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ESG REPORTING IN THE FOCUS OF FINANCIAL MARKETS: A REVIEW OF THE SUSTAINABLE FINANCE DISCLOSURE REGULATION

***Annotation.** This paper explores the role and impact of the Sustainable Finance Disclosure Regulation (SFDR) — Regulation (EU) 2019/2088 — within the context of ESG reporting and the broader transformation of financial market transparency. It provides an overview of the key SFDR provisions, including disclosure requirements at both the entity and product levels, and examines the classification of sustainable financial products under Articles 8 and 9. Special attention is given to the challenges associated with the initial implementation of the SFDR, such as vague terminology, the limitations of the «comply-or-explain» approach, and the absence of mandatory external audits. The adoption of the Regulatory Technical Standards (RTS) in 2022 is highlighted as a crucial development that enhanced the regulation’s clarity, comparability, and practical enforcement. The paper also discusses the SFDR’s growing indirect influence on non-EU countries, particularly Ukraine, where companies engaging with EU investors or financial institutions may increasingly be expected to align with ESG disclosure practices.*

Key words: ESG reporting, sustainable finance, SFDR, responsible investing.

Анотація. У статті досліджується роль та вплив Положення ЄС 2019/2088 щодо розкриття інформації про сталий розвиток у фінансовому секторі (SFDR) у контексті ESG-звітності та загальної трансформації прозорості фінансових ринків. Представлено огляд основних положень SFDR, зокрема вимог до розкриття інформації на рівні компанії та фінансового продукту, а також класифікації сталих фінансових продуктів згідно зі статтями 8 і 9. Особливу увагу приділено викликам, які виникли на початковому етапі впровадження SFDR: нечіткість термінології, обмеження принципу «дотримуйся або поясни» та відсутність обов'язкового зовнішнього аудиту. Прийняття у 2022 році Регуляторних технічних стандартів (RTS) розглядається як важливий етап, що посилив ефективність регламенту завдяки деталізації вимог, стандартизації звітності та покращенню її порівнюваності. Також висвітлюється зростаючий опосередкований вплив SFDR на країни за межами ЄС, зокрема Україну, де компанії, що працюють з європейськими інвесторами або фінансовими установами, дедалі частіше стикаються з потребою дотримання ESG-вимог.

Ключові слова: ESG-звітність, стале фінансування, SFDR, відповідальне інвестування.

Introduction. The landscape of financial reporting has evolved considerably in response to escalating global environmental, social, and ethical challenges. By the late 2000s, financial markets began to actively incorporate sustainability principles into investment decision-making [1]. Environmental, Social, and Governance (ESG) reporting has transitioned from a facet of corporate social responsibility to a fundamental requirement for ensuring transparency and enhancing the investment appeal of companies.

This growing emphasis on sustainable finance gained momentum rapidly; however, for more than a decade, it progressed largely in the absence of comprehensive regulatory supervision. The lack of oversight raised questions about the credibility of disclosures made by corporations and financial institutions, and

contributed to the emergence of «greenwashing», where sustainability claims are misleading or unsubstantiated.

In response to these challenges, the European Parliament and the Council of the EU introduced the Sustainable Finance Disclosure Regulation (SFDR) in November 2019. This regulation forms a core component of the EU Action Plan on Financing Sustainable Growth and aims to bring greater accountability to sustainability-related financial disclosures.

The objective of this paper is to examine the main provisions of sustainable finance as outlined in Regulation (EU) 2019/2088, assess its impact on improving financial market transparency, and explore the implementation challenges and future prospects of the regulation, especially in the context of European integration and its implications for Ukraine.

Research Results. The SFDR (Sustainable Finance Disclosure Regulation) is a regulation of the European Union that mandates the disclosure of sustainability-related information in the financial sector. It came into force on March 10, 2021. The regulation requires all financial market participants — including banks, credit institutions, pension funds, investment firms providing portfolio management services, and management companies of undertakings for collective investment in transferable securities (UCITS) — as well as financial advisors (such as institutions offering investment and insurance advice), to disclose clearly and transparently how they consider sustainability risks and adverse impacts in their activities and financial products, using a standardized format.

The regulation stipulates that entities must disclose information on two levels: at the entity level (company-wide) and at the product level (specific financial products), both of which play a role in financing the transition to a more sustainable economic model (Fig. 1).

