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The regulatory landscape for sustainable investments

Introduction

In recent years the European Union (EU) has been heavily promoting a greener economy and the move to a lower carbon world. Member states are signatories to a number of initiatives and agreements with the aim of combatting climate change and reducing carbon intensive activities. There has also been the introduction of a number of regulations which aim to address these topics from an investment perspective.

They include:

- The overarching EU Taxonomy - 2020
- Sustainable Financial Disclosure Regulation (SFDR) - March 2021
- Updated Insurance Distribution Directive (IDD) - August 2022

This guide gives an overview of the regulatory landscape and includes information on the objectives of the various pieces of regulation, definitions for the terms used, and also some information on what may come in the future. This document is intended for informational purposes and is not intended to be a comprehensive guide to sustainability regulation. This document does not constitite legal advice. Further information in relation to Zurich's sustainability disclosures can be found in *The Zurich Fund Guide* brochure and at www.zurich.ie/responsibleinvestment.

EU Taxonomy

A taxonomy is a system of classification, and the EU taxonomy attempts to codify the EU's approach to promoting sustainable and responsible investment. It defines six overarching environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems.

The taxonomy also sets out a detailed list of economic activities, and associated thresholds, that can contribute to one or more of the six environmental objectives. To be acceptable under the EU taxonomy, an economic activity not only has to contribute to one of the environmental objectives, but also has to ensure that it does not cause significant harm to any of the others. Two key definitions in relation to the Taxonomy are 'eligibility' and 'alignment'.

Eligibility:

An economic activity is deemed eligible under the EU Taxonomy if it makes a substantial contribution to one of the six taxonomy objectives. However, it does not make any assertion on the overall 'sustainability' of the economic activity.

Alignment:

Alignment goes a step further than eligibility. An aligned economic activity makes a substantial contribution to at least one of the objectives (just as an eligible activity does). However, to be aligned the activity must also do no significant harm to any other objectives and also meet minimum standards in relation to human rights.

Taking a simplified example, assume an energy company engages equally in both fossil fuel extraction and the production of renewable energy. The 50% of the business that engages in renewable energy would be deemed 'taxonomy eligible'. If the renewable energy activities meet the alignment requirements outlined above then it could be taxonomy aligned. The 50% of the business engaged in fossil fuel extraction is not taxonomy eligibile, and therefore could never be taxonomy aligned. In this case the company is 50% eligible and therefore could be 50% aligned.

The definitions used within the Taxonomy including eligibility and alignment are linked to classifications used under both SFDR and IDD. For example, products classified as Article 9 under the SFDR require specific disclosures in relation to how that product aligns with information. The EU taxonomy also forms part of the categorisations of sustainability preferences under IDD. Much of the sustainability regulations are overlapping, however it is important to note that each respective regulation contains its own distinct terms and requirements.

Further information on the EU taxonomy can be found here.

Sustainable Financial Disclosure Regulation

SFDR aims to increase the disclosures from financial market participants in relation to sustainability and increase transparency surrounding investment management activities. The SFDR at this time does not introduce minimum thresholds for funds but aims to increase disclosures and to facilitate comparisons between different investment options. The EU SFDR legislation aims to support consumer understanding of sustainability risks by categorising investment funds according to the following criteria:

- **Article 6:** These are funds that integrate sustainability risks into their investment decisions.
- **Article 8:** These are funds that promote environmental or social characteristics, and which invest in companies that follow good governance practices.
- **Article 9:** These are funds with specific environmental or social objectives.

Depending on the classification of the fund (based on the above three options) there are a number of disclosures that are to be made. These include 'pre-contractual disclosures' that are included in *The Fund Guide*, and more disclosure requirements will be applicable in 2023. These future disclosures will also refer to definitions and parameters as outlined by the EU Taxonomy. The SFDR disclosures from January 2023 will help Financial Brokers, Advisors, and customers to assess fund sustainability characteristics. SFDR also requires companies such as Zurich to make disclosures at an entity level and these disclosures can be found at www.zurich.ie/responsibleinvestment.

Further information on the SFDR can be found here.

Updates to Insurance Distribution Directive

The IDD has been updated from a number of perspectives in relation to sustainability. The updates are with effect from 2 August 2022. The update introduced the requirement for insurance intermediaries or insurance undertakings to integrate customers' sustainability preferences when carrying out insurance distribution in relation to the sale of Insurance Based Investment Products (IBIPs). There are several prescribed questions to determine and document customer sustainability preferences.

Further information on the IDD updates can be found here.

