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Kirkland Alert

European Financial Supervisory Authorities Seek Clarification on Key Aspects of the Sustainable Finance Disclosure Regulation

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In our last [Alert on EU ESG initiatives](#), we set out the recent developments in the area and noted that firms should start preparing for compliance with the obligations under the [Sustainable Finance Disclosure Regulation](#) (SFDR). There are several aspects of SFDR that remain unclear ahead of the compliance date of 10 March 2021.

SFDR applies to “financial market participants” and “financial advisers”, each of which is defined by reference to EU legislation and includes Markets in Financial Instruments Directive (MiFID) investment firms, Alternative Investment Fund Managers (AIFM) and Undertakings for the Collective Investment in Transferable Securities (UCITS) management companies. What is not clear in SFDR is whether (and to what extent) the definition of AIFMs includes non-EU AIFMs. [Guidance](#) provided by the European Commission last year in relation to the Taxonomy Regulation suggests that “financial markets participants” could include non-EU AIFMs in certain circumstances, such as when registered for marketing a non-EU fund under a national private placement regime (NPPR) in the EU. However, industry bodies and market participants continue to debate the extent to which non-EU AIFMs are required to comply with SFDR’s disclosure rules, and more generally, definitive guidance on the potential extra-territorial application of SFDR is still not available.

In response to the uncertainty on various key aspects of SFDR, European financial supervisory authorities (ESAs) have recently [requested](#) the European Commission to clarify key areas of uncertainty regarding the scope and application of SFDR.

The five priority areas identified by the ESAs are:

1. the application of SFDR to non-EU AIFMs and registered AIFMs (i.e., sub-threshold AIFMs). The ESAs are seeking clarification on whether SFDR will apply to non-EU AIFMs, including in circumstances when they market a sustainable alternative investment fund under NPPR in the EU;
2. the application of the 500-employee threshold with respect to parent undertakings and large groups for the purposes of applying the principal adverse impact disclosures. In particular, the ESAs are seeking clarification on whether the calculation of the 500-employee threshold to the parent undertaking of a large group should be applied to both EU and non-EU entities of the group;
3. the application of Article 8 of SFDR, in particular, the meaning of “promotion” in the context of products promoting environmental or social characteristics (i.e., the scope of Article 8 funds). This is a key issue in determining which disclosure obligations under SFDR will apply. The ESAs have noted that the provision of examples of different scenarios that are within and outside the scope of Article 8 would be particularly helpful;
4. the application of Article 9 of SFDR, i.e., the scope of application of enhanced reporting obligations to products that have sustainable investment as their objective; and
5. the application of SFDR product rules to portfolios and other tailored products managed in accordance with discretionary client-by-client mandates. Specifically, the ESAs are seeking clarification on whether the requirements in SFDR apply at the level of the client portfolio, or at the level of the investment firm’s standardized portfolio solution.

As next steps, sponsors should continue to monitor further regulatory clarification and market developments in this area as part of their ongoing initiatives to comply with SFDR.

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- Investment Funds

Suggested Reading

- 18 November 2020 Kirkland Alert UK Delays Implementation of Prudential Rules for Investment Firms
- 07 October 2020 Kirkland Alert Cayman Islands Removed From EU Blacklist
- 10 July 2020 Kirkland Alert Summer Update on Recent UK and European Regulatory Developments

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