Under the SFDR, financial market participants and financial advisors are obligated to publish and regularly update the following information on their websites at the entity level:

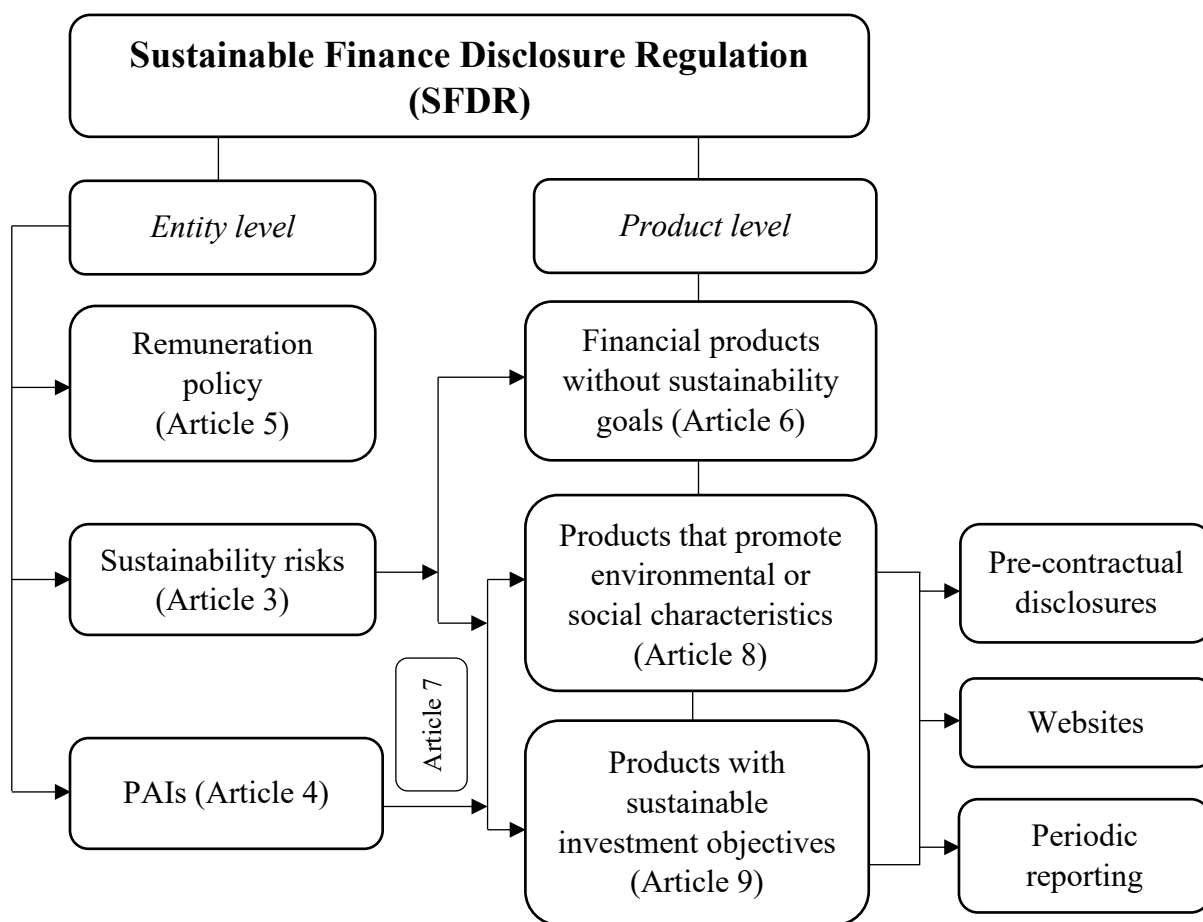


Fig. 1. SFDR reporting framework classification [2]

- a policy outlining how sustainability risks — that is, environmental, social, or governance events that could negatively impact investment value — are integrated into their investment decision-making or advisory processes (Article 3);

- details on how principal adverse impacts (PAIs) on sustainability factors are taken into account (Article 4). This includes an annual report to be published by June 30 of the following year. If PAIs are not considered, a clear explanation must be provided in a dedicated section of the website;

- an explanation of how sustainability risks are factored into the organization’s remuneration policy (Article 5).

Beyond the disclosure obligations at the entity level, the SFDR also requires pre-contractual disclosures, website publications, and periodic reporting related to the sustainability features of financial products.

The regulation identifies two categories of sustainable financial products:

1. Products that promote environmental or social characteristics, or both, provided the investee companies adhere to sound governance practices (Article 8);

2. Products with sustainable investment objectives (Article 9). As defined in Article 2 (17), a sustainable investment is one that supports an environmental objective — such as resource efficiency, waste or emissions reduction, or biodiversity protection — or a social objective, such as reducing inequality, enhancing social cohesion, or investing in human capital and vulnerable communities. Importantly, such investments must not significantly harm other sustainability goals, and the companies receiving investment must demonstrate good corporate governance.

For both categories of financial products, pre-contractual disclosures must include information on how sustainability risks are integrated into investment decision-making or into the provision of investment and insurance advice. Additionally, an assessment of how these risks may affect financial returns must be provided, in line with the “comply or explain” principle.

Furthermore, financial market participants that consider Principal Adverse Impacts (PAIs) at the entity level must clarify whether and how these impacts are addressed by the financial products in relation to sustainability factors. They must also explain how PAIs are incorporated into investment decisions and state that further details are available in periodic reports.

