability risks on the returns of the collective investment schemes.

It is positive to note that the majority of the licence-holders (**72%**) indicated their compliance with the pre-contractual disclosures requirement outlined in Article 6 of the SFDR.

### Interest in Sustainability-Related Products

The Authority requested information on the level of interest licence-holders encountered from their investors in relation to sustainability-related products and also availability of Article 8 and 9 products on the local market.

As the result of the review, only **20%** of licence-holders identified that they have encountered investors’ interest in sustainability-related products. Furthermore, only **10** licence-holders reported having under management financial products that promote ESG characteristics under Article 8 of SFDR with **7** licence-holders managing financial products falling under Article 9 of SFDR.

As a summary, only **25%** of respondents are currently engaged in sustainability-related products, which has the potential to increase by additional **35%** in upcoming two years.

### **Recommendations**

Fund managers are expected to update their internal systems and controls, governance practices, risk management, and relevant policies and procedures to ensure compliance with the relevant disclosure requirements emanating from the SFDR and to integrate sustainability-related risks and opportunities.

In addition, Fund managers should also take the necessary steps to enhance their operational preparedness in complying with the following ESG changes to AIFMD and UCITS-related requirements, *which will have a broader scope than SFDR*:

- [Commission Delegated Regulation \(EU\) 2021/1255 amending the AIFMR as regards the sustainability risks and sustainability factors to be taken into account by AIFMs](#);
- [Commission Delegated Directive \(EU\) 2021/1270 amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for UCITS](#).

### **Next Steps**

In the course of the coming months, the Authority shall be testing a selection of funds against the SFDR requirements and the findings will be communicated to the market participants so that they can continue improving the disclosures and the information they provide in relation to sustainability. This includes self-managed PIFs and deminimis AIFMs which – as outlined in our circular of [30 September 2021](#) – fall within the scope of SFDR.

## **4.3 Insurance**

On the basis on the review, the MFSA identified a number of manufacturers of Insurance-Based Investment Products (IBIPs), brokers and tied insurance intermediaries which distribute IBIPs. When reviewing the responses from a holistic point of view, it should be noted that while the majority of licence-holders expressed that they are aware of their obligations emanating from SFDR, at the same time, relevant entities are still in the process of planning to incorporate sustainability factors in their product governance framework. In this respect, all entities indicated that they have considered the impact of overhauling their documentation to reflect new disclosures and are thus engaging in internal and external discussions.

In light of this, the MFSA encourages both financial advisers and financial market participants to make further efforts towards compliance with the provisions of the SFDR and to ensure smooth adaptation to new framework.

Amid these licence-holders, the majority have already published information about policies on the integration of sustainability risks in their investment decision-making process in accordance with the requirement laid down under Article 3 of the SFDR.

When it comes to the consideration of principal adverse impacts on investment decisions on sustainability factors at an entity level, in accordance with Article 4 of the SFDR, the respondents to the MFSA questionnaire stated they consider such principal adverse impacts are in the minority and that the relative disclosures have been made available to clients. However, some of those who responded in the negative indicated that their position is being assessed and such considerations are being discussed.

Notably, compliance with Articles 8 and 9 of the SFDR is problematic as none of the respondents to the MFSA questionnaire indicated compliance. It is to be noted that Article 8 and Article 9 of the SFDR relate to transparency of the promotion of environmental or social characteristics in pre-contractual disclosures and transparency of sustainable investments in pre-contractual disclosures respectively. Licence-holders have linked non-compliance with the lack of demand for sustainability-related products.

### **Challenges Encountered**

The main concern raised by respondents on the requirements laid down in the SFDR pertains to the submission of periodic reporting of disclosures under Article 11 SFDR, with the following being cited as the main issues behind such concerned feedback:

- Availability of data
- Exorbitant costs of collecting data
- Costs in relation to the integration of additional reporting into current IT systems
- Costs in relation to the additional human resources required
- Uncertainty relating to launching of a sustainable fund

### **Recommendations**

Entities falling under the scope of SFDR are to thoroughly assess their obligations deriving from the Level 1 text of the SFDR to ensure their compliance with such regulations. Furthermore, licence-holders are to prepare for the forthcoming application of RTS under the SFDR by familiarising themselves with the available content in this regard. Entities are also being specifically reminded of the Insurance Distribution Directive delegated regulation on sustainability that will apply from 2 August 2022.

Finally, all applicable licence-holders are encouraged to continuously monitor developments surrounding sustainable finance and to actively participate in webinars and discussions that are may be held by different entities such as private institutions,



NCAAs and ESAs, particularly on an international level by EIOPA, and any other communication the Authority may publish in the future in this regard.

#### **4.4 Retirement Scheme Administrators (RSAs) Compliance with SFDR**

In response to the request for information, the MFSA received replies from the majority of RSAs (85%). After reviewing the responses to the survey, the MFSA notes that a number of RSAs may not be fully compliant with the SFDR. Almost two-thirds of the RSAs have failed to publish on their website information about their policies on the integration of sustainability risks in their investment decision-making process as required by Article 3 of the SFDR. RSAs are reminded that they fall within the scope of the definition of financial market participant and – given that RSAs approve investment decisions – they should be abiding by the said Regulation.

##### **Challenges Encountered**

With the exception of one RSA, the MFSA notes that the majority of RSAs have not provided disclosures in the pension scheme documents and websites were not actioned in accordance with the SFDR. This leaves the Authority to conclude that they are not fully compliant and encourages the RSAs to take further action in this regard.

##### **Recommendations**

Each RSA is expected to provide feedback to the MFSA at the earliest as to how they will regularise their position in accordance with the SFDR. The MFSA will continue to monitor the application and compliance with the SFDR.

# Annex 1 - Disclosure Requirements at the Level of the Entity and of the Product

Entity-Level Disclosure	Product-Level Disclosures	
<p>Publish information on the policies regarding the taking into account of sustainability risks in investment decisions/advice.</p>	<p>Description of the characteristics and objectives, and of the methodologies for the assessment, measurement and monitoring.</p>	<p><b>Special Disclosures</b></p> <p>For products promoting environment or social characteristics or having sustainable investment as their objectives.</p>
<p>Explain the due diligence policies regarding the Principle Adverse Impacts on Sustainability of investment decisions/advice. Where the Principle Adverse Impacts on Sustainability are not considered, explain why.</p>	<p>Explain how sustainability risks are integrated in investment decisions/advice, and the impact of these risks on the returns of the products. If risks are not integrated, explain why.</p>	<p>In pre-contractual disclosure, on website and in periodic reports.</p>
<p>Explain how the remuneration policy is consistent with the integration of sustainability risks.</p>	<p>Explain whether, and if so, how a product considers the Principle Adverse Impacts on Sustainability. If it is not considered, explain why.</p>	<p><b>Taxonomy Disclosures</b></p> <p>Explain which environmental characteristics the product promotes or which environmental objective it has. Also explain to what extent the investments underlying the product are in activities that qualify as “environmentally sustainable” under the Taxonomy Regulation.</p>
<p>On Website</p>	<p>On Website and in Pre-Contractual Disclosure</p>	<p>In Pre-Contractual Disclosure</p>

## Contact

Should financial market participants and financial advisers have any queries in relation to the above, please do not hesitate to contact the Authority on [sustainable.finance@mfsa.mt](mailto:sustainable.finance@mfsa.mt).

Malta Financial Services Authority

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