There are three categories in relation to these preferences:

a. IBIPs that considers principal adverse impacts on sustainability factors

b. IBIPs for which a minimum proportion shall be invested in sustainable activities according to SFDR

c. IBIPs for which a minimum proportion shall be invested in environmentally sustainable activities which are taxonomy-aligned

Sustainability investment options in relation to the IDD:	Definitions:
Principal Adverse Impacts	Investments which consider Principal Adverse Impacts (PAIs) on sustainability factors: • The investment considers negative, material, or likely to be material effects on sustainability factors. • Sustainability factors include environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters. *Information on how the underlying funds available across our multi-option products consider PAIs is available in the relevent fund literature.* *More information on Principal Adverse Impacts can be found at* zurich.ie/responsibleinvestment
Sustainable Investment (SFDR-Aligned)	Sustainable Investments as defined by the SFDR: • The SFDR was introduced to improve transparency in the market for sustainable investment products by making the sustainability profile of products more comparable and better understood by end-investors. • Sustainable investments as defined in the SFDR are investments in an economic activity that contributes to an environmental or social objective. • This is provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices. *More information on SFDR-Aligned Investments can be found at* zurich.ie/responsibleinvestment
Environmentally Sustainable Investment (Taxonomy-Aligned)	EU Taxonomy-Aligned Investments: • The EU Taxonomy is a green classification system that translates the EU's climate and environmental objectives into criteria for specific economic activities for investment purposes. • An EU Taxonomy-Aligned investment contributes substantially to one or more environmental objectives and does no significant harm to any of the remaining environmental objectives. • The investment is carried out in compliance with minimum social safeguards and complies with (detailed) technical screening criteria established in the Climate Delegated Act. *More information on EU Taxonomy-Aligned Investments can be found at* zurich.ie/responsibleinvestment

The below table provides a comparison of some of the characateristics across the three categories:

	Sustainability investment options in relation to the IDD:			
	Environmentally Sustainability Investment (Taxonomy-Aligned)	Sustainable Investment (SFDR-Aligned)	Principal Adverse Impacts	No Sustainability options
Consideration of sustainability risk in investment decisions	Y	Y	Y	N
Considerations of Principal Adverse Impacts	Y	Y	Y	N
Promotes environmental or social characteristics, or a combination	Y	Y	N	N
A proportion designated a 'sustainable investment*': Do No Significant Harm principle AND principle adverse impact indicators (18+) to be taken into account	Y	Y	N	N
Must undertake Economic activities that contribute to an environmental objective	Y	N	N	N
Minimum proportion in taxonomy aligned	Y	N	N	N

*For the purposes of a customer's sustainability preferences under the IDD, a sustainable investment is an investment which contributes substantially to one or more environmental objectives and does no significant harm to any of the remaining environmental objectives. It also takes into account ALL of the Principal Adverse Impact indicators.

Please note, the three categories above should not be viewed as a hierarchy of 'doing good' as each contribute to a more sustainable world. There is no right or wrong answers in respect to sustainability preferences.

Definitions

EU Taxonomy

The EU Taxonomy is a green classification system that translates the EU's climate and environmental objectives into criteria for specific economic activities for investment purposes. It recognises as green, or 'environmentally sustainable', economic activities that make a substantial contribution to at least one of the EU's climate and environmental objectives, while at the same time not significantly harming any of these objectives and meeting minimum social safeguards.

Insurance-based investment product' or 'IBIP'

An insurance product which is made available to a customer, and which offers a maturity or surrender value that is wholly or partially exposed, directly or indirectly, to market fluctuations. Typically, this covers unit-linked life insurance, with-profits life insurance or hybrid products.

Investments aligned with the EU Taxonomy

Environmentally sustainable investments as defined under the EU Taxonomy.

Principal Adverse Impacts under IDD

"Principal Adverse Impacts" are the most significant negative impacts of investment decisions on sustainability factors relating to environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Examples include Greenhouse Gas emissions and carbon footprint.

Sustainable investments

Sustainable investments as defined in the SFDR are investments in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices

Sustainability preferences under IDD

a. an IBIP for which the customer determines that a minimum proportion should be invested in environmentally sustainable investments (as defined under the EU Taxonomy)

b. an IBIP for which the customer determines that a minimum proportion should be invested in sustainable investments (as defined under the SFDR)

c. an IBIP that considers "Principal Adverse Impacts" on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the customer

Sustainable Finance Disclosure Regulation (SFDR)

The SFDR was introduced to improve transparency in the market for sustainable investment products by making the sustainability profile of products more comparable and better understood by end-investors. It was also introduced to prevent greenwashing and to increase transparency around sustainability claims made by financial market participants. It began applying from 10 March 2021, but the detailed requirements underpinning are not due to apply until January 2023.

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