

## European Commission Clarifies Scope and Application of the Sustainable Finance Disclosure Regulation

28 July 2021

In January 2021, European financial supervisory authorities (the “ESAs”) [requested](#) the European Commission (the “Commission”) to clarify key areas of uncertainty regarding the scope and application of the Sustainable Finance Disclosure Regulation (the “SFDR”), which we discussed in more detail in our previous [Alert](#). In response to the five priority topics raised by the ESAs, the Commission has now provided guidance to market participants as they prepare for compliance with the more detailed rules under the regulatory technical standards (the “RTS”) of the SFDR. On 23 July 2021, the Commission announced that application of the RTS would be delayed until 1 July 2022.

### **1. Application to non-EU managers (and sub-threshold AIFMs)**

There has been uncertainty around the extent to which certain provisions of the SFDR apply to non-EU managers. The Commission has now confirmed that the SFDR will apply to non-EU managers when they are marketing a fund in a member state of the EU through the national private placement regime. While the Commission’s response is not express in this respect, we believe that the Commission expects to extend both the “entity-level” and the “fund-level” requirements to non-EU managers.

### **2. Calculation of the 500-employee threshold with respect to parent undertakings and large groups for the purposes of applying the principal adverse impact disclosures**

The Commission has taken a literal interpretation of the rules and notes that EU and non-EU subsidiaries of a group must be included in the calculation of whether a sponsor (or a sponsor that is a parent undertaking) has 500 employees and therefore meets the threshold. If a sponsor does meet this test, then it will be required to make substantive principal adverse impact disclosures, including the detailed disclosures required under the RTS.

### **3. Meaning of “promotion” in the context of Article 8 funds (i.e., those products that promote environmental or social characteristics)**

The scope of Article 8 has been the subject of much uncertainty, and has been a key area of focus for sponsors as they determine which disclosure obligations under the SFDR will apply to them. The Commission has made clear that the mere integration of sustainability risks is not sufficient for categorisation as an Article 8 fund.

Sustainability risk in this context means an environmental, social or governance condition that, if it occurred, could cause an actual or a potential material negative impact on the value of an investment.

In addition, the Commission helpfully notes that an Article 8 fund may comply with the principal adverse impact disclosures (but is not required to do so), and if it does comply with the principal adverse impact disclosures, it does not automatically fall to be an Article 8 fund. Article 8, the Commission has clarified, does not prescribe minimum investment thresholds or otherwise restrict investment strategies or composition of investments.

The Commission, however, has taken a wide interpretation on what “promotion” may mean in this context. It notes that promotion encompasses any disclosure or provision of information and an “impression” that the investments pursued by a fund *also* consider specific environmental or social characteristics. These characteristics may be expressed in the form of investment policies, goals, targets or objectives or a general ambition. Promotion may occur through the provision of pre-contractual and periodic documents or marketing communications, product categorisation, information on adherence to sustainability-related financial product, standards and labels, compliance with sectoral exclusions or statutory requirements.

This interpretation should be understood in the context of a fund being subject to binding criteria in relation to specific environmental or social characteristics, which might assist managers in avoiding their funds inadvertently tipping into the Article 8 category.

### **4. Application of Article 9 of SFDR (i.e., the scope of products that have sustainable investment as their objective)**

The Commission has noted that an Article 9 fund may invest in those assets that qualify as “sustainable investments”. A sustainable investment is defined in the SFDR as any economic activity that contributes to an environmental or a social objective, as long as such an investment does not significantly harm any of those objectives and the investee companies follow good governance practices.

An Article 9 fund may also invest in other assets for specific purposes (such as hedging or liquidity) as long as such investments meet the minimum safeguards set out in the SFDR. However, the fund documents must explain how the mix of investments complies with the sustainable investment objective of the fund.

For funds that have 'a reduction in carbon emissions' as their objective, the ESAs sought clarification on whether it is necessary for a fund to track an EU Climate Transition Benchmark or EU Paris-aligned Benchmark (to the extent they exist) on a passive basis. The Commission has responded that where such a benchmark exists, a fund must track this.

### **5. Application of SFDR product rules to portfolios and other tailored products managed in accordance with discretionary client-by-client mandates**

In line with industry expectation, the Commission has confirmed that the SFDR applies to individual client mandates.

In addition, the Commission helpfully noted that website disclosures relating to the promotion of environmental or social characteristics and/or of sustainable investments must be compliant with data protection laws and client confidentiality requirements. This response indicates that it may be possible for managers to publish website disclosures in a confidential manner (e.g., requiring a login and password to access).

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## Related Services

### Practices

- Investment Funds

## Suggested Reading

- 22 September 2021 - 23 September 2021 Sponsored Event Private Debt Investor New York Forum Virtual Experience
- 28 July 2021 Kirkland Seminar Hot Topics in Private Fund Examinations
- 27 July 2021 Press Release Kirkland Advises TPG on \$5.4 Billion First Close of TPG Rise Climate Fund

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