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SFDR RTS – implementation date looms

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Background

On 10 March 2021, the Sustainable Finance Disclosure Regulation ((EU) 2019/2088) ("**SFDR**") came into force. This imposes environmental, social and corporate governance ("**ESG**") and reporting requirements on a wide range of "financial market participants", including investment firms and fund managers.

The SFDR should be read alongside the Regulation on the establishment of a framework to facilitate sustainable investment ((EU) 2020/852) ("**EU Taxonomy**"), which came into force on 12 July 2020. This is a classification system which provides definitions for which economic activities can be considered environmentally sustainable.

On 6 April 2022, Regulatory Technical Standards under the SFDR ("**SFDR RTS**") were published by the European Commission. These provide further detail as to the content, methodologies and presentation of information required to be disclosed under the SFDR and EU Taxonomy, as well as templates for the relevant disclosures.

These requirements come into force on **1 January 2023**.

Who is this applicable to?

The SFDR and Taxonomy impose transparency and disclosure requirements on, amongst others, alternative investment fund managers ("**AIFMs**") who manage or market their funds ("**AIFs**") in the EU. Therefore, non-EU managers who market their funds via EU National Private Placement Regimes, will also be subject to the requirements.

The SFDR RTS outlines the disclosures at both the entity (i.e. AIFM) and product (i.e. AIF) levels. Additional disclosures may be required, depending on the nature of the fund. The categories of funds can be broadly summarised as follows:

- "Article 8" funds: funds that promote environmental and/or social characteristics;
- "Article 9" funds: funds that have sustainable investment as their objective; and

- “Article 6” funds: all other funds.

General Disclosures

All funds to which the SFDR is applicable must make the following entity and product level disclosures (on their website / as pre-contractual disclosures respectively):

- about its policies on the integration of sustainability risks in its investment decision-making process (and how this may impact financial returns); and
- on how its remuneration policies are consistent with the integration of sustainability risks.

Article 8 Disclosures

Article 8 funds are required to make certain additional disclosures.

Website disclosures (Articles 24 to 36, SFDR RTS):

A disclosure with the following sections should be published:

- Summary (note: where the product is marketed in more than one EU Member State, the SFDR RTS states that this section should be translated to an additional language “*customary in the sphere of international finance*”);
- No sustainable investment objective;
- Environmental or social characteristics of the financial product;
- Investment strategy;
- Proportion of investments;
- Monitoring of environmental or social characteristics;
- Methodologies;
- Data sources and processing;
- Limitations to methodologies and data;
- Due diligence;
- Engagement policies; and
- where an index is designated as a reference benchmark to attain the environmental and/or social characteristics promoted by the financial product – Designated reference benchmark.

Pre-contractual disclosures (Annex II, SFDR RTS):

Certain disclosures including:

- a description of how the product promotes environmental and/or social characteristics;
- the investment strategy of the product; and
- if an index has been designated as a reference benchmark, information on whether and how this index is consistent with environmental and/or social characteristics and where the calculation methodology can be found.

Periodic disclosures (Annex IV, SFDR RTS):

- Certain disclosures including the extent to which the environmental and/or social characteristics were met.

Article 9 Disclosures

Article 9 funds are required to make certain additional disclosures.

Website disclosures (Articles 37 to 49):

A disclosure with the following sections should be published:

- Summary (note: where the product is marketed in more than one EU Member State, the SFDR RTS states that this section should be translated to an additional language "*customary in the sphere of international finance*");
- No significant harm to the sustainable investment objective;
- Sustainable investment objective of the financial product;
- Investment strategy;
- Proportion of investments;
- Monitoring of sustainable investment objective;
- Methodologies;
- Data sources and processing;
- Limitations to methodologies and data;
- Due diligence;
- Engagement policies; and
- Attainment of the sustainable investment objective.

