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Breaking Down the New EU ESG Disclosure Regulation: One Month to Go

February 10, 2021

The EU Sustainable Finance Disclosure Regulation (2019/2088) ("**Disclosure Regulation**" or "**SFDR**") will come into force on 10 March 2021. As detailed in our update in September last year, the SFDR has a wide scope and will impose environmental, social and corporate governance ("**ESG**") disclosure and reporting requirements for a wide range of "financial services participants" including investment firms and fund managers.

This will include fund managers established outside the European Union ("**EU**") such as US fund managers that market funds in the EU under the national private placement regime ("**NPPR**").

What are the main disclosure requirements under SFDR?

The SFDR introduces disclosure obligations at both a firm and product level - outlining requirements for asset managers to:

1. disclose how sustainability risks are incorporated in their decision making;
2. disclose the principal adverse impact of investments ("**PAIs**") made on external sustainability factors; and
3. make product-level disclosures - particularly for those products which promote environmental or social characteristics or have ESG as a specific objective.

The SFDR does not set out the technical detail on what must be disclosed but instead mandates the European Supervisory Authorities ("**ESAs**") to develop draft regulatory technical standards (known as "**Level 2 SFDR**"), to provide further details with regard to the content, methodological criteria and presentation of disclosures under the SFDR.

What is the current status of Level 2 SFDR?

The latest draft Level 2 SFDR were published on 4 February 2021. This sets out more details on the content, methodologies and presentation of disclosures under the SFDR.

It is expected that this will be endorsed and subsequently implemented.

What is the impact of Level 2 SFDR?

Some of the main points covered under the Level 2 SFDR requirements are as follows:

- general principles in relation to the presentation of information disclosed;
- in relation to firm-level disclosures, the Level 2 SFDR requirements have updated the list of indicators for PAIs, while noting that PAI reporting is based on the principle of proportionality;
- in relation to product-level disclosures, the sustainability characteristics or objectives of financial products are to be disclosed in an annex to the respective sectoral pre-contractual and periodic documentation in mandatory templates and on firms' websites. Proposals in the Level 2 SFDR relate to:
    - disclosure of pre-contractual information and the presentation of the same;
    - disclosure of information on the firm's website;
    - periodic report disclosures; and
    - information relating to the "do not significantly harm" principle.

What next and timing?

The European Commission is expected to endorse the Level 2 SFDR within 3 months of its publication.

While the application of the SFDR will enter into force from 10 March 2021, the Level 2 SFDR requirements will be delayed to a later date - the ESAs have proposed an application date of 1 January 2022.

Although the Level 2 SFDR requirements will not be implemented at this stage, firms should, as part of their preparation for the SFDR requirements, take into account the fact that the Level 2 SFDR requirements will come into force in due course and that further clarity and market consensus on many issues will gradually develop. Firms should assess whether they are in scope of the new requirements and to what level, as this will impact the level of disclosures that they will be required to make.

Related Professionals

- **John Verwey**
  Partner
- **Michael Singh**
  Associate