For financial products that promote environmental or social characteristics, it is essential to disclose the methods used to achieve these characteristics. In the case of products with sustainable investment objectives, information must be provided on how the objective will be realized.

Under Article 10 of the SFDR, financial market participants are obligated to publish on their websites a description of the product’s environmental or social characteristics or its sustainability objectives, along with details of the methodologies applied to assess these characteristics or the impact of the investments.

Additionally, websites must include the relevant pre-contractual disclosures and periodic reporting associated with both types of products—those promoting

environmental and/or social characteristics and those with defined sustainable investment objectives.

As stipulated in Article 11 of the SFDR, periodic reports must contain information on any Principal Adverse Impacts (PAIs) considered, the extent to which environmental and social characteristics are met for relevant products, and the overall sustainability impact for products with sustainable investment objectives.

Furthermore, financial market participants and financial advisors are required to ensure that the content of their marketing communications aligns with the disclosures made under the SFDR and does not contradict them.

In essence, the SFDR seeks to reduce information asymmetry between investors (principals) and financial intermediaries (agents) by mandating the latter to formally disclose—both prior to contract conclusion and throughout the service period—how well the provided information and reporting adhere to ESG standards, particularly when intermediaries act on behalf of investors.

Despite its strengths, the SFDR faced several limitations when it came into effect, which hindered its practical impact.

One of the primary issues was the presence of vague and unclear definitions—especially in relation to sustainable investments, environmental and social characteristics, and good governance principles. This lack of clarity led to wide-ranging interpretations and reduced the comparability of disclosures across market participants.

Secondly, the «comply-or-explain» approach enables companies to appear compliant with the SFDR while avoiding meaningful integration of ESG factors into their operations. The lack of clearly defined requirements allowed many financial institutions to leverage non-financial indicators primarily for marketing purposes. Studies revealed that by February 2021—just before the Regulation took effect—256 investment funds across the EU had rebranded themselves using terms such as «sustainable», «ESG», «impact», or «green» [1]. This pattern raised concerns that numerous market participants were making cosmetic changes to product names rather

than implementing substantive shifts in their investment strategies aligned with sustainability goals.

Thirdly, the absence of compulsory external audits for ESG disclosures undermines confidence in the credibility of such reports.

To tackle the identified shortcomings, the Regulatory Technical Standards (RTS) were introduced at the end of 2022 as a complementary framework to the SFDR. These standards defined specific obligations for financial products that are offered or operate within the EU, including:

- detailed guidance on the structure and content of disclosures aligned with the «Do No Significant Harm» (DNSH) principle;
- specifications for the content, methodologies, and procedures for disclosing sustainability indicators and Principal Adverse Impacts (PAIs);
- requirements for how information on the promotion of environmental or social characteristics and sustainable investment objectives should be presented in pre-contractual materials, on websites, and in periodic disclosures [3].

By standardizing ESG-related reporting, the RTS significantly improved the consistency and practical application of the SFDR. However, some commentators argue that the SFDR remains largely focused on transparency rather than on defining technical thresholds for categorizing financial products. This results in criteria that are broad and open to interpretation. Furthermore, the complexity of disclosure requirements can pose challenges for retail investors, potentially limiting their understanding and effective use of the information [4, 5].

Although the SFDR requirements do not directly apply to Ukrainian companies, they may still face indirect pressure from EU-based investors. This is particularly relevant if they offer financial products—such as investment funds or bonds—to EU investors, collaborate with European financial institutions (e.g., banks, investment funds, insurance companies) that are obligated to report on the sustainability of their investments, or are part of supply chains or recipients of funding from entities subject to the SFDR. For instance, if a Ukrainian company receives financing from a European investment fund, the fund is required to disclose ESG-related information

about that investment, which may lead to a request for relevant ESG data from the Ukrainian company.

Conclusions. Regulation (EU) 2019/2088 (SFDR) marked an important step toward increasing the transparency of financial markets in the context of sustainable development. It laid the regulatory foundation for the integration of environmental, social, and governance (ESG) factors into financial practice, strengthened non-financial reporting requirements, and helped prevent the spread of greenwashing.

The adoption of the Regulatory Technical Standards (RTS) in 2022 represented a logical stage in the evolution of the SFDR and significantly enhanced its effectiveness through reporting standardization, more detailed disclosure requirements, and improved comparability of financial products. At the same time, the SFDR's emphasis on transparency rather than substantive ESG content leaves room for formal compliance without real changes in sustainable investment strategies.

Although the SFDR does not formally apply to companies outside the EU, including Ukrainian firms, it is exerting an increasing indirect influence on businesses targeting the European capital market, engaged in international cooperation, or seeking foreign investment. In this context, adapting to transparency principles, integrating ESG factors, and adhering to best European practices could become a significant competitive advantage for Ukrainian companies in the future.

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