Pre-contractual disclosures (Annex III, SFDR RTS):

Certain disclosures including:

- details on the sustainable investment objective of the product;
- the investment strategy of the product;
- if an index has been designated as a reference benchmark, information on how this index is consistent with the sustainable investment objective, how this differs from the broad market index, and where the calculation methodology can be found;
- if no index has been designated, how the objective is to be attained; and
- for an Article 9 fund with a carbon emission reduction objective, how that objective will achieve the long-term global warming objectives of the Paris Agreement.

Periodic disclosures (Annex V, SFDR RTS):

- Certain disclosures including the extent to which the fund's sustainable investment objective was met.

Principal Adverse Impacts

In addition to the compulsory disclosures, outlined above, the SFDR RTS provides a reporting template for the principal adverse impacts a fund's investment decisions have on sustainability factors ("**PAI**").

Disclosure of PAI is not compulsory unless an AIFM has more than 500 employees in their financial year. If an AIFM does opt-out, however, it must provide reasons as to why it has not considered PAI – "comply or explain".

A firm who opts-in (or who is compelled to do so) must use the template in Annex I of the SFDR RTS and provide the required information on its website by 30 June each year, covering the prior calendar year (the "**Reference Period**"). AIFMs must, at a minimum, collect quarterly "snapshots" of information on the indicators and publish the average of those figures for the Reference Period.

As clarified in a Q&A published by the European Supervisory Authorities ("**ESAs**") in November this year, when considering "all investments" for the purposes of these PAI calculations, this should include both direct and indirect investments.

Taxonomy Alignment

Article 8 and 9 funds may also be “Taxonomy-aligned”. A fund will be Taxonomy-aligned where it contributes significantly (as per the Taxonomy’s Technical Screening Criteria) to one of the six environmental objectives in the Taxonomy:

- Climate change mitigation;
- Climate change adaptation;
- The sustainable use and protection of water and marine resources;
- The transition to a circular economy;
- Pollution prevention and control; or
- The protection and restoration of biodiversity and ecosystems.

In addition, the fund must “do no significant harm” to the other objectives in the Taxonomy.

If the fund is Taxonomy-aligned, further pre-contractual / periodic disclosures are required that provide:

- information on the environmental objective(s) in question; and
- a description of how and the proportion of the product’s underlying investments qualify as environmentally sustainable under the Taxonomy (as a percentage).

Upcoming developments

ESG remains a hot topic for regulators around the world.

In the UK, the FCA recently published its consultation paper (CP22/20) on Sustainability Disclosure Requirements (“**SDR**”) and investment labels (please refer to our separate note here). In early October, the UK’s Green Technical Advisory Group published its first report on the development of a UK Green Taxonomy (please refer to our separate note here).

Once finalised, the SDR and UK Green Taxonomy will represent the UK’s efforts to match the SFDR and Taxonomy.

The EU is also continuing its work in this space. In March this year, the Platform on Sustainable Finance (the "**Platform**"), tasked with providing expert support to the European Commission, published its report on extending the Taxonomy. This set out the concept of a "traffic light" system – covering activities that have an ambiguous impact on environmental sustainability ("amber") and those that have a detrimental impact ("red"). The European Commission is currently considering these proposals.

The EU also intends to introduce a taxonomy regulation for social investments (a "**Social Taxonomy**"), which will define a set of social objectives, the types of activities that contribute to those objectives, and a criteria for the activity to make a substantial contribution to the objectives. Following difficulties in establishing such a framework, however, plans for a Social Taxonomy have been delayed until 2025 at the earliest, after the European Commission's current term.

The SFDR RTS itself will also continue to be developed. In April this year, the Chairs of the ESAs were tasked with reviewing the indicators for PAI and the financial product disclosures. Their report was due in April next year, but has since been delayed a further 6 months. Additional Q&A documents will also continue to be published, providing further clarification on existing requirements.

Next steps

Firms should pay close attention to the templates in the SFDR RTS and continue their preparations for 1 January 2023.

If any further questions arise, please get in touch with your usual Proskauer contact.

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